

UNIVERSITY OF BAHRAIN

College of Business
Administration

Department of Islamic
Banking

Justice of Weights in the Distribution of Profit for Mudharaba-based Accounts in Islamic Financial Institutions

A Thesis Submitted in Partial Fulfilment of the Requirements for the M.Sc.
Degree in Islamic Banking and Finance

Submitted by

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Supervised by

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(Associate Professor)

University of Bahrain

Kingdom of Bahrain

September 2024

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Thesis Discussion Committee Decision

Student Name: Mohamed Yaser Mohamed Alkhedri	Student ID: 20143123
Department: Islamic Banking	College: Business administration
Program: Masters in Islamic Banking and Finance	
Thesis Title: justice of weights in the distribution of profit for Mudharaba-based accounts in Islamic financial institutions	
Supervisor Name: Dr. Abdulrahman Alsaadi	Student GPA: 3.75

The Discussion Committee met on 01-Sep-24 In room S1B-241. Upon discussing the student whose details are stated above in public, the discussion committee recommends the following:

The student is awarded a grade of in the thesis subject. *Pass*

☒ Without making any changes to the thesis.

☐ After making the modifications attached with this decision.

Discussion Committee Members Approval:

Name

Signature

1. Dr. Abdulrahman Alsaadi (Advisor)
2. Dr. Mohamed Sayed Abou Elseoud (Internal Examiner)
3. Dr. Dr. Alija Avdukic (External Examiner)

Abstract:

This study examines the justice of profit distribution in Islamic financial institutions by analyzing the performance of the weights system. It intends to assess whether the weights system effectively achieves justice in calculating and distributing profits between the institution and its clients in these contracts. The research questions include whether reliance on weights as a fair system in the distribution of profit in mudharaba-based deposit accounts between Islamic financial institutions and their customers provides justice for both parties of the contract. The study also examines the notion of justice in Islam and its quantification in the banking sector. This study focuses exclusively on mudharaba-based accounts inside Islamic financial institutions while excluding non-mudharaba-based accounts. The theoretical framework has three components: mudharaba in Islam and the financial system, justice and consent between parties, and investment pools and weights system in Islamic financial organizations. The research employed qualitative methodologies, namely exploratory and analytical approaches, to collect insights into the weights system in Islamic financial institutions. The data was collected via interviews with specialists from various Islamic financial organizations. One of the key study findings is the presence of Justice while implementing the weights system, which is approved by Sharia supervisory boards in Islamic financial institutions and several fatwa committees, as well as AAOIFI sharia standards. Furthermore, the weights system must be detailed by the relevant organizations, such as Islamic financial institutions (IFIs) and regulatory bodies. The research suggests enhancing the openness and disclosure of the relevant weights in Islamic financial institutions, as well as providing a well-defined framework for the weights system that promotes fairness and guarantees the independence of Islamic financial institutions.

ملخص الدراسة

تبحث هذه الدراسة عدالة توزيع الأرباح في المؤسسات المالية الإسلامية من خلال تطبيق نظام الأوزان. تهدف إلى تقييم ما إذا كان نظام الأوزان يحقق العدالة بفعالية في حساب وتوزيع الأرباح بين المؤسسة وعملائها في العقود القائمة على المضاربة. تتضمن أسئلة البحث ما إذا كان الاعتماد على الأوزان كنظام عادل في توزيع الأرباح في حسابات الودائع القائمة على المضاربة بين البنوك الإسلامية والعملاء يوفر العدالة لكلا طرفي العقد. كما تبين الدراسة مفهوم العدالة في الإسلام وكيفية قياسها في القطاع المصرفي. تركز هذه الدراسة بشكل حصري على الحسابات القائمة على المضاربة داخل المؤسسات المالية الإسلامية بينما تستبعد الحسابات غير المستندة إلى المضاربة. الإطار النظري يتكون من ثلاثة مكونات: المضاربة في الإسلام والنظام المالي، العدالة والرضا بين الأطراف، والأوعية الاستثمارية ونظام الأوزان في المنظمات المالية الإسلامية. استخدمت الدراسة مناهج نوعية، وهي النهج الاستكشافي والتحليلي، لجمع رؤى حول نظام الأوزان في المؤسسات المالية الإسلامية. تم جمع البيانات من خلال مقابلات مع متخصصين من مختلف المؤسسات المالية الإسلامية. أحد النتائج الرئيسية للدراسة هو وجود العدالة في تطبيق نظام الأوزان، والذي تدعمه الهيئات الشرعية الرقابية في المؤسسات المالية الإسلامية وعدة لجان فتوى، وكذلك معايير الشريعة الصادرة عن هيئة المحاسبة والمراجعة للمؤسسات المالية الإسلامية (أيوبي). علاوة على ذلك، يجب أن يكون نظام الأوزان مفصلاً من قبل الجهات المعنية مثل المؤسسات المالية الإسلامية (IFIs) والهيئات التنظيمية كالمصارف المركزية. تقترح الدراسة تعزيز الشفافية والإفصاح عن الأوزان المعتمدة في المؤسسات المالية الإسلامية، وتوفير إطار عمل من قبل المؤسسات الرقابية لنظام الأوزان يعزز العدالة ويضمن استقلالية المؤسسات المالية الإسلامية.

