Investment Accounts Practice in Oman's Islamic Banks: A Comparative Study with AAOIFI's Standards

ممارسة الحسابات الاستثمارية في البنوك الاسلامية بسلطنة عمان : دراسة
مقارنة مع معايير الأيوفي

by

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ABSTRACT IN ENGLISH

Research Questions/Issue: What is the current practice of PSIAs in IBWs in Oman compared to AAOIFI's standards?

Purpose: The main purpose of this research is to reveal the PSIAs practice in Oman's IBWs in comparison with AAOIFI's standards, particularly concerning the sharia and disclosure issues.

Research Methodology: With the purpose of studying this research issue, the researcher gathered the relevant data from two full-fledged Islamic banks and five Islamic windows located in Oman, using their annual reports and published contracts in the year 2021. Therefore, a combination of content and ratio analysis and comparative approach were used to investigate the issue of research.

Research Findings/Insights: The main findings found in this research generally that there were positive disclosure practices regarding equity and assets distribution. However, there was a lack of information concerning the kind of contractual relationship that links the different stakeholders involved in PSIAs. In addition, the practice of PSIAs was found to a big extent compatible with AAOIFI's standards.

Theoretical/Academic Implications: the found results to some extent bridge the gap between the theory and practice in the issue of PSIAs, providing some suggestions to reduce this gap between the two sides.

Keywords: IBWs in Oman, Profit Share Investment Accounts, AAOIFI's Standards, Islamic banks, GCC countries

ABSTRACT IN ARABIC

أسئلة البحث : ما هي الممارسة الحالية لحسابات الاستثمار في البنوك والنوافذ الإسلامية في سلطنة عمان مقارنة بمعايير أيوفي؟

الهدف من البحث

الهدف الأساسي للبحث هو إظهار الممارسة الحالية لحسابات الاستثمار في البنوك والنوافذ الإسلامية بسلطنة عمان مقارنة بمعايير أيوفي، وبشكل خاص فيما يتعلق بالجوانب الشرعية جوانب الإفصاح.

منهجية البحث

في ظل الهدف الأساسي للبحث، قام الباحث بجمع البيانات والمعلومات ذات الصلة المتعلقة ببنكين إسلاميين و 5 نوافذ إسلامية من خلال التقارير المالية السنوية و نماذج العقود المسخدمة هذه البنوك. وعليه تم تبني المنهج التحليلي والمنهج المقارن للإجابة عن سؤال البحث.

نتائج البحث

أهم النتائج التي توصل إليها البحث هو جودة ممارسات الإفصاح المتعلقة بالحسابات الاستثمارية بشكل عام. أيضا، توصل البحث إلى وجود قصور في بيان نوع العلاقات التعاقدية التي تحكم الحسابات الاستثمارية. كذلك، يتضح أن ممارسات البنوك المشمولة في الدراسة متوافقة إلى حد كبير مع المعايير الصادرة من أيوفي.

التطبيقات الأكاديمية والنظرية

يمكن أن تساهم النتائج التي توصل إليها البحث في ردم الهوة التي بين النظرية والممارسة فيما يتعلق بالحسابات الاستثمارية بالبنوك الإسلامية.

الكلمات المفتاحية

البنوك والنوافذ الإسلامية بسلطنة عمان، الحسابات الاستثمارية ، البنوك الإسلامية، دول الخليج

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PSIA: Profit Share Investment Account

IB: Islamic Bank

IFI: Islamic Financial Institutions

CB: Conventional Bank

PER: Profit Equalization Reserves

IRR: Investment Risk Reserves

AAOIFI: The Accounting and Auditing Organization for Islamic Financial Institutions

IBWs: Islamic Banks and Windows

DCR: Displaced Commercial Risk

IAHs: Investment Accounts Holders

CHAPTER 1

INTRODUCTION

1.1 Background

The profit share investment accounts (PSIAs) represent a watershed in Islamic banking compared to conventional banking. While the investment deposits are considered a form of liability from a conventional banking perspective, PSIAs represent equity and shareholders' equity. From this point, PSIAs in Islamic banks (IBs) have gained significance and prominence. However, due to the novelty of the Islamic finance concept, banks at their early adoption of Islamic banking still deal with Islamic deposits as conventional deposits in many aspects. Hence, the demands were raised to establish new regulations that cater to the nature of Islamic deposits.

As a result, the Islamic supervisory and regulatory entities started paying attention to PSIAs in IBs. As a result, many particular regulations and standards for the PSIAs have been issued to ensure the correct practice of Islamic deposits. One of these entities is the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), which has issued many standards regarding PSIAs. However, there are still numerous gaps in the practice. On the other hand, the practice of Islamic banking and investment deposits, in particular, is considered recent in Oman compared to other Gulf countries such as UAE, Kuwait, and Saudi Arabia. This reveals the lack of studies that examine the practice of Islamic banking in Oman. Therefore, this study aims to evaluate the practice of PSIAs in the Islamic banks and windows (IBWs) in Oman compared to the relevant standards issued by AAOIFI.

1.2 Types of Accounts in Islamic Banks

According to Bellalah and Masood (2013), there are three types of accounts in Islamic banks as follows;

Current Accounts

These accounts are structured either based on Qard (loan) contract or Wadiah contract. In both cases, the Islamic bank guarantees the current deposits, and the depositors have not entitled to any profits against their deposits. Islamic banks usually use the funds collected under current accounts to meet their urgent liquidity needs and in the short-term transaction.

Savings Accounts

These accounts are structured based on the Wadiah contract. However, the main difference between current and savings accounts is that in the latter, the bank can distribute some profits to depositors as Hipah (grant). However, some shariah scholars stipulated that this profit or hipa should be given under three conditions. First, it should not be conditioned or stipulated in the contract. Second, it should not be customary or like customary. Third, it should not be given regularly. In addition, some Islamic banks accept savings accounts based on the Mudarabah contract. This aligns with sharia rules as long as all rulings of the Mudarabah contract are applied in these accounts.

Investment Accounts

These accounts are usually operated under the Mudarabah contract. The Islamic bank acts as a Mudarib (investment manager) while the depositor acts as a Rab Al Mal (investor). Nonetheless, these accounts could be opened under the Wakala contract. The shariah rules differ with each kind of contract. The main differences between investment accounts and savings accounts are as follows; First, the minimum balance required by the investment account is higher than that in savings accounts. Second, the funds' length of stay in investment accounts is longer than the duration in savings accounts. Unlike savings accounts, the money in investment accounts cannot be withdrawn unless written notification is sent to the bank. Third, depositors in savings accounts do not share in the loss resulting from using their funds, but deposits in investment accounts are exposed to potential losses in their accounts.

1.3 Investment Accounts Between Islamic and Conventional Banks

Despite the main purpose of investment accounts in Islamic and conventional banks being similar, they significantly differ in tools and mechanisms used to achieve this target. In other words, both kinds of banks accept deposits to invest and generate revenue over the principle. However, the contractual relationship between the bank and depositors is dramatically different between Islamic banks and conventional banks. The main cause of this difference is the legal reference texts that each type of bank refers to and builds its financial structure based on. Werner (2014) identified three theories that could explain the nature of banking work. These theories are financial intermediation, fractional reserve, and credit creation. However, recent empirical studies showed that credit creation is the most likely to present an accurate interpretation of the philosophy behind banking function.

According to the financial intermediation concept, conventional banks operate on the premise that the role of banks should be restricted to accepting funds from investors and handing them over to people who have enough skills and experience to operate them in gainful activities.

However, this should be implemented so that the bank should not bear any risks that could arise from investing in these funds. Therefore, to achieve this goal, conventional banks almost structure their financial instruments based on a loan contract that lets them guarantee the capital of the loan and the fixed interest over the principal. According to Somashekar (2000), the conventional bank earns income mainly by taking advantage of the difference in the interest rate between borrowing and lending money. It borrows funds from depositors at a certain interest rate and then lends them to consumers at a higher interest rate. Hence, concerning investment accounts, conventional banks borrow money from investment account holders (IAHs) against fixed interest paid periodically over the principle of the loan, which in turn is paid eventually at the end of the agreed period. On the other hand, the bank operates these funds in interest-based activities. These activities are either retail and corporate financing or securities purchase; all operate based on interest-bearing loan contracts.

Machiraju (2008) has divided the deposits in traditional banks into two types; demand deposits and time deposits. A demand deposit or current deposit is an outstanding deposit without any interest paid over the principal. This kind of account is usually opened for short-time money-saving and daily financial transactions needs. However, a time or term deposit is the account that is opened for the interests earning purpose, and it is divided into two accounts categories: savings account and term deposit. However, Islamic banks are governed by Islamic commercial law (sharia rules), which largely imposes rules contrary to those applied by conventional banks. Islamic commercial law, in general, encourages people to take and bear reasonable risks in the context of business and commercial activities. Therefore, making money by adopting interest-bearing loan contracts as conventional banks do is prohibited from the point of view of sharia, as the risk is zero in this case. In addition, “ Muslim scholars considered money a medium of exchange, a standard of value, and a unit of account but rejected its function as a store of value. Lending on interest was prohibited because this was an act of ingratitude and considered unjust since money was not created to be sought for its own sake but other objectives. The Qur’an (2, 275) makes a clear distinction between engaging in trade and commerce and earnings through riba: “However, God permits commerce, and prohibits usury (interest)” (Iqbal & Mirakhor 2006, p. 58).

Islamic banks are required to avoid interest-based contracts at all in operating investment accounts and embrace profit and loss sharing models as alternatives. Also, theoretically, Islamic banks are expected to manage and invest funds collected from investment accounts and play a role beyond just the financial intermediation between depositors and entrepreneurs by taking risks and sharing in profit and loss resulting from investment activities. In this context, Islamic finance offers many profits and loss-sharing-based alternatives to be adopted in investment accounts. Some of them are commonly used in Islamic banks. However, the others have limited applications in such institutions.

The main aim of this research is to uncover Oman's IBWs practice of PSIAs in comparison with AAOIFI standards. The rest of the research is divided into five chapters. Second chapter is the literature of the research topic including the relevant studies conducted in this field. Third chapter touched upon the methodology that has been used in the study. Fourth chapter touched upon the investment accounts and its types in Islamic banks as well as details regarding the AAOIFI organisation and its standards that are relevant to PSIAs. Fifth chapter is the data analysis and the last chapter is conclusion and findings.

CHAPTER TWO

LITERATURE REVIEW

Since the emergence of the Islamic finance concept, the discussion, and research of the potential applications of this concept have been continuing and expanding. This was enhanced after the financial crisis in 2008 when the Islamic financial institutions showed a stable and positive financial performance during the crisis compared to other conventional institutions. As a result, the research momentum headed towards exploring possible solutions in Islamic finance, resulting in a rich literature in this field. Many aspects and subjects relating to Islamic finance have been studied. However, in reality, the practice of this concept has also created an opportunity for researching new areas and fields.

Meanwhile, finding suitable alternative solutions for conventional financial products was an urgent necessity. One of these needed alternatives was the PSIAs in Islamic banks. In this regard, successive studies and research have been conducted to crystallise a new financial product as an alternative to interest-based investment accounts. The aspects addressed in these studies have diversified into many issues. For example, the rate of return and profit distribution and the rights of IAHs represented the greatest part of the PSIAs' literature. Alhammadi et al. (2018) examined empirically whether IAHs in Islamic banks are treated equally compared to shareholders.

The study investigated this issue using a sample of 28 Islamic banks between 2002 to 2013 from five countries. The research found that IAHs are not treated fairly, as they are given a low risk-adjusted rate of return compared to what is given to shareholders. In addition, though IAHs are more exposed to the risk than their counterparts in conventional banks, it is found that they are paid less profit rate. The study also showed that the existence of a governance committee in the Islamic bank would improve the situation of IAHs.

