

Guidelines on the Specimen Reports and Financial Statements for Licensed Islamic Banks (GP8-i)

The Guidelines on the Specimen Reports and Financial Statements for Licensed Islamic Banks or GP8-i was issued to the Islamic banks (IBs) in August 2003. It sets out the minimum requirements for the presentation and disclosure of reports and financial statements of IBs. The GP8-i is to be adopted by the IBs for annual accounts commencing 2004.

The objective of the GP8-i is to provide the basis for presentation and disclosure of reports and financial statements of the IBs. GP8-i is also aimed at ensuring consistency and comparability of the reports and financial statements amongst the IBs in complying with the provisions of the Islamic Banking Act 1983, Companies Act 1965, Shariah requirements and other Bank Negara Malaysia guidelines. As a comprehensive guideline, GP8-i also incorporated the new requirements of MASB standards, specifically the MASB *i-1*: Presentation of Financial Statements of Islamic Financial Institutions. The standard, which came into effect in 2003, was issued to streamline the disclosure and presentation of financial statements of the IBs and the conventional banks that participate in the Islamic Banking Scheme (IBS banks).

Prior to the issuance of the GP8-i, the IBs observed the various provisions of the Companies Act 1965, the applicable accounting standards and the Guidelines on the Specimen Financial Statement for the Banking Industry (GP8) which was formulated to facilitate the conventional banking operations. Some of the requirements have been modified for the IBs, particularly those under the GP8, to reflect the Islamic banking operations such as the disclosure on the various Shariah concepts applied in financing.

Salient Features of GP8-i

The salient features of the GP8-i, amongst others, are as follows:

a) Performance Overview and Statement of Corporate Governance

In promoting good corporate governance, IBs are required to report their performance overview and corporate governance practices. The performance overview requires the IBs to disclose their review on performance, measures, business plans and strategies, whilst the statement of corporate governance requires IBs, among others, to disclose the composition and responsibilities of the Board, internal audit and control activities and risk management strategies and policies. These report requirements are important in providing additional information to users in evaluating the performance and conduct of an IB.

b) Disclosure of Shariah Advisory Board/ Committee and Zakat Obligations

The Shariah Advisory Board or Committee plays an important role in monitoring the compliance of Islamic banking activities with the Shariah requirements. Given its importance, the IBs are required to disclose the functions and duties of their Shariah Advisory Board or Committee in monitoring the activities pertaining to Shariah matters under the Directors' Report. With respect to the *zakat* obligations disclosure, IBs are required to disclose the responsibility towards payment of *zakat* either on the business or shareholders or on behalf of depositors.

c) Report of the Shariah Advisory Board/ Committee

The IBs are required to report the conformity of the IB's operations with the Shariah principles under the Report of the Shariah Advisory Board/Committee. The Report, which is akin to the Auditors' Report, will enhance the credibility of the IB's operation in complying with the Shariah principles.

d) Profit Equalisation Reserves (PER)

PER is a mechanism introduced in the Framework of the Rate of Return to stabilise the rate of return to depositors. Disclosure of PER would reflect the capability of the IBs in managing the level of profit distribution to the *mudharabah* depositors. The IBs are required to disclose their policy on PER as well as its movement (provision and write-back) during the financial year.

e) Classification of Deposits from Customers and Placements from Banks and Other Financial Institutions

The IBs are required to disclose their deposits into two categories i.e. *mudharabah* and non-*mudharabah* deposits. As the manager of public funds, the disclosure would provide additional information on the risk profile of the IBs' deposits portfolio to the public.

f) Presentation of the Income Statement

Presentation of the Income Statement of the IBs is structured to reflect the nature of the Islamic banking operation, mainly on the application of *mudharabah* concept in the deposit-taking activities. The statement discloses the incomes and expenses that are either shared by the bank and depositors or solely belonged to the bank.

Product Approval

- In tandem with the gradual progression towards a market-driven regulatory environment, Bank Negara Malaysia issued the Guidelines on New Product Approval Requirements for Islamic Banking Institutions (the Guidelines). These replace the existing product pre-approval requirements and came into effect on 2 January 2004. The Guidelines outline the notification and specific approval process for new products submitted by Islamic banking institutions.

In formulating the Guidelines, Bank Negara Malaysia adopted the approach that "what is not prohibited is allowed" on new Islamic banking products. This was to provide greater clarity, transparency and speedy product approval. For a new product to qualify for automatic approval (under notification process), the submission to Bank Negara Malaysia must be made at least 21 days before its launch date. The definition of a new product has also been widened to include an existing approved product or service that is applying a different or a new combination of Shariah concepts. In addition, the Islamic banking institutions are required to submit a detailed explanation on the Shariah concepts used in the product as endorsed by their Shariah committee. This is to ensure that a thorough research on the product has been carried out by the Islamic banking institutions and thus, would not lead to any detrimental effect on the customers and on the stability of the financial system. A new product that does not qualify for automatic approval would require specific approval from Bank Negara Malaysia and may require, among others, the deliberation of the Shariah Advisory Council of Bank Negara Malaysia. The Guidelines place significant emphasis on self-regulation, where the

Islamic banking institutions are required to ensure consistency of the products introduced with the Guidelines.

- In line with efforts to streamline the regulatory framework of the credit card industry, Bank Negara Malaysia issued the Credit Card-i Guideline (the Guideline) in January 2004. This was an extension to the Credit Card Guideline issued to the conventional banks in March 2003. Under the Guideline, the credit card-i can apply either *bai' inah* (sell and buy back arrangement) or BBA (deferred payment sale) Shariah concept. Under the *bai' inah* concept, the fund for the cardholder's spending limit is created upon the bank buying back the asset from the cardholder for cash which it previously sold to the cardholder on deferred terms. Under the BBA concept, the fund is created upon the bank purchasing the asset from the cardholder for cash which will be sold back to the cardholder on deferred basis.

The Guideline also prescribes the treatment on penalty and fee structure according to the Shariah principles. In terms of late payment charges, issuers of credit card-i are allowed to impose a compensation fee on the defaulters subject to specific terms and conditions imposed by Bank Negara Malaysia. The terms and conditions, among others, prohibit the Islamic banking institutions from compounding the compensation fee for late payment and monthly charges. This provision was intended to protect the customers as well as to streamline the penalty structure of credit card-i.

Strengthening Shariah and Legal Infrastructure

One of the pre-requisites for a strong and stable Islamic banking system is the existence of a