Dedication

To my esteemed father, whose steadfast support and encouragement have been the cornerstone of my academic pursuit. Your enduring sacrifices and unwavering belief in my capabilities have illuminated my path toward my life and academic achievements.

To the memory of my dear mother, whose love, wisdom, and everlasting presence continue to shape my journey, even though she's no longer with us. Her heart and ceaseless affection inspire me every day, infusing every pursuit of my life.

To my siblings and family, whose love and camaraderie have been a source of strength and joy, thank you for always standing by my side and cheering me on.

To my dedicated instructors, your guidance, expertise, and patience have been invaluable. I am deeply grateful for the knowledge and skills you have imparted to me, your belief in me, and the opportunity creating are shaping my academic and personal growth.

In recognition of my respected colleagues in the academic and financial sector, whose cooperation, experience, and fellowship have contributed to the enhancement of my academic and professional path. Because of your assistance, ideas, and encouragement, I am grateful to you for your unwavering commitment and the collaborative effort that you have shown throughout the process of completing this thesis.

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Chapter 1

Introduction to the Study

1.1 Introduction

1.2 Research problem

1.3 Research questions

1.4 Research objective

1.5 Research Significance

1.6 Research limitation

1.7 Research terms

Chapter One: Introduction To The Study

Introduction

Islam has provided several methods for conducting trade that provide justice and fairness for all parties involved in the transactions. These instructions are obtained from divine sources and encompass principles of justice, ethics, self-control, Sharia objectives, and balancing between individual and public interests. Driven by the mentioned principles, Islamic financial institutions started operating in the last century over 60 years ago, and since then Islamic finance has emerged as a rapidly growing sector that is an alternative to the conventional financial sector and it has a market cap of 4.5 trillion dollars in 2023¹. The basis for establishing those institutions was the mudharaba contract, a contract of profit and loss sharing between two parties where one provides capital and the other partner performs work and they share profit if it is achieved.

Islamic financial institutions are performing the role of mudharib as they accept investors' money who are called arbab almal or capital providers. Islamic financial institutions have adopted this contract and developed it into the financial seek of the institution and its customers. In this research, the details of this contract and its features will be explained to clarify the research objective and to satisfy the research problem.

Various institutions worldwide, whether in the financial sector or other sectors, employ diverse methods and mechanisms for distributing profits. This research will cover and focus on the main method used by different Islamic financial institutions, which is the weights system, in addition to its effectiveness in attaining justice.

¹ IIFM report 2023

The research title is “Justice of weights in the distribution of profit for mudharaba based accounts in Islamic financial institutions”. Justice, a primary objective of Sharia higher goals derived from the Quran and the Sunnah of the Prophet (peace and mercy be upon him), will be examined in the context of Islamic financial institutions and their mudharaba transactions with customers. These institutions employ a unique system for applying mudharaba and distributing profits to customers, called the ‘weights system’ which will be explained in detail. This system may or might not provide justice to the parties involved in the contract.

Research problem

This research stems from the probability that there is a problem in the currently applied method of distributing profits in most Islamic financial institutions, as the system of weights currently applied adopts the mechanism of differentiation between the owners of investment accounts in the amount they deserve from the profit based on criteria and preferences determined by the institution, and this system from the researcher's point of view may or may not achieve the desired justice for the parties to the contract, as it gives customers as capital providers a weight of profit in exchange for the greater weight of the institution as a mudharib. The research aims to reach a clear opinion on whether justice is achieved in the distribution of profits in these contracts or not.