Likewise, Kusuma (2018) studied the injustice phenomenon regarding profit rate determination in the Mudarabah contract in Indonesian Islamic banks. The study found that there is a phenomenon of unfairness in the profit rate determination in terms of the customer's profit rate. According to the researcher, this phenomenon occurs due to many reasons. First, in comparison to conventional banks, Islamic banks do not have a standard pricing mechanism. The former applies a determined pricing benchmark such as LIBOR in interest rate determination. Second, there is no standard pricing method even between Islamic banks. This means that there will be a great difference in product prices between Islamic banks.

In addition to the studies mentioned above, Hussan and Masih (2014) investigated whether the investment deposits in Islamic banks in Malaysia are influenced by the interest rate used in conventional banks or performance-based deposits. The study selected the 6-months investment deposits in Malaysian Islamic banks to test their performance and 6-month fixed deposits from their conventional counterparties. Using a time series analysis technique, the study tried to find a relation between the profit of Islamic deposits and the interest rate of their counterparties. The study found a strong significant relationship between the profit rates of Islamic deposits and the interest rates of conventional banks' deposits which indicates that the former is highly influenced by the latter. This has also been explored and emphasised in a prior study conducted by Azhar Rosly and Ashadi Mohd. Zaini (2008). They found in their empirical study that despite the clear contractual difference between conventional and Islamic banks' deposits, and subsequent high risk taken in the latter, there is no considerable variance between the rate of interest and return of depositors, respectively.

In addition, it found that the yields of investment deposits in Islamic banks do not reflect the risk-taking characteristics marked in Islamic deposits compared to shareholders. However, these findings are contrary to the results found in the study conducted by Lahrech et al. (2014), which found a strong and positive link between the performance of Islamic banks and profit or loss distributed to IAHs. This indicates that the returns of PSIAs in IBs are related to the actual investment outcomes. In the relevant context, Bilal et al. (2016) conducted a comparative study between the performance of IBs and conventional banks CBs in Oman in the period 2013-215. The study found that CBs are more profitable than IBs as the former outperformed the latter in ROE, ROA, and NPM ratios. However, IBs outperformed CBs in solvency ratios such as DAR and DER, as they found less reliance on debt financing. Therefore, IBs were found to be better than CBs in their ability to protect depositors' funds, as they recorded a higher credit deposit ratio.

However, AlShattarat and Atmeh (2016) investigated the problems and challenges of Islamic banks in executing the Mudarabah contract. It found that implementing the Mudarabah contract has led to many difficulties, particularly in the context of investment deposits. The major problem -in this regard- is the determination of total profits resulting from Mudarabah-based investment deposits and the allocation of these returns between parties- including the depositors- involved in the investment pool. In addition, the current practice of Islamic banks in smoothing the returns of unrestricted investment accounts has been criticized, as the concept of profit and loss sharing is broken.

Similarly, Atmeh and Hadi Ramadan (2012) argued that the reserves set aside from the PSIAs' return for smoothing profit distributable to IAHs contradict the principle of profit and loss sharing (PLS). Also, Diaw and Mbow (2011) compared the returns on Mudarabah deposits (ROMD) and ROE, taking 9 Islamic banks from different countries from 2006 to 2011 as a sample. It is found that ROE is at least two times higher than returns on Mudarabah deposits, and there is no clear link between the two. Instead, ROMD is more correlated to IR in conventional banks.

However, ROE is significantly more affected by ROA than ROMD, which means that equity holders take advantage of the leverage more than IAHs. The priority is granted to the shareholders in assets and income allocation at the expense of the IAHs. But this could be argued by the fact that the shareholders benefit from PSIAs from two sides; first, as a Rub Al Mall, the bank commingles its funds with other IAHs' funds in the Mudarabah pool. In this case, the contractual relationship between the shareholders and IAHs is the Musharakah contract. Second, as a Mudarib (investment manager), the bank is entitled to a share of the profit generated from the Mudarabah pool as per the agreed profit rate. Therefore, it makes sense that the ROE is higher than IAHs' return.

In contrast, Hamza (2016) found that investment accounts in Islamic banks do not reflect the profit and loss sharing principle due to the moral hazard behaviour and excessive risk-taking by the Islamic bank. Second, IAH's high-level expectation of return places Islamic banks in comparison with conventional banks, which offers a rate of return depending on the interest rate. Consequently, Islamic banks are inforced to adopt an interest rate benchmark to measure their deposits profit rate.

Archer and Karim (2009) were the first to investigate the potential issues resulting from using profit-sharing investment accounts in Islamic banks (PSIAs). The study found that a key regulatory problem could arise from PSIAs adoption by Islamic banks where the nature of these accounts does not meet the authority condition for banks to be depository institutions. Unlike conventional banks, Islamic banks do not guarantee either the capital provided by IAHs or the profit this capital could produce. Additionally, profit and loss sharing features in these accounts expose Islamic banks to displaced commercial risk (DCR) due to the profit and loss volatility.

As a result, Islamic banks apply many strategies to avoid this risk, such as the profit equalisation reserves (PER) technique to cover the return rate presented by conventional banks. However, this leads to another key problem: the lack of transparency in PSIAs regarding the actual attained profit and loss on these accounts. To solve or reduce the effects of these problems, the study suggested changing the structure of Islamic banks, where the funds of PSIAs are managed and invested by another investment company established as a subsidiary of the retail bank.

On the other hand, Khan and Ahmed (2001) examined PSIAs from a risk management perspective. They discussed the nature of risks faced by IFIs and the regulatory and sharia concerns in this regard. The researchers organized a survey to examine the types of risks in such institutions. It is found that there are two types of risks in the context of Islamic banks. The first type is similar to risk existing in traditional institutions; however, the second type is unique for Islamic finance. The profit and loss sharing component in Islamic banks poses unique risks. This is particularly evident in investment deposits, where the bank is compelled to pay a share of profit to investment account holders, resulting in withdrawal, fiduciary, and commercial risks.

On the other hand, the disclosure of information relating to PSIAs and the compliance of PSIAs practice with different applicable standards had a comprehensive discussion of the literature. Lahrech et al. (2014), in their empirical study, found that augmenting the Islamic bank transparency by increasing the level of disclosure regarding the investment accounts leads to more reliability in the allocation of profit ratio distributed to IAHs. These results align with the findings of another study conducted by Saidani et al. (2021). The study examined the factors that could determine the IAHs' disclosure in annual financial statements. It is found that there is a significant positive relationship between IAHs' disclosure level and the amount of IAH funds, the return on IAH funds, adoption of AAOIFI standards, liquidity level, bank size, and ownership.

In this regard, another study conducted by Ameer et al. (2012) examined the compliance of full-fledged Islamic banks in Malaysia with the Bank Negara Malaysia (BNM) disclosure guidelines regarding the PSIAs. The study found that most checklist items based on BNM guidelines are not met by the examined banks, which means that the practice of PSIAs in these banks lacks transparency. Therefore, the study proposed that Investment Account holders (IAHs) should be represented on the audit committee board or at the annual meeting of Islamic banks. However, due to shariah rules consideration, their involvement could restrict the monitoring and supervision processes and decision-making outside of the management area.

In addition, Albarrak and El-Halaby (2019) attempted to measure the compliance level of sharia disclosure between Islamic banks (IB) that apply AAOIFI standards, and IBs apply IFRS in 2016. In addition, the research aims to reveal the economic consequences of sharia disclosure. The study included 120 Islamic banks from 20 different countries. It is found that the sampled bank achieved 53% of sharia disclosure compliance with higher levels for IBs applying AAOIFI standards compared to those applying IFRS. In addition, there is a positive relationship between Sharia compliance disclosure and the value of the company presented by financial performance.

Following this discussion, there was an argument regarding the current accounting practice of PSIAs. Atmeh and Hadi Ramadan (2012) criticised many AAOIFI-based current accounting practices concerning Mudarabah-based investment accounts. First, there is no fair presentation of assets attributable to IAHs, as all assets are classified under one category. This has been enhanced by AlShattarat and Atmeh (2016) in their study regarding the problems and challenges faced by Islamic banks in executing the Mudarabah contract. They believe that listing all assets under one classification on the asset side without distinguishing who belongs to IAHs and who owns assets belonging to other stakeholders contributes to income inequality. To solve such a problem, they suggested reclassifying these assets under two categories; the first includes the assets financed by IAHs, and the second includes assets attributable to stakeholders.

Additionally, Suandi (2017) examined the accounting experience of PSIAs in Islamic Financial institutions (IFIs) under different accounting standards such as AAOIFI and IFRS standards. The research takes 63 full-fledged Islamic banks from 15 different countries as a sample of the study, in which the annual reports and financial statements for the year 2013 of these banks have been collected and surveyed. The study found that the accounting practice of PSIAs has significantly varied due to the variation of standards applied in Islamic banks. Also, divergence has been found even among Islamic banks that adopt IFRS standards. However, Islamic banks which apply AAOIFI standards show more consistency in their financial reports regarding PSIAs. Most Islamic banks that adopt IFRS, NAS, or NIAS classify PSIAs as a liability.

In contrast, banks that follow AAOIFIs' standards classify it as quasi-equity between the liability and shareholders' equity. Additionally, the disclosure of returns attributable to IAHs varies as well, in which most Islamic banks that follow IFRS disclose them as expenses. At the same time, they are classified as profit or loss by Islamic banks that follow AAOIFI and NAS standards. However, some Islamic banks mention the term ‘’distribution to depositors' to refer to the returns belonging to IAHs. Moreover, Isa and Abdul Rashid (2017) discussed the relationship between the investment and deposits accounts on the liability side and equity-based financing on the assets side using time series analysis data of 25 full-fledged Islamic banks under the Association of Islamic Banking Institutions Malaysia between 2005 and 2016. It is found that there is a co-integration relationship between the investment and deposits accounts and the equity-based financing of the sample banks.

Another important issue concerning PSIAs that has been addressed is the governance of PSIAs. Syamlan (2018) discussed the issue of corporate and shariah governance in IFIs. The researcher concluded that the Islamic concept of governance is represented in three areas: accountability, transparency, and trustworthiness. In this regard, the research found that IAHs are not given the right to monitor their investments. In addition, there is a lack of information delivered to IAHs compared to those delivered to shareholders. To reduce the impact of these issues, the researcher suggested adopting IFSB's guidance which advised establishing a governance committee. Also, he suggested setting a global professional ethic for SSB members, which is supposed to govern the behaviour of sharia scholars.

Additionally, Elgattani and Hussainey (2020) examined the influence of some corporate governance (CG) features on the level of AAOIFI's governance standard's (GS) disclosure requirements in Islamic banks. They found that only the audit committee size mechanism positively correlates with the level of AAOIFI governance disclosure. Likewise, Mnif and Tahari (2020) investigated the influence of main CG mechanisms on compliance with AAOIFI's GS's disclosure requirement. It found that compliance with AAOIFI's GS is positively influenced by Audit Committee (AC) independence, AC accounting, and financial expertise, industry expertise, auditor industry specialisation, IB size, and listing status. However, contrary to Elgattani and Hussainey's (2020) study, this research found that AC size has an insignificant relationship with compliance with AAOIFI’s GS.

However, sharia concerns have occupied an important portion of the literature on PSIAs. This makes sense, particularly if it is known that the sharia aspect constitutes the cornerstone in structuring the contractual relationship of PSIAs. Shaharuddin (2010) examined the extent to which current applications of the Mudarabah contract in Islamic banks meet the rules and concept of this contract as presented by classical Islamic jurists. The study found that the current practice of the Mudarabah contract does not fulfil the classical principles and framework of this contract. According to the researcher, the main reason behind this is the market-driven methodology adopted by sharia scholars. This methodology is concluded by ridding some restrictions and rules of the contract due to banking sector needs which are so called in Islamic jurisprudence (AL Maslaha).