Research questions

The research was conducted to answer this question: Does reliance on weights as a fair system in distributing profit in Mudharaba-based deposit accounts between the Islamic Bank and its customers provide justice for both parties of the contract? Based on this question, other subordinate questions need answers:

- 1- What is the concept of justice in Islam? And how is it measured in banking?
- 2- What are the applicable systems in determining profits for customers in various financial institutions?
- 3- Is the current system in Islamic financial institutions optimal for justice?
- 4- Is the satisfaction requirement sufficient to adopt the weights system or others in determining profit?

Research objectives

This research aims to ensure that justice is achieved in the case of adopting the system of weights for the distribution of profits between customers and the institution in Mudharaba-based investment products in Islamic financial institutions. To achieve this goal, it is important to clarify the concept of justice and how to achieve it in these contracts, in addition to indicating the existing systems for the distribution of profits in banking, the research also aims to indicate the condition of consent which it exists implicitly when signing the contract between the customer and the bank and its adequacy to consider Any clause in the contract is valid even if it does not bring justice to both parties of the contract.

Research significance

The significance of this research is to reach a clear perception of the achievement of justice in the adoption of the system of weights for the distribution of profits in mudharaba-based accounts in Islamic financial institutions by clarifying the foundations of the profit distribution system, and its effectiveness in achieving justice. The current system in various Islamic financial institutions and its effectiveness in achieving the intention of justice between the institutions

as Mudharib and their clients as owners of funds will also be explained. One of the most important things expected from this research is to ensure the achievement of one of the higher purposes of Sharia, which is the implication of justice among people. It also aims to increase people's confidence in the commitment of financial institutions to the rules of Islamic law in their transactions completely, in addition to confirming confidence in workers in the Sharia sectors in these institutions and their constant pursuit of applying Islamic rules to the fullest.

Research limitations

This research studies mudharaba-based accounts in Islamic financial institutions, therefore it excludes any non-mudharaba-based accounts. This research studies the contracts whose parties are Islamic financial institutions and their customer, therefore it excludes any other contracts.

Research terms

Among the most prominent terms of this research are the following:

Justice – Mudharaba - Weights System - Investment Pool.

Chapter two:

Conceptual framework & literature review:

2.1 conceptual framework

2.1.1 Mudharaba

2.1.1.1 The Concept of Mudharaba in Islam

2.1.1.2 Mudharaba in Islamic financial institutions

2.1.2 Justice and Consent Between Parties

2.1.2.1 The concept of justice in Islam and banking

2.1.2.2 consent between contracting parties

2.1.3 Investment pools and weights system in Islamic financial institutions

2.1.3.1 Investment pools

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2.2.1 Controls of justice in the distribution of profits of investment accounts in Islamic banks - Dr. Muhammad Ali Al-Qari, AAOIFI conference, Bahrain, 2023

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2.2.3 A proposed accounting approach to measuring and distributing profits in Islamic banks - Ali Abdullah Shaheen, Islamic University of Gazza, 2005

Chapter Two: Theoretical Framework & Literature Review

2.1 Theoretical Framework

The theoretical framework consists of three parts

- 1- Mudharaba in Islam and the financial system.
- 2- Justice and consent between parties.
- 3- Investment pools and weights system in Islamic financial institutions.

2.1.1 Mudharaba

This part of chapter two discusses mudharaba on two levels, initially, it discusses the mudharaba originally in Islam and gets into its detail, and then it will discuss how mudharaba is implied in the financial transactions through Islamic financial institutions.

2.1.1.1 The concept of mudharaba in Islam

Mudharaba is a form of company in Islam, it is when a person provides capital to another person to work with it and the profit is shared between them according to their pre-agreement.²

Mudharaba is permissible according to the Quran, sunnah, and consensus. In the Quran Allah SWT Sayed:

(لَيْسَ عَلَيْكُمْ جُنَاحٌ أَنْ تَبْتَغُوا فَضْلًا مِّن رَّبِّكُمْ فَإِذَا أَفَضْتُمْ مِّنْ عَرَفَاتٍ فَاذْكُرُوا اللَّهَ عِندَ الْمَشْعَرِ الْحَرَامِ^٣ وَادْكُرُوهُ كَمَا هَدَيْتُكُمْ وَإِنْ كُنْتُمْ مِّن قَبْلِهِ لَمَنِ الضَّالِّينَ)

(There is no blame upon you for seeking bounty from your Lord)³

² Alqadori p.113

³ Quran 2:198

Also, Allah SWT Said:(وَءَاخَرُونَ يَضْرِبُونَ فِي الْأَرْضِ يَبْتَغُونَ مِنْ فَضْلِ اللَّهِ)

(and others traveling throughout the land seeking [something] of the bounty of Allah)⁴, and from the sunnah that the prophet (PBUH) has received revelation and people were dealing with mudharaba before it and he did not deny it, so it is an approval for mudharaba transactions. Also, the prophet's companion was dealing with it and the scholars after them and no one denied its permissibility so there was a consensus approval for the permissibility of the mudharaba contract. Such permissibility was a translation of Allah SWT instructions for people to earn a living. It is possible for someone to possess wealth but he/she is unable to grow it, while others may have the experience to invest but lack the necessary funds. Islam allows for this transaction so that both parties can benefit. The investor (rab almal or capital provider) benefits from the mudharib expertise, while the mudharib benefits from the investor's capital. Together, they both share profit, with one contributing their money and the other their effort.

The pillars of mudharaba vary among sharia scholars. According to Hanafis, all contracts including mudharaba consist of a single pillar, which is the offer and acceptance, or any equivalent terms⁵. Malekis considered it from 4 pillars which are: parties, capital, work, and form of the contract⁶. While Shafeis added one more pillar to that which is profit⁷. The Hanbali considered mudharaba to consist of 5 pillars which are: form, parties, capital, work, and mudharib profit percentage⁸. It must be mentioned that some Hanbali scholars consider mudharaba as Wakala or service rent (Ijara in person)⁹.

⁴ Quran 73:20

⁵ Alkasani, p6:79

⁶ Aladoui p3:418

⁷ Alsharbini p2:399

⁸ Albahouti p3:508

⁹ Kuwait fiqh Encyclopedia p38:41

Pillars conditions:

Mudharaba pillars have some conditions that are required for the validity of the contract, here are some of them in brief in accordance with each school pillars:

- 1- Form of the contract conditions: some scholars stated that mudharaba can be conducted only by specific words of offer and acceptance, while others stated it can be with any words or act that indicates a contract.
- 2- Parties of the contract: they must be able to act on behalf of themselves and have power of attorney to appoint someone to act on behalf of themselves. Therefore, a minor or incapacitated person cannot perform a mudharaba contract.
- 3- Capital: it must be cash, known to both parties, it must not be debt and it must handle to the mudharib¹⁰.
- 4- Profit: it must be known as a proportionate share of profit, such as half, third, etc., rather than a specific amount.
- 5- Work: The work should be a trade, and the employer should not impose financial burdens on the worker in their job, and the worker should not violate the common terms of the contract.

Mudharaba may be classified into two types: restricted mudharaba and unrestricted mudharaba. The unrestricted mudharaba refers to a case when the capital provider entrusts their funds to the mudharib, allowing them to invest and utilize the money without any limitations or conditions regarding timing, location, specific markets, countries, or counterparties. Restricted mudharaba refers to a case when the capital provider imposes certain conditions, such as a specified work period or trading in a particular market or country. The mudharib is obligated to adhere to the directions of the capital provider.

¹⁰ Kuwait fiqh encyclopedia p38:43

Scholars generally agree that mudharib is entrusted with the capital in his hand because he is managing the capital provider with their permission so he is a trustworthy agent as long as he is managing it within the customs of mudharaba, and he must not guarantee any amount unless he exceeds the limits of generally accepted mudharaba practices.

Contracts in Islam can be either binding or non-binding. There is consensus among fiqh scholars about the non-binding of mudharaba before the mudharib starts his work. There is a controversial opinion about whether the mudharib starts his work, as the majority of scholars from Hanafis, Shafeis, and Hanbalis agree that mudharaba is a non-binding contract even if the mudharib started to work. The Hanafis added a clause that mudharib must notify the capital provider if he wishes to nullify the contract and the capital must be cash at that time¹¹. While Malikis scholars stated it is a binding contract once the mudharib begins operating and he cannot nullify it unless the capital provider approves it.¹² So mudharib is considered a trusty when he receives the capital and then an agent when he starts operating.