Additionally, Mazuin Sapuan (2016) discussed the evolution of the Mudarabah contract from a classical perspective. In addition, the research attempted to evaluate the asymmetric information risk that could be involved in such a contract. The study emphasised the development of the Mudarabah contract from the prophet's era to the contemporary days. This evolution is a response to the rapid needs and changes in the financial sector. This is not an issue from an Islamic commercial law perspective as long as the general framework and rules of the Mudarabah contract are not broken. However, the Mudarabah contract is less desirable than other debt financing instruments due to asymmetric information risk. The researcher suggested granting Rab Al Mal (investor) more powers to monitor and screen the investment as the best tool to reduce this risk.

Besides, few studies have discussed the experience of customers in PSIAs. For example, Karim (2010) attempted to explore to what extent Malaysian Islamic banks' investment account holders are aware of investment account features as per sharia rules and regulations. The study found that although the depositors have a higher level of religious knowledge of Islamic deposits, there has been a lack of understanding regarding the specialty of sharia products. From a shariah perspective, the depositors have not accepted the most preferred features and practices of investment accounts.

In addition to that, Begum (2014) has investigated customer gratification regarding the services provided by Oman's Islamic banks compared to conventional banks. The study adopted a descriptive approach and took two Islamic banks and five conventional banks as a sample. Surveys and interviews were deployed and conducted with the customer to measure their level of satisfaction. The study found that the customers of both kinds of banks are satisfied, but conventional bank clients are slightly more satisfied.

CHAPTER 3

METHODOLOGY

Since the general purpose of this study is to uncover the current practice of IBWs in Oman regarding the PSIAs and compare this practice with the relevant AAOIFI standards, the general approach that has been adopted is qualitative. In addition, a combination of content analysis and comparative methods was used to investigate the research topic. The case study methodology was highly suggested to answer the research questions. But many constraints prevented the researcher from using it. First, the case study method usually focuses on one participant, which means that the study will not reflect the practices of other participants, which is not compatible with the purpose of this research which aims to investigate the practices of Oman's Islamic banking sector broadly. Second, it was not easy to get consent for research conduct from the local Islamic banks and windows to conduct interviews and deploy surveys. It seems that the management of these banks has some concerns regarding the topic of research, particularly regarding AAOIFI standards.

However, since all IBWs in Oman must follow AAOIFI standards by the Central Bank of Oman, they are supposed to disclose all important information, particularly concerning PSIAs. Therefore, the content analysis of this information, besides the contracts used by the bank for investment accounts, is to a large extent thought to be enough to make a solid judgment regarding the practice of PSIAs. In addition to previous methods, there was a need to use the ratio analysis method to show some statistics regarding the PSIAs in Oman's Islamic banking sector.

The researcher has selected all Islamic banks and windows in Oman as a research sample for many reasons. First, it is important to cover all relevant participants in the subject of research to accurately the conclusion is reflected. Second, although there is a difference between the full-fledged Islamic banks and Islamic windows in terms of the structure of each type, the researcher thinks that this difference will not affect the subject of research since both kinds of entities should follow and apply the same regulations and standards imposed by the Central Bank of Oman. In addition, Islamic windows are the majority of Islamic banking sector participants in Oman, as they are 5 Islamic windows compared to only two full-fledged Islamic banks. Hence, excluding them means excepting the most effective factor in the research topic.

The study is concentrated on revealing the PSIAs practice of IBWs in Oman, mainly in terms of disclosure and sharia aspects, therefore, the data has been gathered from the annual reports of the Islamic banks and windows as well as the published contracts that are used for opening accounts relating to PSIAs. First, the content of these reports and contracts was analysed and discussed to uncover the bank's practice concerning issues. Furthermore, since the second purpose of the study is to compare the practice with AAOIFI standards, the conclusion extracted from the content analysis stage would be later compared with the relevant AAOIFI standards.

Besides, the researcher restricted the annual reports to the year 2021 to make sure that the latest practices were observed. Also, AAOIFI is constantly issuing new standards, and the current standards are only effective after the year that the standard has been issued. Hence it was important to restrict the data to last year to ensure that the recently issued standards are included in the study. However, the annual report for Alizz Islamic banks is not available for the year 2021. Thus the annual report for 2020 has been analyzed. In addition, only the financial position statement is available for the Maisarah Islamic Banking window for the year, while the notes to financial statements are not found.

In this regard, the main data that was extracted from annual reports are as follows:

1- Quantitative data

These data refer to information relating to the bank's financial performance concerning PSIAs, such as assets financed by PSIAs, amount of PSIAs' equity, IRR and PER reserves, and returns generated from PSIAs.

2- Qualitative data

These data refer to information disclosed in the financial report to illustrate the qualitative aspects of PSIAs. This includes, for example, the mechanisms used to calculate returns attributable to IAHs. In addition, the factors applied in determining the expenses and profit rates attributable to PSIAs.

However, the contracts were used mainly to know how the Islamic banks and windows have structured their investment accounts. This includes all legal aspects of the contract, such as the contractual relationship between the bank and depositors and the legal effects arising from this relationship.

CHAPTER 4

Investment accounts in Islamic banks and AAOIFI standards

4.1 Investment accounts in Islamic banks

4.1.1 definition of investment accounts

According to AAOIFI, Investment accounts are "the amounts which the institution receives from investors based on participatory Mudarabah (al-Mudarabah al-Mushtarakah). The holders of such accounts delegate the institution to invest their funds through Mudarabah" (AAOIFI 2017, SS40).

From this definition, investment accounts are categorised amongst agency contracts. One party (investor) appoints the second party (institution) to manage and invest his money as per terms and conditions agreed upon. In addition, the funds collected in investment accounts are managed and invested by the institution collectively. This means that there is no separation of funds, and each portion of funds is attributable to an unidentified investor. But, the definition of AAOIFI has restricted the contractual relationship that governs investment accounts to the Mudarabah contract. This is considered logical as the standard, speaking of Mudarabah-based investment accounts, has defined the investment accounts. But, from an Islamic commercial law perspective, investment accounts could be structured based on many other contracts, such as Musharakah and wakhalah contracts. In addition, the Mudarabah contract has widespread use, and it is preferred by many Islamic banks when it comes to investment accounts due to its practical advantages. In addition, Atmeh and Hadi Ramadan (2012) suggested that AAOIFI's definition of equity of IAHs is inconsistent with the definition of the owners' equity and could be misleading.

However, IFSA (2013, cited in Rosman et al. 2015, p. 133) provides the following interpretation of an investment account: "Investment account" means an account under which money is paid and accepted for investment, including for the provision of finance, following Shariah on terms that there is no expressed or implied obligation to repay the money in full and -a) either only the profits or both the profits or losses, thereon shall be shared between the person paying the money and the person accepting the money; or b) with or without any return. Investment accounts in Islamic banks correspond to term deposits in conventional banks regarding the general purpose for which they are designed. In other words, people usually deposit funds in such accounts to achieve long-run increases, revenues, or capital protection (Investment Account Definition - What is an Investment Account? n.d.), and both kinds of accounts could achieve these targets. However, they differ in mechanisms and laws by which they are operated. The main difference between investment accounts in Islamic banks and their counterparts is the relationship between the bank and depositors. While they are always based on loan contracts in conventional banks, they are structured based on the profit and loss sharing(PSL) model in Islamic banks. This model has many implications in Islamic commercial law, such as Mudarabah, Musharakah, and wakalah contracts.

The current practice of Investment accounts in Islamic banks showed that there are two contractual relationships regarding the investment accounts:

First, between the depositors and the bank as an agent manager. In this case, savers or depositors agree with the bank to manage and invest their funds in appropriate investments. The depositor provides the capital, and the bank provides his efforts and works to invest the funds. Many contracts could govern this agreement, and the rules will differ per each contract. The Islamic bank usually gathers all collected funds from deposit accounts in one large pool and manages them collectively.

Second, between depositors and other bank's stakeholders such as shareholders and savings and current accounts holders. This relationship arises from commingling deposit funds, shareholders' funds, and current accounts funds in one investment pool. Thus, each direction will contribute a certain amount to this investment pool. Current accounts funds belong to the shareholders as these accounts are governed by Qard (free-interest loan) contract from a commercial Islamic law perspective. This means that the bank borrows these funds from the current account holders and returns them when the account holders withdraw them. Therefore, the contractual relationship between the investment accounts holders and bank's shareholders is a partnership. In Islamic commercial law, partnership contracts fall under the Musharakah contract, particularly Sharikat Al Aqd. Under this contract, the shareholders (represented by the bank) and investment account holders provide a part of the capital. They share in the generated profit according to the agreed ratio. However, each party bears the loss following his share percentage in the capital.

4.1.2 Types of investment accounts

Investment accounts have many divisions and types according to many considerations. These considerations could be divided into three categories; contractual relationship, purpose, and control and management.

First, types of investment accounts in terms of the contractual relationship

This kind of contractual relationship is the cornerstone of all commercial and financial transactions. This relationship determines all rights and obligations for each party. In addition, the contract will determine how each party to the contract should behave and act as per terms and conditions that have been agreed upon at the time of the contract.

According to this, investment accounts are governed by a contractual relationship whereby the rights and obligations of involved parties are known and identified. This relationship could be structured based on three contracts:

1- Mudarabah-based investment accounts

The Mudarabah contract is considered one of the equity-based partnership contracts in Islamic commercial law. In addition, this contract is a combination of fund and work partnership. One party provides the capital, and the other party provides work. The party that contributes with the capital is called “Rab Almal”. However, the party that provides work is called “Mudarib”.

“Mudarabah is a special kind of Shirkah(Musharakah) in which an investor or a group of investors provides capital to an agent or manager who has to trade with it; the profit is shared according to the pre-agreed proportion, while the loss has to be borne exclusively by the investor”(Ayub 2007,p320)

Although the Mudarabah contract is categorised as a partnership contract, the contract tends to be an agency contract at its initial stage, where the mudarib in this phase contributes with just his efforts. However, as the revenues are generated, the relationship is developed to be a partnership (Kureshi & Hayat 2015).

Most investment accounts are structured based on the Mudarabah contract, and it seems that Islamic banks prefer to use this contract due to its flexibility. As per sharia rulings of the Mudarabah contract, the Mudarib does not bear any loss incurred in Mudarabah investment except for the case of negligence, misconduct, and terms violation, where he should bear the loss.

2- Musharakah-based investment accounts

This kind of investment account depends on Musharakah (partnership) contract. According to AAOIFI (2017), “ Sharikat al-’Aqd (contractual partnership) means an agreement between two or more parties to combine their assets, labour or liabilities to make profits”. As per this definition, the bank will enter into a partnership contract with the investment accounts holders in which each partner contributes a portion of the capital. As a result, each party has entitled to a share of the profit following the agreed profit ratio. However, if it happens, the loss will be borne according to the percentage of share of each party in the capital.

The main differences between Mudarabah-based investment accounts and Musharakah-based investment accounts are that in Mudarabah deposits, as per Islamic commercial law, depositors are almost not competent to manage or even monitor their funds. At the same time, Musharakah depositors have the right to manage and make decisions regarding their investments. In addition, the bank as a Mudarib does not bear the loss unless in the case of negligence, misconduct, and condition violation. However, as a partner, he will bear the loss if it happens as per his capital ratio. Therefore, for this reason, Islamic banks prefer to adopt Mudarabah-based investment accounts, and it is rare to find investment accounts structured based on the Musharakah contract.