Some conditions in mudharaba lead to the invalidity of the contract such as if one of the parties requires a specified amount of profit, also if the capital provider requires a guarantee of capital, then the contract is void, another condition is if the capital provider required to work with mudharib, in this case, the scholars have two opinions:

1. The majority of Hanafis, Malikis, Shafeis, and some Hanbalis agree that the contract is void and the profit is entitled to the capital provider and mudharib deserves payment for his effort based on market prices.¹³

¹¹ Alkasani, p6:109, Alshirazi p3:486, Ibn qodama p7:172

¹² Abi Qasim albasri p2:193

¹³ Alkasani p6:85 Alsharbini p:313

2. The majority of Hanbalis agree that the contract is valid.¹⁴

A Mudharaba contract is considered invalid in many cases such as if one of the parties is deceased or lost capacity. Also, the contract is nullified if the capital is deceased or if the capital provider is apostatized from Islam.

The profit must be distributed based on pre-agreement and after it is achieved, and in case the profit distribution ratio is not agreed on the contract is invalid in Hanbalis opinion¹⁵, but according to the majority of other scholars it is valid mudharaba and the profit is divided equally between the parties¹⁶.

Here are some general rules about mudharaba derived from the aforementioned sources:

- 1- It is permissible to have multiple mudharibs work for the same capital provider. As well as having multiple capital providers dealing with the same mudharib.
- 2- The profit must be distributed after the liquidation of the asset into cash, whether it is real liquidation or constructive liquidation.
- 3- Mudharib costs must be within the customs of mudharaba.
- 4- Mudharib can add his money into mudharaba so he would be a capital provider and mudharib at the same time and will get his share of profit from mudharaba contract and his full profit for his money.
- 5- It is permissible to set a time limitation for the contract so both parties agree on a time for ending the mudharaba and liquidating its assets.

¹⁴ Ibn qodama p3:356

¹⁵ Ibn qodama p3:358

¹⁶ Alkasani p6:56

2.1.1.2 Mudharaba in Islamic financial institutions

Islamic financial institutions have historically employed an alternate approach to conventional financial institutions, which rely on interest-based loans and deposits. Instead, Islamic financial organizations utilize the mudharaba contract for investments and financing for many of their transactions. The reflection of a crucial role in economic development is in the creation of asset-based markets and genuine financial activity, as opposed to debt activities. Furthermore, it serves as a genuine and significant contrast to the ribba and its negative effect on the economy.

The Islamic financial institutions adopted the mudharaba contract and developed it to satisfy the current market demands and created several new types of mudharaba such as joint mudharaba which is when multiple investors (capital providers or customers) give their money into a single person or institution to invest with his or its expert or within a specified kind of investments, with the permission to combine their money into one pool of investments. Joint mudharaba is rooted in what scholars agreed upon of having multiple capital providers dealing with the same mudharib. In such a contract the mudharib¹⁷ is allowed to combine his own money with investors¹⁸ in the same pool and works as an agent for investors and deserves his pre-agreed share of profit if it is achieved, as well as his full share of profit in his money.

Mudharaba has been involved in Islamic financial institutions multiple products, as those institutions created banking accounts that accept customers' money based on mudharaba such as saving accounts and investment accounts for a specific period (month, 2 months, 3 months, 6 months, 12 months, 18 months, 24 months and 36 months and other types based on institution and investor's needs). Those accounts are considered mudharaba contracts where the customer

¹⁷ Mudharib can be either a person or an institution, the research is dealing with institutional mudharib only.

¹⁸ The research refers to investors as capital providers or customers and vice versa.

is the capital provider and the institution is the mudharib. Those accounts are subjected to profit and loss sharing principles, so the parties agree on a profit-sharing ratio on the day of opening the accounts, and if the profit is realized then the institution takes its share as mudharib and transfers the capital provider share into his account. In those accounts, the institution permitted approval from the customer to invest his money as it is unrestricted mudharaba and the institution must invest within its expert. The multiple account holders are considered multiple capital providers for a single mudharib, so the mudharib gathers all account money into a single investment pool¹⁹ and invests it. Here is a summary of how joint mudharaba works in four steps:

- 1- Capital providers deposit their money in the form of an investment account within the institution to invest it appropriately.
- 2- The institution combines the invested amount into one pool and starts investing it to generate profit.
- 3- The profit is calculated during a specified period (daily, weekly, monthly) and then performs real or constructive liquidation.
- 4- The profit is being distributed to account holders (capital providers) based on the agreed ratio of profit and the specified date of the contract.

This product has different profit-sharing ratios based on the investment period and the investment amount; therefore, the institution sets the profit-sharing ratio for each different product based on its period and announces it to the investors.

¹⁹ The investment pool detail will be discussed in an upcoming topic

2.1.2 Justice and Consent Between Parties

This part of chapter two consists of two parts that are related to the research problem which are the justice in Islam and the other is the consent between parties.