3- Wakalah Bil Istithmar

Wakalah is a contract between two parties in which one party delegates the other to act on behalf of him. According to Kureshi and Hayat (2015, pp. 151), the Wakalah contract “can be comparable to the concept of agency in general, whereby one party (muwakkil) would give authorization to another (wakil) to perform a task as an agent on behalf of the muwakkil in the matters that can be delegated”.

In the context of investment accounts, Islamic banks could structure these accounts based on the wakalah contract in which the depositors appoint and delegate the bank to manage and invest their money against agreed and identified fees. The concept of wakalah is applied in the Mudarabah contract mentioned earlier. In which the Rab Al Maal appoints the Mudarib as an agent of him, however, the main difference is the sharia rulings of both contracts, which are as follows:

- In the Mudarabah contract, the Mudarib shares in the profit resulting from the Mudarabah investment and just losing his efforts in the case of loss. However, Al-Wakeel (agent) does not share in the profit; instead, he charges a fixed and agreed-upon fee against his services. (can the agent take a percent of the profit from a sharia perspective)
- In unrestricted investment, the Mudarib has more discretion in investment management than the Wakeel, which is required to constantly refer to the principal (Kureshi & Hayat 2015).

Second, types of investment accounts in terms of the purpose

Investment accounts are divided into two types (Bellalah & Masood 2013);

1- General investment accounts (GIA)

This type usually includes the biggest segment of depositors, and the funds collected from GIA are combined and commingled in one large investment pool. Therefore, each amount of money in this pool is not distinguished and not known to whom it is attributable. Typically, the bank invests these funds in its operations, such as; individuals, corporate financing, and interbank loans.   In addition, this type of investment account is usually linked to upper and lower limits in terms of the number of funds that should be available. On the other hand, GIA differs from a savings account by these features:

- The lowest amount of money should be available, where it is in GIA higher than in savings accounts.
- The length of duration that the money should not be withdrawn in GIA is longer than in savings accounts.
- In GIA, the depositor should bear the loss if it happens. However, in savings accounts, banks usually do bear the loss.

2- Special investment accounts (SIA)

This type is similar to GIA in terms of the contractual relationship between the bank and depositors that the accounts could be structured based on. However, SIA is customised for large investors and institutions. They have a choice to invest their funds in special projects carried out by the bank. Hence, the level of risks in these accounts is higher than in GIAs, and the profit rate is higher. “To some extent, these accounts resemble specialised funds to finance different asset classes. The maturity and the distribution of profits for special investment accounts are negotiated separately for each account, with the yield directly related to the success of the particular investment project” (Iqbal & Mirakhor 2006, pp154).

Third, types of investment accounts in terms of the management and control

According to this consideration, investment accounts are divided into two types;

1- Unrestricted investment accounts

This kind refers to accounts that the Islamic bank manages at its full discretion and without any limits or restrictions imposed by the depositor. So, the bank does not need to refer to the IAHs regarding the type and place of investments in which their funds will be invested.

2- Restricted investment accounts

This kind of account is restricted to some conditions that the depositors impose in terms of -for example- types of investments and places that their investments would be operated in.

4.1.3 Investment accounts risks

Due to the unique nature of Islamic financial products, Islamic banks face various risks when it comes to investment account deposits. These risks result mainly from the nature of the equity-based contractual relationship between the bank and depositors and subsequent sharia rules and legal framework to this unique contractual relationship (El Tiby Ahmed 2011).

However, Khan and Ahmed 2001 have studied risk management issues in Islamic financial institutions. The study discussed the nurture of risks faced by Islamic financial institutions and the regulatory and Sharia concerns in this regard. In addition, the research has run a survey to examine the types of risks that exist in such institutions. It is found that there are two types of risks in the context of Islamic banks. The first type is similar to risk existing in traditional institutions. However, the second type is unique for Islamic finance. The unique risks belong to Islamic banks' profit and loss sharing feature.

Hence, there are two main categories of investment accounts risks. First, risks arise from the unique contractual relationship between the Islamic bank and IAHs. This includes profit and loss sharing features between parties to the contract. Second, risks arise from the investments in which the funds of IAHs are invested. This entails risks relating to the rate of return and investment management. As such, risks relating to IAs could be divided into these types;

First; the rate of return risk

According to IFSB, the rate of return risk means "possible impact on the net income of the IIFS arising from the impact of changes in the market rates and relevant benchmark rates on the return on assets and the returns payable on funding" (2007, Article 59). In other words, the risk of return rate comes mainly from investing IAHs' funds in fixed-return assets such as Murabaha. In which the maturity of such assets comes after a long period. Meanwhile, the market rates and benchmarks constantly change, which leads IAHs to change their expectations proportionally regarding their investments' rate of return(IFSB 2007).

However, this risk is not present in the case of CBs, as they use interest rates in rewording their investment deposit holders. Van Greuning and Iqbal (2007) determined the main difference between interest rate risk and return risk as follows;

- Doubt in return of investment accounts is higher than in interest rate of conventional deposits, as the former comes from a mixture of debt and equity-based investments. The latter is fixed and linked to fixed-income instruments such as securities.
- The return rate of investment deposits in Islamic banks is not predetermined. In contrast, the interest rate is identified at the account opening, making conventional deposits less risky than Islamic deposits.

- Returns on equity can not be known until the end of projects that the funds were invested in, while interest rate does not need to wait until the end of investments to be known.

In this regard, IFSB(2005) has set two principles to manage and mitigate the rate of return risk. Firstly, IFIs should have a robust framework to manage, report, and assess the effects of market rates on the rate of IAs return. Secondly, they should adopt an appropriate system to manage DCR.

Second, displaced commercial risk (DCR)

According to IFSB (2005), displaced commercial risk (DCR) is a consequence of the rate of return risk. As a result, IAHs' expectations increase because of the market rate growth. At the same time, their assets are underperforming. Therefore, IFIs, from the perspective of commercial competition, will rush to satisfy IAHs by giving them a portion of their return to avoid withdrawing their funds.

Third, equity investment risk

IAs face another kind of risk that lies in using and investing the IA's funds. As known and unlike CBs, IBs can not use and operate their funds in debt-based instruments such as interest-based loans. Therefore, they must look for PLS models to deploy their funds. In this regard, equity-based investments are considered the common structure of the PLS model, such as Mudarabah and Musharakah-based partnerships. This includes purchasing shares in the stock markets, private equity, and involvement in equity investments and projects.

On the other hand, equity-based investments have more risks than interest-based instruments in CBs, as a natural result of the IB's role, which is supposed to be more than just financial intermediation. More accurately, equity investment risks are concluded in the following features (Iqbal & Mirakhor 2006); 1- Participating in equity investment involves robust monitoring and screening of the project's activities to mitigate asymmetric information risk that could arise between the bank and the project management. This includes periodically examining financial disclosures and closely participating in the management.

2- Lack of a secondary market for some equity investment which means the difficulty of an early exit from the investment.

3- Volatility of the equity investment’s income leads to cash flow management challenges.

4.2 AAOIFI’s investment accounts standards

4.2.1 Background of AAOIFI

AAOIFI is a non-profit based in Bahrain organisation that aims at developing and issuing international standards in the Islamic finance and banking industry. It was established in 1991, and since then, it has been issuing dozens of standards. The main objectives of this organisation are as follows;

1- Build and develop accounting, governance, and ethical thinking about Islamic financial institutions through the sharia framework.

2- Increase the awareness of accounting, auditing, and ethical concepts relating to Islamic finance.

3- Hormonise and improve the practices of accounting, auditing, and governance practices in Islamic financial institutions by issuing standards in these areas.

4- achieve unity between Sharia Supervisory Boards through issuing standards in sharia matters to avoid differences in Fatwas between them.

4.2.2 AAOIFI's Structure

The structure of AAOIFI consists of two main categories;

First, management and execution boards

These boards are responsible for the management and executive duties such as decision-making, supervision, and committee members' appointment. These boards are as follows;1- General assembly 2- Board of trustees 3- AAOIFI secretariat 4- Executive committee.

Second, technical boards

These boards are responsible for issuing standards concerning Islamic financial institutions' practices such as accounting, Sharia, auditing, and governance. This includes two main boards;

1- Sharia board

2- Accounting and auditing standards board

4.2.3 AAOIFI's Standards

So far, 113 standards have been issued in Sharia, accounting, auditing, ethics, and governance. The efforts are continuing to issue new standards and develop and revise current standards. The issued standards are divided into these categories;

1- Sharia standards

These standards aim at standardising the practices of IFIs in sharia matters. Particularly the uniformity of the Fatwas issued by Sharia Supervisory Boards in IFIs. So far, 60 sharia standards have been issued, and more standards are expected to be issued in the future.

2- Accounting standards

Accounting standards are designed to find an alternative accounting system for IFIs as the current and in place, accounting standards are not compatible with the nature of Islamic commercial law and do not reflect sharia rules. The 40 issued accounting standards addressed main matters concerning accounting treatments in IFIs, such as disclosure and presentation in IFIs, contracts used in financing in IBs, profit distribution and disclosure, investment accounts, etc.

3- Governance and auditing standards

These standards cover and address the issue of the auditing system in IFIs internally and externally. In addition, the standards illustrate in detail the principles of governance that should be applied in IFIs. The auditing standards have covered the major issues: auditing reports, SSB appointments, external and internal auditing, and sharia auditing. However, the central sharia board, sharia compliance functions, and Sukuk governance were the main subjects addressed by the governance standards.

4.2.4 AAOIFI's standards on PSIAs

If we look closely enough at the nature of PSIAs and their current practices, we will find that it interferes with many other aspects. In other words, investment accounts are a combination of legal, financial, regulated, and Sharia issues, and all these aspects constitute the ultimate design and shape of PSIAs. In addition, PSIAs in IFIs are rarely structured based on multiple contractual relationships, and each contract has its own distinguished and different rulings, conditions, and implications.

From this perspective, AAOIFI has dedicated a comprehensive discussion of its standards to investment accounts due to its prominence in the Islamic banking and finance industry. Investment accounts have earned this place due to many following reasons.

First of all, PSIAs' funds usually represent the highest source of funds in Islamic banks compared to other accounts and shareholders' funds. Secondly, from a practical view and despite the above fact, IAHs are not represented in the bank. Hence, they cannot defend their rights, making them vulnerable to exploitation from other parties (Archer & Karim 2009). Thirdly, particularly in Islamic banks, the relationship between IAHs and the bank is governed via an equity-based contract which means that both parties share in risks, losses, and profits. Hence, due to this prominence, AAOIFI addressed investment accounts in 5 standards; 3 Sharia standards (SS) and two Financial And Accounting Standards (FAS). These standards are as follows:

SS (13) Mudarabah

The AAOIFI Sharia Board approved this standard in its meeting No.8 on 16 May 2002 after a series of meetings, suggestions, amendments, and public hearings. This standard aims to illustrate the sharia rulings concerning the Mudarabah contract, whether the IFI plays the role of Mudarib (entrepreneur) or Rab Al mall (investor).

SS (13) broadly addresses the Mudarabah contract between the IFI and other institutions or individuals. Moreover, joint investment and special investment accounts are included under this standard if structured based on the Mudarabah contract. The standard has touched upon the definition of Mudarabah, the Mudarabah financing agreement, and some technical sharia rulings regarding the Mudarabah contract. In addition, the standard has illustrated the types of Mudarabah and the conditions of each type.

Besides, guarantees in the Mudarabah contract, profit distribution, and responsibilities and rights for each party have been explained in detail. Finally, the standard dealt with the liquidation of a Mudarabah contract and relevant sharia rulings(AAOIFI 2002).

SS (40) Distribution of Profit in Mudarabah-Based Investment accounts

SS (40) was approved and issued on 19 June 2009 by the AAOIFI Sharia Board in its 24th meeting. This standard mainly covers three key issues relating to Mudarabah-based IAs. These issues are realisation of profit, entitlement to profit, and profit distribution. The terms and controls of profit recognition and entitlement have been addressed. In addition, it illustrated how the profit to be distributed between the IFI as a Mudarib and depositor as a Rab Al Mall.

The main difference between SS(13) and SS(40) is that the former talks about the Mudarabah contract and its rulings generally regardless of its use as a contractual relationship in IAs, while the latter talks, particularly about the use of this contract the issue of profit distribution in Mudarabah-based IAs. In addition, the SS(13) includes the Mudarabah contract as a financing instrument used by the IFI appearing on the assets side where the IB acts as a capital provider (Rab Al Mal) and as an investment instrument appearing on the liability side where the IB acts as an entrepreneur (Mudarib). However, SS(40) is restricted to Mudarabah as an investment tool where the depositors represent the investor (Rab Al Mall) while the IB represents the Mudarib.

Although the SS(13) has touched on profit distribution in the Mudarabah contract, SS(40) has addressed and discussed this issue in-depth and in more detail, focusing on IAs. In this regard, the following subjects are the heads of SS(40)s' main articles(AAOIFI 2009) :

- Definition and types of investment accounts
- Realisation of profit
- Entitlement to profit
- Distribution of profit
- The difference between an investment account and a current account and its likes

SS (46) Al Wakalah Bi Al Istithmar (Investment Agency)

This standard addresses investment agencies in general, including the IAs in IBs. This means that SS (46) is not restricted to investment accounts operated in IBs; any investment has been structured based on the Wakalah contract. On the other hand, the general Wakalah contract in other investment fields is not covered by the standard.

SS (46) also includes using the Wakalah contract as a financing instrument on the assets side, particularly for working capital financing. IAs are included under this standard because they could be built based on the Wakalah contract mentioned in the chapter, where the depositors delegate IB to manage and invest their money against a fixed fee.

Therefore, the key issues that have been touched upon by the SS (46) are the types, features, and critical pillars of the investment agency contract. In addition, the standard elaborated on the rules and conditions of fee and profit and rights and obligations of each party to contracts. Finally, there are some articles regarding the constraints that the principal could impose on an investment agency(AAOIFI 2011).

FAS (27) Investment Accounts

The scope of this standard includes Mudarabah-based investment deposits and interbank deposits. This standard is the ultimate version of FAS No. (5): Disclosure of Bases for Profit Allocation Between Owner's Equity and Investment Account Holders, and FAS.(6): Equity of Investment Account Holders and their Equivalent after the consolidation.

The main purpose of FAS (27) is to lay out the accounting principles regarding the recognition, measurement, and presentation of investment accounts in IFIs. So, FAS (27) is more broadly than FAS (21) in which the latter is only concerned with the disclosure requirements of IAs' assets transfer while the former addresses the accounting treatments as well as the presentation of IAs. However, It is noted that the IAs that are structured based on Wakalah and Musharakah contracts are not included under the provisions of this standard as each one has its financial standard.

In this regard, the main issues that the standard has touched upon are the criteria for recognition and derecognition of investment accounts in IFIs. In addition, the standard explains in detail how the impairment attributable to IAs is treated.

Moreover, the disclosure requirements for IAs are identified(AAOIFI 2016).

FAS (31) Wakalah Bil Istithmar (Investment Agency)

This standard aims to determine the accounting and reporting principles for the investment agency instrument. Therefore, this standard shall be applied only in investment accounts offered by the IBs, investment funds based on investment agencies, and Wakalah Bil Istithmar Sukuk issuances. In addition, the standard touched upon the accounting treatment for investment agency instruments from the perspective of the principal (investor) and the agent (investment manager). However, the main issues that have been addressed in this standard are as follows; board classification of the investment agency instrument, revenues and expenses measurement, presentation and disclosure, and the different approaches that could be applied in accounting for the investment agency instrument(AAOIFI 2020).

CHAPTER FIVE

DATA ANALYSIS

The practice of investment accounts in Oman’s Islamic banks

5.1 Introduction to Islamic Banking in Oman

Islamic banking started in Oman just after May 2011 when a royal act was issued and allowed Islamic banks to begin their activities in the country. This was followed by issuing Islamic Banking Regulatory Framework (IBRF) by the Central Bank of Oman in December 2012. The IBRF has organised the work of Islamic banks and windows in Oman through 10 titles which are; licensing requirements, general obligations and governance, accounting standards and auditor reports, power of supervision and control, capital adequacy, credit risk, market risk, operational risk, liquidity risk, and miscellaneous.

Therefore, many Islamic banks and windows were established and launched in 2012. So far, there are two independent Islamic Banks and six Islamic windows. The independent Islamic banks are Bank Nizwa and Alizz Islamic Bank. However, the Islamic windows are Meethaq Islamic banking, the window of Bank Muscat, Mzun Islamic banking, the window of the National Bank of Oman, Maisarah Islamic Banking, the window of Bank Dhofar, Sohar Islamic, the window of Bank Sohar, and Ahli Islamic, the window of Ahli Bank, and Al Yusr Islamic Banking, the window of Oman Arab Bank. The Islamic banking sector in Oman witnessed rapid growth compared to its conventional banking counterparty. According to Fitch Ratings (2022), the Islamic banking sector in Oman recorded an 11.6 % growth rate in 2021 compared to just 3.1 % achieved by the conventional banking sector. Thus the capital share of IBWs in Oman increased by 15.2% at the end of 2021 compared to 14.3 % at the end of 2020.

5.2 Investment Accounts in Oman's Islamic Banking Sector

Since the beginning of Islamic banking activity in Oman, the IBWs have focused their efforts on attracting depositors' funds who would like to invest their money following shariah rulings. As it is known, deposits are considered a key source of funds in the general banking sector. Hence, the priority of IBWs in Oman was to get funds from the depositors to operate them in their financing and investment activities. Acquiring depositors was not a serious issue, particularly for the IBWs in Oman, as most people in Oman have been demanding that Islamic banks be authorised for a long time. Thus, when the Islamic banks were licensed, they were driven to deal and save their funds in such banks.

Today, investment deposits constitute an integral part of the funds of IBWs in Oman, which are employed to operate their critical functions and activities. The total of IAHs' equity of IBWs in Oman represented about two-thirds (62.40%) of the total liabilities and equities in these IBWs in 2021. Figure 1 shows the percent of the IAHs' equity of each IBW in Oman compared to its total equities and liabilities:

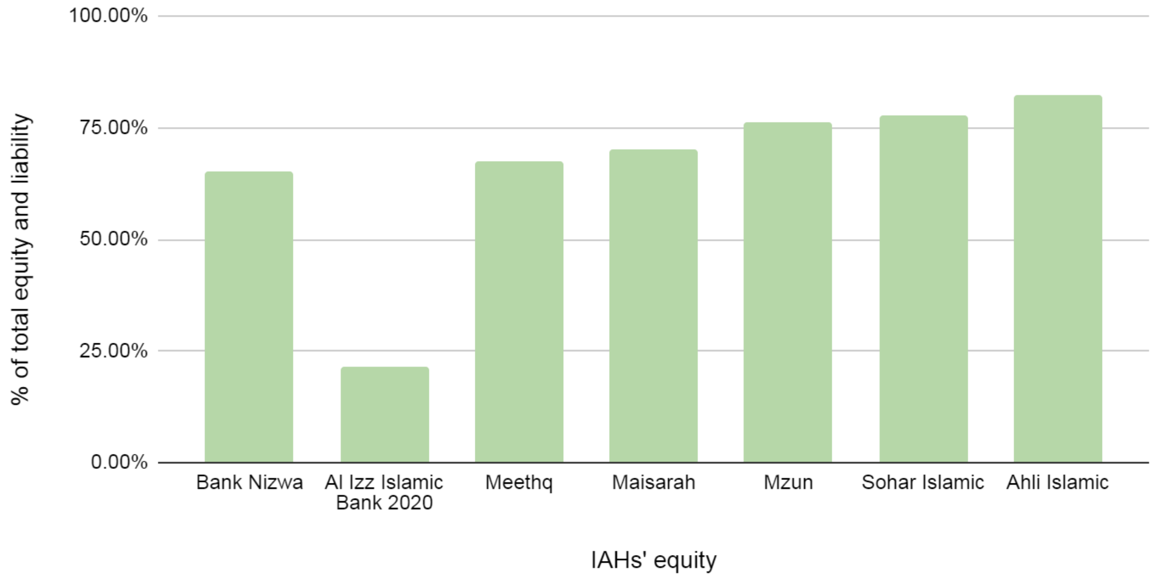

Figure 1: percentage of the IAHs' equity of each IBW in Oman to total equities and liabilities

In addition, the practice shows that the IBWs accept these deposits under two main contractual relationships. First, Mudarabah-based deposits are structured based on the Mudarabah contract. In this type of deposit, the Islamic bank acts as a Mudarib (investment manager), while the depositor acts as a Rab Al Mall (capital provider). The depositor delegates the bank to invest the deposited funds without any restrictions. The Islamic bank and depositor are entitled to a share of generated profits as per the profit rate agreed at the time of contract. According to Mudarabah sharia rules, the bank as a Mudarib does not bear any loss that could happen to the capital of Mudarabah. However, this loss should be borne solely by the depositors unless the loss has occurred due to bank's negligence, misconduct, and terms violation. Second, Wakalah-based deposits are structured based on the Wakala contract. The practice reveals that all IBWs in Oman that accept deposits under wakala contract act as a Wakeel (agent) while the depositor acts as Muwakkil (principal).

In addition, they apply all requirements of AAOIFI's standards regarding the Wakalah contract. Unlike Mudarabah-based deposits, the IBWs charge a fixed fee against their work as an agent, while all returns generated from Wakalah-based deposits are given to the principals. However, some Islamic banks like Bank Nizwa require in the agreement that if the returns of Wakalah-based deposits have exceeded the expected rate of return, the increased profit will be taken by the bank as an incentive. Such a practice is in line with AAOIF's requirements.

The amount of IAHs' equity of all IBWs in Oman in 2021 has been RO 3,511,730,338, representing about 60% of their total assets. The majority (94.42%) of IAHs' equity has been accepted under the Wakalah contract. Mzun Islamic Banking window has accepted the highest recording of about 94% of its total IAHs' equity. In contrast, the lowest percentage of Wakala-based deposits has been recorded by Bank Nizwa with just 2.24%. Following that was the Meetha Islamic Banking window, which only took Wakala-based deposits for around 6% of its total investment deposits, given that no information on the Alizz Islamic Bank in 2021 is available. Therefore, it could be concluded that Bank Nizwa and Meetha Islamic Banking window have acquired the highest proportion of Mudarabah-based deposits, recording about 97% and 93% of their total investment deposits, respectively. Figure 2 shows the percentage of Wakala-based deposits in each IBW in Oman:

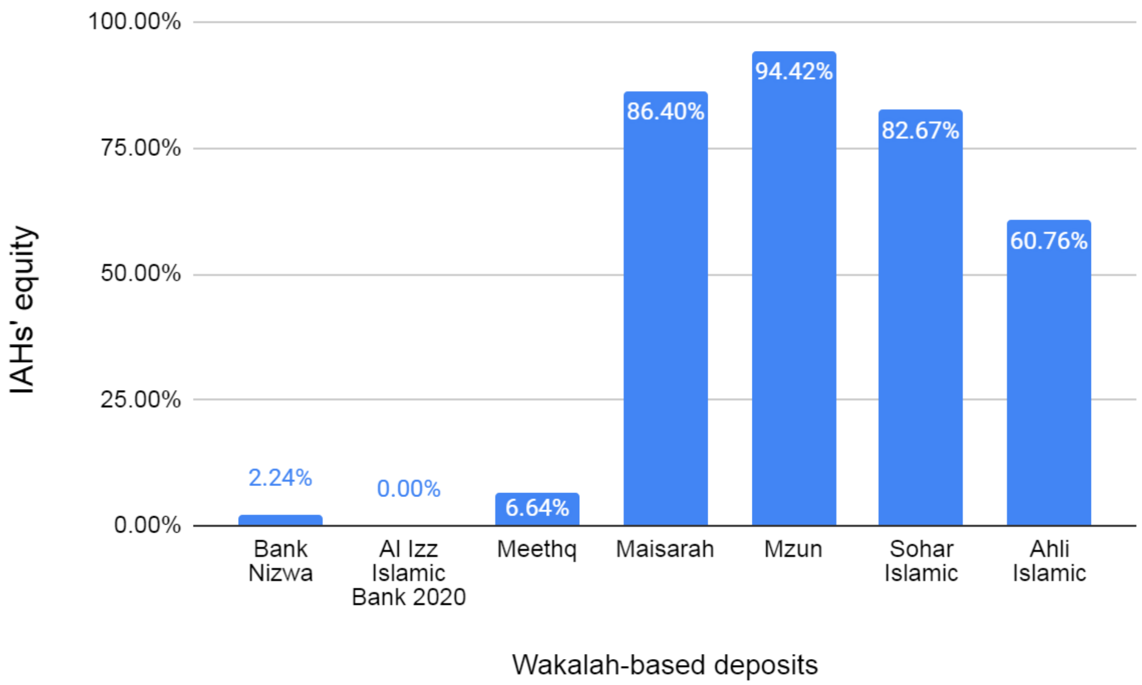

Figure 2; Percentages of Wakala-based deposits in each IBW in Oman in 2021

On the other hand, the IBWs use the collected funds from investment deposits in their financing and investment activities as they commingle these funds with some of their funds. This practice is adopted by all IBWs in Oman. In the notes to the financial statement, they reported that the funds of IAHs and shareholders are combined and commingled to constitute a large Mudarabah pool. Although the contractual relationship between the IAHs and shareholders, particularly in the pool, is not explicitly disclosed, it could be concluded from profit and loss distributions practices that the relation is the Musharakah contract (partnership).

Nonetheless, the commingled funds are jointly used to finance assets and investments. Although AAOIFI's standards do not require it, IBWs in Oman distinguish in the notes to their financial statements between the assets that have been jointly financed by the IAHs and shareholders and the assets that have been financed solely by the bank. This plays a critical role in separating the profits generated from both kinds of assets, hence achieving the equitable allocation of profits between the parties. Figure 3 shows the percentage of jointly financed assets of some IBWs in Oman compared to their total assets in 2021.

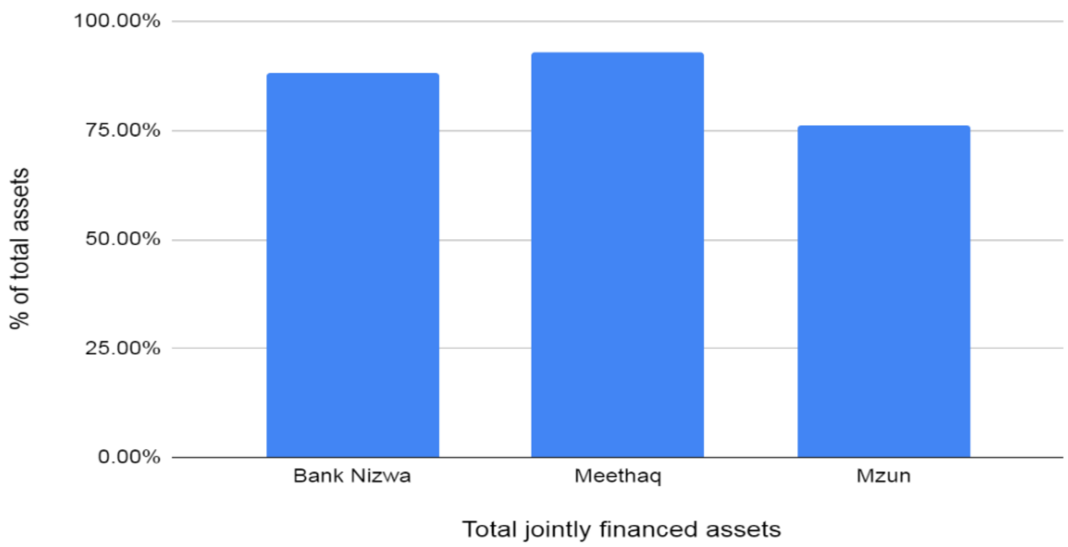

Figure 3: percentages of jointly financed assets of some IBWs in Oman

In this regard, IAHs' funds have been diversificated between different and multiple activities. However, these activities could be grouped into two main categories: financing activities and investment activities. However, the main instruments used to operate the IAHs' equity funds are; Musharakah financings, Investment securities, Murabaha financings, Wakalah Bil Istithmar, and Ijarah Muntahiyah Bittamlik. Figure 4 shows the distribution of financial instruments that have been used by Bank Nizwa to operate funds of IAHs in 2021.

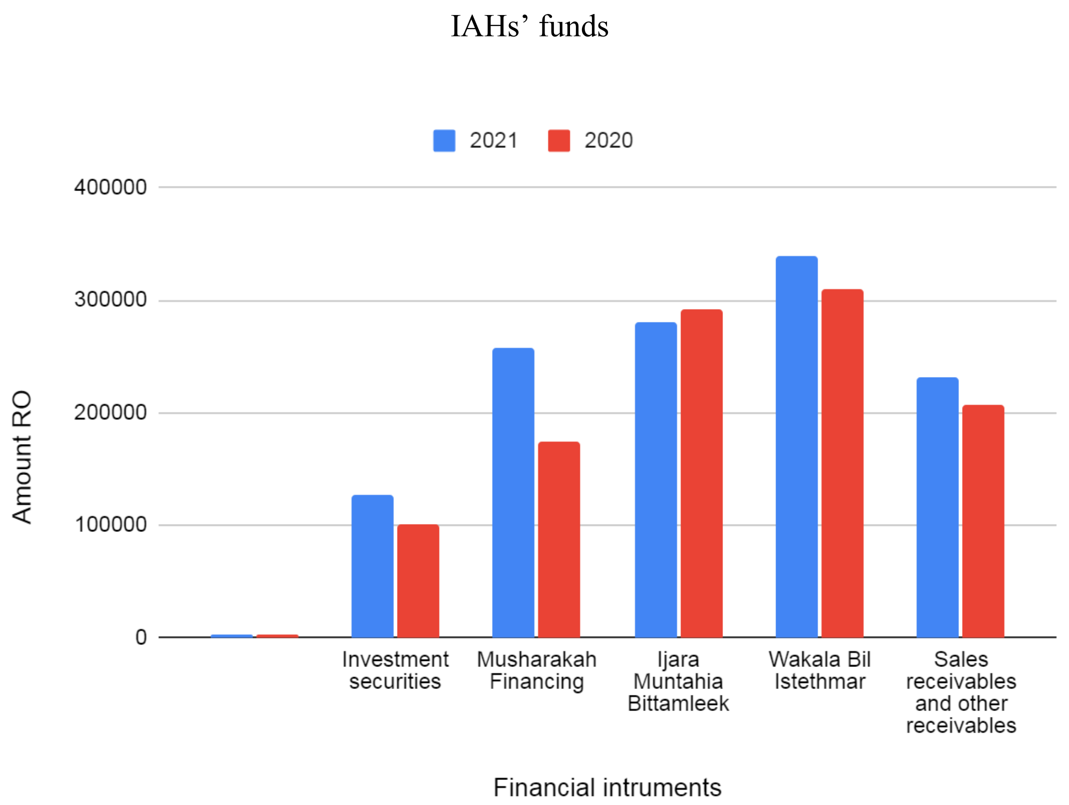

Figure 4 : Distribution of financial instruments used by Bank Nizwa in operating

5.3 Investment accounts practice in Oman's Islamic banks in comparison with AAOIFI's standards

5.3.1 Classification and Presentation of PSIAs

According to AAOIFI (2016), the bank's authority over the investment account is a key criterion in determining whether presenting the investment accounts should be an on-balance sheet item or not. The bank should have the full power to use the funds attributable to IAHs to disclose them as an on-balance sheet item; otherwise, they should be presented on the off-balance sheet. Therefore, restricted investment accounts can not be disclosed in the on-balance sheet because their holders usually do not give the IFI enough authority to manage these investments and make decisions. Nevertheless, the same standard stated that Mudarabah-based investment accounts should be presented as an on-balance sheet if they fulfil the following terms:

First, the bank has the authority to make decisions regarding these accounts. Second, they have risk features, just like investment accounts presented on-balance sheet. In this issue, the practice of Oman's Islamic bank and windows reveals that most of them presented the investment accounts as an on-balance sheet item. The reason behind such practice is that all Islamic banks and windows do not accept restricted investment accounts; rather than it is always stipulated that the bank has the full authority to manage these accounts at its complete discretion. However, there is little difference in classifying and presenting PSIAs in the financial statement position. While most banks present them as independent equity between the liability and owner's equity, the Maisarah Islamic banking window discloses PSIAs as independent quasi-equity between the liabilities and shareholders' equity. This is because paragraph 22 of FAS

No.31 stipulated that PSIAs shall be presented as independent equity between the liabilities and owner's equity(AAOIFI 2020), which is consistent with the practice of most Islamic banks.

In addition, referring to the notes to the financial statement of Islamic banks showed that the components of investment accounts equity widely differ from bank to bank. However, all components could be labelled under two main categories. First, Mudarabah-based investments refer to deposits that have been structured based on Mudarabah contracts. This includes savings accounts, investment accounts, Fixed term accounts, Call accounts, and other deposits. Second, Wakalah-based investment accounts are structured according to the Wakalah contract. This entails; interbank wakala deposits, customer wakalah deposits, and Wakala acceptances.

Nevertheless, and though the majority of banks disclosed in detail the components of the equity of investment accounts, some banks and windows such as Bank Nizwa, Meethaq Islamic Banking, Maisarah, and Ahli Islamic do not mention Mudarabah-based accounts explicitly. However, it is considered a key contract in structuring the investment equity. Instead, they mentioned "Unrestricted Investment Accounts" to indicate accounts that are built based on the Mudarabah contract. Moreover, it is noted that Ahli Islamic does not accept deposits based on the Mudarabah contract, and it seems that all deposits are accepted based on the Wakala contract.

There is a clear separation from the Islamic finance theory perspective between the assets funded by general IAs, special IAs, demand deposits, and equity. But, the practice reveals that this principle is not met, particularly on the asset side, where all assets are shown as one large pool attributable to stakeholders, affecting the profit and loss allocation between the holders of these assets (Iqbal & Mirakhor 2006). However, though there is no clear article in AAOIFI's standards that requires the investments and assets financed by PSIAs to be distinguished from those financed by the owner's funds, the practice showed that Islamic banks and windows in Oman disclosed in the notes to the financial statement which assets have been financed solely by the owners and which have been jointly financed by the IAHs and shareholders owners which could be considered as an advantage for the practice of Islamic banking in Oman.

According to FAS No.31, the bank as an agent should recognise the investment agency (Wakalah Bil Istithmar) under its off-balance sheet if it does not control this instrument (AAOIFI 2020). However, it is recorded as an on-balance sheet item if the bank controls the assets or business relating to the investment agency instrument. In this regard, FAS No.31 considered that the bank as an agent controls the investment agency if it "has substantially all risks and rewards incidental to ownership of such asset or business" , and this could be achieved by fulfilling the following terms: first, the bank should be directly affected by the resulting profit and loss as a result of its engagement in such investment. Second, the bank can affect the returns due to its command over the investment agency asset(AAOIFI 2020,paragraph.33).

In the case that the investment agency instrument meets the conditions to be recognised on-balance sheet, as per same standard, it could be presented as either a separate class of equity or a quasi-equity according to two considerations. First, suppose the investment agency is subordinated to all other obligations and quasi-equities. It is considered a different class of equity that cannot be liquidated by the principle (investor) and can be converted to the agent shares capital. Second, it is treated as a quasi-equity if it is subordinated to all other liabilities; it could be liquidated by the principal but is not transferable to share capital(AAOIFI 2020).

According to the practice of Islamic banking in Oman, before the issuance of AAOIFI's accounting standard No.31, the Wakala instrument was classified under the liability item, although that is considered a profit-share instrument. However, after issuing FAS No.31, which shall be effective for the period after 2020, the Islamic banks and windows started applying the requirements of this standard starting from the end of 2021. Thus, the first change has been reclassifying Wakalah instruments from banks or customers to be embedded into the equity of investment accounts. In this regard, almost all Islamic banks and windows have labelled Wakalah investment as a component of equity of investment account. However, they do not mention it explicitly in the balance sheet; rather, it has been mentioned in the notes to financial statements as a portion of the whole investment accounts equity.

5.3.2 Valuation of PSIAs

Valuing the PSIAs and their assets is considered a critical issue from a shariah perspective, particularly regarding distributing profits or losses between the partners. The valuation gains its importance because "no profit can be recognised or claimed unless the capital of the Mudarabah is maintained intact" (AAOIFI 2002,article.8/7). Hence, the role of valuation is to ensure that the capital of Mudarabah is protected. Indeed the valuation stage comes at the time of assets liquidation. There are two types of liquidation in Islamic commercial law: actual liquidation, where all assets are valued and sold and get their value—second constructive liquidation, where assets are valued by using the valuation tools without selling them. However, due to the unique nature of banks' work which is represented in the continuing acceptance of deposits throughout the year and the huge amount of deposits they have, it is difficult to adopt actual liquidation. However, constructive liquidation will be perfect in this case. Constructive liquidation mainly depends on valuing assets and investments attributable to PSIAs.

According to Shariah standard No.13, it is permissible to evaluate PSIAs based on the selling price, known as actual liquidation. Also, it is permissible to adopt constructive valuation using fair value. In addition, receivables attributable to Mudarabah-based investment should be valued at the cash equivalent or net realisable value(AAOIFI 2002). But the standard did not define the term "fair value." Fair value is a general approach to evaluating assets, and many methods are integrated into this approach. Thus, it could be understood that the standard has opened the door for the IFI to estimate and adopt the appropriate fair value method. Nevertheless, it prevented the time value and discount on current value from being considered when evaluating receivables attributable to PSIAs.

In the context of the Islamic banking experience in Oman, all assets and liabilities attributable to PSIAs are measured at fair value. This could be found in the notes to financial statements, where almost all Islamic banks and windows have stipulated that the financial statements are prepared based on historical cost except for some instruments measured at fair value. This exception has been illustrated later in the subsequent notes; for example, Meethaq Islamic Banking's note No.3.1.9 stated that "Investments comprise of equity-type instruments carried at fair value through equity or statement of income and debt type instruments carried at fair value through equity" (Bank Muscat 2021, p.221).

The fair value differs according to the nature of asset and liability; hence the practice revealed variation in fair value definition for each asset and liability category as follows (Bank Nizwa 2021):

First, fair value for financial assets

The fair value for the investment quoted in an active market is the investment price in that market. However, if there is no active market, then the fair value would be similar to the current market value of the most similar financial instrument. If the fair value cannot be measured, then the asset could be measured at amortised cost. On the other hand, the fair value of sales receivables is determined based on their cash equivalent value.

Second, Fair value for non-financial assets

The fair value for non-financial assets is determined by the market price. However, if the market price is not available, then they are assessed based on the average value of three valuations conducted by experts in the field.

With little differences, this approach to determining fair value is generally found with most Islamic banks and windows in Oman except for Mzun and Maisarah Islamic windows, where not enough information has been mentioned regarding this issue. Moreover, the Meethaq window has added another method to determine fair value for some assets, the present value of estimated future cash flows. This is also found with Al Izz Islamic Bank, particularly in valuing fixed or determinable cash flows investments. However, this method contradicts article 8/8 of AAOIFI's SS No.13, which stipulated that "In measuring receivables, neither time value (interest rate) nor discount on current value for extension of the period of payment shall be taken into consideration(AAOIFI 2002).

5.3.3 Profit and Expenses

Profit-sharing and expenses, income, and loss allocation concerning PSIAs represent a solid challenge, particularly in the context of IBs practice. This belongs to the complex nature of the contractual relationship between the Islamic bank and depositors. In addition, IBs usually in PSIAs commingles their funds with the funds collected via PSIAs. Furthermore, all funds attributable to IAHs are commingled in one large pool and shareholder's funds, which multiplies the difficulties, specifically regarding income and loss allocation. As a result, Shaharuddin (2010) found a huge difference between the profit distributed to IAHs and shareholders, although their funds were operated in the same investments. This has been enhanced by another study conducted by Diaw and Mbow (2011), where they compared the returns on Mudarabah deposits (ROMD) and ROE, taking 9 Islamic banks from different countries in the period 2006-2011 as a sample. It is found that ROE is at least two times higher than returns on Mudarabah deposits, and there is no clear link between the two. Instead, ROMD is more correlated to IR in conventional banks.

However, ROE is significantly more affected by ROA than ROMD, which means that equity holders take advantage of the leverage more than IAHs. However, this could be explained by the fact that the shareholders benefit from PSIAs from two sides; first, as a Rub Al Mall, the bank commingles its funds with other IAHs' funds in the Mudarabah pool. The contractual relationship between the shareholders and IAHs is the Musharakah contract. Second, as a Mudarib (investment manager), the bank has entitled to a share of the profit generated from the Mudarabah pool as per the agreed profit. Therefore it makes sense that the ROE is higher than IAHs' return. In addition, Hamza (2016) found that the return of IAs and equity does not reflect their risk-taking features.

Also, Ryandono, Kusuma, and Prasetyo (2021) found a notable divergence between IBs and CBs regarding pricing standards and even between IBs themselves in the profit ratio determination. As a result, Kusuma (2018, cited in Ryandono, Kusuma & Prasetyo 2021) found in his empirical study that customers of Islamic banks in Indonesia feel aggrieved regarding the profit ratio they are given against their investment deposits. However, this unfairness belongs to the wrong application of the Mudarabah contract by IBs.

For all results and reasons mentioned above, current practice is facing many difficulties in dealing with PSIAs. The most significant problem in this regard is how each depositor and stakeholder's investment and profit share could be accurately determined. As the bank invests the funds in multiple projects, and some of these projects could end before the others, it is unknown to whom each project and asset belong?. This problem could be exaggerated by another problem: the bank's inability to invest all deposited funds (Ahmed 1995). However, according to (AlShattarat & Atmeh 2016), this problem could be solved by the concept of accounting separation. According to AL-Deehani et al. (1999, cited in AlShattarat & Atmeh 2016), there are two methods used by Islamic banks to deal with profit allocation. First is the pool method, where all sources of funds in the bank share all generated revenue and loss. Second is the separation method, in which IAHs only share in the profits, expenses, or losses resulting from PSIAs. However, the expenses and losses generated from other than PSIAs will be borne by other stakeholders.

The practice of the Islamic banking sector in Oman shows that the second method, which is the separation method, has been adopted by the majority of Islamic banks and windows. From the beginning, they separate the assets that the IAHs and shareholders have jointly financed from those financed solely by the owner's equity. Therefore, the profits, expenses, and losses relating to PSIAs' equity will be separately calculated from those attributable to owners' funds. In the notes, they even disclose exactly the assets that are jointly financed and the assets that are financed only by the bank. There is no clear clause in AAOIFI's standards requiring Islamic banks to separate and distinguish between the funds and assets attributable to IAHs, and the funds owned by the shareholders. But from a practical point of view, non-separation in this issue will result in the misallocation of income and assets between the stakeholders.

Hence, the basis applied by the IBWs in Oman in determining the profit share of IAHs is based on the income generated from jointly financed assets fewer expenses directly relating to PSIAs' pool. These expenses include all reserves set aside from the investment pool. Despite that, the IBWs in Oman have mentioned many times in their statements that there are no expenses have been charged to IAHs. Instead, all expenses are charged to the shareholders only. In fact, this practice involves some ambiguity, as, from a shariah perspective, the expenses resulting from Mudarabah investment are classified into two main categories. First, direct expenses refer to expenditures directly associated with investments and work of Mudarabah funds. These costs should be borne by the Mudarabah capital only. Second, indirect expenses refer to costs that are not directly related to the investments and work of Mudarabah, such as administrative expenses. These costs should be borne solely by the Mudarib. Therefore, it is impossible to state that all expenses are charged to shareholders because it makes no sense to say that all assets and investments attributable to the Mudarabah pool do not result in any direct expenses.

In addition to that, the practice shows that some IBWs in Oman combine and commingle

Mudarabah-based deposits and Wakala-based deposits in one large pool, and the bank manages this pool. This can raise the issue of contractual relationship conflict; particularly, there is no disclosure made by the bank regarding the nature of the relationship between the combined funds. In essence, the nature and effects of the contractual relationship in the Wakalah contract are different from those of the Mudarabah contract. For example, in the Wakalah contract, the agent is entitled agreed fixed fee. However, in Mudarabah, the Mudarib deserves a share of generated profit based on the agreed profit rate, and he should not get a fixed fee. Hence, commingling the two types of deposits in one pool will lead to misallocation of income between the bank as a Mudarib and agent and the IAHs.

However, to avoid this problem, some IBWs attempted to solve this ambiguity by stating, "In case of Wakala contracts, the Islamic Window does not act as both an investment agent and Mudarib of the same fund at one time. Therefore, in case of commingling Wakala investment funds with the Mudaraba pool, the investment agent will only charge Wakala Fee and will not share profits from the Mudaraba investment pool in the capacity of Mudarib"(Ahli Bank 2021).

Nonetheless, this solution could be acceptable if there is a separation between assets attributable to the Wakalah contract and assets attributable to the Mudarabah contract, where the returns of each category of assets are distinctly recognised and calculated. But this is not the case when it comes to the practice of IBWs in Oman. As the funds attributable to equity of IAHs are commingled and invested together. Only there is a separation between the shareholders' assets and the assets of IAHs. However, Bank Nizwa and Sohar Islamic window commingle these funds under a clear contractual relationship: the partnership contract.

According to Bank Sohar (2021, p.249), “The window maintains multi-level investment arrangements to invest funds received under " Wakala" as "Mudaraba" under express authority from Wakala account holders in its financing and investment assets. Profit is allocated to Wakala funds based on their contribution in the commingled assets”. Thus, after calculating the return of equity of IAHs, each kind of fund (Wakalah and Mudarabah) will share profits according to its contribution to the capital of the Mudarabah pool. In this way, the issue of contractual relationship conflict is solved, as the profit share of the bank as a Mudarib and as an agent will be known and distinguished.

Furthermore, it is noted that there is a lack of disclosing the nature of the relationship between the IAHs and the shareholders. For example, despite all IBWs having disclosed that they have commingled the funds attributable to IAHs and shareholders, there is not enough information regarding the percentage of funds of each class of stakeholders in the Mudarabah pool. In addition, the shareholders’ share of profit is not disclosed. Such a shortage of disclosure is considered non-compliant with the requirements of AAOIFI’s FAS 27.

5.3.4 Risk Reserves (PER and IRR)

Risk reserves refer to identified amounts usually set aside by the Islamic bank to cater against any potential loss that could occur in the future regarding the PSIAs. These reserves are divided into two types.

First, Profit Equalisation Reserve (PER)

The Islamic bank sets this reserve aside by the Islamic bank from the PSIAs' returns before deducting the bank's share of profit as a Mudarib. This means that the bank and IAHs jointly contribute to creating this reserve. The main purpose of PER is to mitigate the risk of the rate of returns attributable to IAHs, maintaining the level of distributed profits.

Second, Investment Risk Reserve (IRR)

IRR is set aside from the PSIAs' return after deducting the bank's profit share as a Mudarib, which means that the bank does not participate in such reserves. The purpose of IRR is to cater against any potential loss that could happen to the funds attributable to PSIAs. According to AAOIFI's FAS No.35, the IFIs are not required to set aside these reserves, but if they do so, they are required to abide by their rulings stipulated by AAOIFI's standards. However, paragraph 34 of FAS 27 requires IFIs to disclose these reserves in the financial statements if they have been used. In addition, as per article 26 of FAS 35, the IRR and PER must be disclosed in addition to the equity of stakeholders they have been set aside from. Therefore, the Islamic bank's share of reserves should be disclosed under the shareholders' equity in the financial position statement. However, the reserves share attributable to IAHs should be presented under their equity. Also, it is important to disclose in the notes to financial statements the changes that happened to these reserves during the financial period and the basis that has been applied to determine these reserves(Suandi 2017).

According to El Tiby Ahmed (2011), PER and IRR reserves have been criticised for many reasons. First, there is a lack of disclosure regarding these reserves. Second, IAHs have no access to these reserves and do not have the right to oversee their use. Third, there is unfairness in the reserves distribution after the end of the financial period. The

IAH who draws his deposits before that will not get his share in these reserves. Furthermore, adopting profit equalisation reserves(PER) could lead to many problems. First, maldistribution of income between IAHs, as the earned profit in an identified period could be distributed to IAHs in another period. In addition, the IAH who will draw his fund before the end of the financial period would be deprived of his share in the reserves. Moreover, investment risk reserves could encourage the bank to enter into excessive-risk investments at the expense of IAHs (Atmeh & Hadi Ramadan 2012).

The practice of the IBWs in Oman revealed a wide variation concerning PER and IRR application. First of all, it was found that not all IBWs in Oman maintain PER and IRR; instead, only one Islamic bank and one window were found setting aside these reserves. The secret behind the non-adoption of such reserves is to enhance the level of returns attributable to IAHs. Moreover, some IBWs stated that the bank might cover the loss or decrease of returns incurred in the PSIAs from its fund. Such practice could lead these banks to have what is known as Displaced Commercial Risk (DCR). DCR emerges due to the pressure to pay competitive rates of return compared to the market. The PER and IRR play an important role in avoiding DCR. Therefore, the Islamic banks and windows that do not adopt PER and IRR are forced to absorb the loss that could happen in PSIAs. Also, they are forced to pay a portion of their income to cover the decline in the return of IAHs to keep and prevent them from leaving to other banks.

Three IBWs out of six have maintained PER and IRR: Bank Nizwa, Meethaq Islamic Banking window, and Mzun Islamic Banking Window. As a result, they have presented the IAHs' share of PER and IRR directly under the equity of IAHs, and the shareholders' share under their equity in the notes to the financial position statement. However, Bank Nizwa has only maintained IRR, and it seems that it did not set aside PER for the current years 2021 and 2020, as it stated that the bank used a full amount of PER during the year, and no more PER has been set aside(Bank Nizwa 2021). However, the bank illustrated the mechanism that would be applied if the returns of IAHs are not enough to face the competition in the market, as the equity owners may grant a portion of their profits to the IAHs. On the other hand, the bank also could deduct a portion of the IAHs' share of the profit if the rate of return has exceeded the level market, and it will be transferred to the PER (Bank Nizwa 2021).

However, Mzun Islamic Banking window disclosed that 0.5 % had been deducted as an IRR and 1 % as a PER(Oman National Bank 2021). While Meethaq Islamic Banking did not maintain PER for the year 2021, it does not mean that the window does not do that as a policy, but there has been a PER balance from the last year 2020 amounting to OMR 2,563,000, which has not been utilised since the last financial period. And this amount has not been utilised for the 2021 period as well. According to the window, the PER will not be used unless the window can not pay a rate of return to IAHs similar to that given in the market, which could be why the window did not set aside PER for this year. Nonetheless, it is found a lack of disclosure regarding these reserves. For example, none of these IBWs has mentioned the purpose that PER and IRR have been used for or whether they have been invested, despite mentioning that the reserves will revert to IAHs when they are no longer needed. In addition, Only the Meethaq Islamic Banking window and Bank Nizwa have disclosed the movement of the PER and IRR , see tables 1,2, and 3.

Table 1: Movement in PER - Meethaq Islamic Banking 2020-2021

	2021	2020
	RO 000's	RO000's
Balance as at 1 January	**2,563**	**2,177**
Apportioned during the year	**-**	**386**
Amount utilised during the year	**-**	**-**
Balance at 31 December	**2,563**	**2,563**

Table 2: Movement in IRR -Meethaq Islamic Banking 2020-2021

	2021	2020
	RO 000's	RO 000's
Balance as at 1 January	**390**	**323**
Apportioned during the year	**-**	**67**
Amount utilised during the year	**-**	**-**
Balance as at 31 December	**390**	**390**

Table 3: Movement in IRR - Bank Nizwa 2020-2021

	2021	**2020**
Balance as at 1 January	355000	580000
Apportioned during the year	0	0
Amount utilised during the year	(266000)	(225000)
Balance at 31 December	89000	355000

CHAPTER SIX:

FINDINGS AND CONCLUSION

This study investigates Oman's IBWs practice of PSIAs compared to AAOIFI standards. Therefore content analysis, ratios analysis, and comparative methods were adopted using data extracted from the annual reports and published contracts. As a result, it is found that the equity of IAHs in the Islamic banking sector consists of about 62% of the total liabilities and equities of IBWs in Oman. This means that PSIAs represent the biggest source of funds in the Islamic banking sector in Oman, requiring particular importance to be given to such accounts.

Considering some aspects concluded by the literature review on PSIAs, particularly concerning the lack of disclosure and its effects on income allocation, considerable progress was found by the IBWs in Oman regarding this issue. The adopted policy disclosure avoids, to some extent, potential misallocation of income between shareholders and IAHs. This is mainly represented by separating between the assets jointly financed by the IAHs and shareholders and assets financed solely by shareholders. Hence separating between the returns and expenses attributable to each kind of asset.

In addition, all IBWs in Oman commingle the funds collected from PSIAs with their funds. But, it is found that there is not enough disclosure regarding the type of contractual relationship that governs the commingled funds, whether in annual reports or contracts. In addition, the profits rate of income distribution between the funds attributable to IAHs and shareholders is not disclosed.

The funds of equity of IAHs are accepted under two main Islamic contracts: the Mudarabah contract and the Wakalah contract. Despite that the investment pool is managed based on the Mudarabah contract, Wakalah-based deposits constitute the majority of IAHs' equity in four Islamic banking windows: Maisarah, Mzun, Sohar Islamic Ahli Islamic. As their Wakala-based deposits represented about 86% ,94%, 82%, and 60%, respectively.

However, Mudaraba-based deposits represented the majority in Bank Nizwa and Meethaq Islamic Banking, recording about 98% and 93%. This could be explained by the fact that some Islamic banks and windows prefer to accept investment deposits under the Wakala contract due to some legal features that this contract has. As the bank in Wakala contract as a Wakeel (agent) is entitled to a fixed fee against its work as agreed upon at the time of the contract, it could not be linked to the rate of returns. This means that the bank is entitled to the identified fee regardless of the outcomes of the Wakalah investment. However, in the Mudarabah contract, Mudarib shares the capital provider in the generated profits as per the agreed-upon ratio. Therefore, the risks in the Wakalah contract are less than the risks in the Mudaraba contract concerning the rate of return.

There is a problem determining the nature of the contractual relationship between the deposits accepted under the Wakala contract and Mudarabah-based deposits. In other words, since the two kinds of funds are commingled in one large pool, it is important to determine the contractual relationship that would govern this relation. There is no adequate disclosure regarding this issue except for some indirect statements found with Bank Nizwa and Mzun Islamic Banking. Most IBWs have distinguished between the returns generated from Wakala and returns generated from other assets.

IBWs in Oman do not accept deposits under restricted Mudarabah or Wakalah. Therefore, and following AAOIFI requirements, they present the equity of IAHs as an on-balance sheet item in a separate class of equity between the liability and owner's equity. Hence, they disclose the returns attributable to this equity in the income statement.

The practice shows that IBWs in Oman conduct a constructive liquidation to evaluate the PSIAs. In addition, these accounts are valued based on a fair value in most Islamic banks and windows following requirements of AAOIFI standards. However, the fair value definition differs according to the assets and liabilities being valued.

It is found that all IBWs in Oman does not charge any expenses to PSIAs. Instead, they stated many times that all expenses are charged to the funds attributable to shareholders. This practice violates the requirements of AAOIFI standards which differentiate between two kinds of expenses concerning PSIAs. First, the expenses directly associated with the IAHs' investment include expenses resulting from operating IAHs' funds. This kind of expense should be charged to PSIAs. Second, the expenses that are indirectly linked to the funds of IAHs, such as costs resulting from the management of PSIAs. These expenses shall be charged to the bank as Mudarib.

Half of IBWs in Oman maintain PER and IRR reserves: Bank Nizwa, Meethaq Islamic Banking, and Mzun Islamic Banking. However, under the pretext of enhancing the returns of IAHs, Maisarah, Sohar Islamic, and Ahli Islamic do not set aside these reserves. Therefore, these windows are exposed to the DCR because they are forced to pay from their share of the profit if the generated profit is less than the expected rate of returns. On the other hand, there is a lack of PER and IRR disclosure regarding how they were used during the financial period, despite a quantitative disclosure of the movement of the change during the financial period. In this regard, it is clear that the balance of IRR and PER is not retained at the end of the financial period; instead, it is transferred to the next financial period, which means that the depositors who withdraw their funds before or even at the end of the financial period will lose their share in these reserves.

Suggestions and Future Research

The researcher suggests that many issues and ideas be revised and discussed. First of all, the current AAOIFI disclosure standards of PSIAs need to be enhanced to cover more aspects such as the relationship between different commingled funds in the Mudarabah pool and subsequent issues of profits and expenses distribution. In addition, there should be a clear requirement from AAOIFI to separately disclose the assets attributable to IAHs and assets attributable to shareholders. This will greatly assist in achieving equality between the IAHs and shareholders. Furthermore, AAOIFI standards should make a clear definition of fair value because current practice shows that some Islamic banks value their assets using some fair value methods, which are contrary to the concept of fair value from the Islamic finance perspective.

In this context, the research suggests some subjects to be studied in the future. First, there should be comparative studies regarding the governance of PSIAs between the practice and relevant standards. In addition, it should be an empirical study that investigates the determinants of IAHs' rate of return in Oman. Finally, it is important to have a theoretical study investigating the exact meaning of fair value from the Islamic finance point of view.

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