2.1.2.1: The concept of justice in Islam and banking

Justice refers to the concept of treating individuals fairly about their rights and responsibilities. It also includes extending this principle to non-human creatures, such as animals and plants. In Islam, the responsibility for upholding justice rests with individuals who hold positions of control over others. Islam requires the practice of justice in all relationships between people. This section will present a thorough examination of the notion of justice, starting with its definition and thereafter illustrating it via many instances mentioned in the Quran and Sunnah.

Before the dawn of Islam, humanity was primarily familiar with violence rather than justice, and it placed greater value on power than on values. In a society marked by the domination of one person by another, the powerful took advantage of the vulnerable and the capable violated the rights of the helpless. However, even though the Arabs preferred the personal origin of their kind over non-Arabs, They understood the need to support the downtrodden and stick with them until they obtained their just claims from the oppressor as they created an alliance for refusing any injustice in Makkah. The alliance, in which the Prophet Muhammad, may peace be upon him, stated his willingness to accept an invitation to participate in Islam, presented evidence of a noble nature²⁰.

The Quran refers to the notion of justice 28 times, while the phrase "equity," which has a similar meaning, is cited 25 times. This emphasizes its

²⁰ Ahmed, 1655

significance and majestic position in Islam. Within the context of Islam, rulers have a mandatory responsibility to uphold justice towards both their citizens and those under their governance. It is also stressed in interpersonal interactions and relationships between those in positions of power and subordinates. The Quran contains divine commands and exhortations to uphold justice, as decreed by Allah.

Justice is defined as ingrained in people's minds that righteousness is upright and justice is the ruling of truth, opposing oppression²¹. Justice is derived from the word just and it was referred to in the Quran: (وَأَشْهِدُوا ذَوَىٰ عَدْلٍ مِّنكُمْ)

“and call to witness two just men among you”²². Just is also the name of Allah SWT as he is above every shortage and all his provisions are and encourage justice.

Justice in Islam was defined by multiple scholars, such as:

1. Ibn Hazem: it is to give and take the rights.²³
2. Ibn Othaimen: it is to give everything that it deserves.²⁴
3. Aljaheth: using the appropriate things in the appropriate locations and times.²⁵

As we can see from those definitions and interpretations of different scholars, they all agree on the concept of justice and its importance, and such importance is derived from the Quran and Sunnah.

²¹ Alzubaidi p29:445

²² Quran 65:02

²³ Ibn Hazem, p81

²⁴ Ibn Othaimen, p3:80

²⁵ Aljaheth, p28

In the Quran Allah SWT says:

- 1- (إِنَّ اللَّهَ يَأْمُرُ بِالْعَدْلِ وَالْإِحْسَانِ وَإِيتَاءِ ذِي الْقُرْبَىٰ وَيَنْهَىٰ عَنِ الْفَحْشَاءِ وَالْمُنْكَرِ وَالْبَغْيِ ۚ يَعِظُكُمْ لَعَلَّكُمْ تَذَكَّرُونَ)

(Indeed, Allah commands justice, grace, as well as generosity to close relatives. He forbids indecency, wickedness, and aggression. He instructs you so perhaps you will be mindful.)²⁶

- 2- (قَالَ لَقَدْ ظَلَمَكَ بِسُؤَالِ نَعَجَتِكَ إِلَىٰ نِعَاجِهِ ۖ وَإِنَّ كَثِيرًا مِّنَ الْخُلَطَاءِ لِيَبْغِيَ بَعْضُهُمْ عَلَىٰ بَعْضٍ إِلَّا الَّذِينَ ءَامَنُوا وَعَمِلُوا الصَّالِحَاتِ وَقَلِيلٌ مَّا هُمْ ۖ وَظَنَّ دَاوُدُ أَنَّمَا فَتَنَّاهُ فَاسْتَغْفَرَ رَبَّهُ وَخَرَّ رَاكِعًا وَأَنَابَ ﴿١﴾)

(David eventually ruled, “He has wronged you in demanding to add your sheep to his. And certainly, many partners wrong each other, except those who believe and do good—but how few are they!” Then David realized that We had tested him so he asked for his Lord’s forgiveness, fell in prostration, and turned to Him in repentance”)²⁷

In Sunnah:

- 1- Ubadah ibn Alsamet narrated: We gave the oath of allegiance to Allah's Messenger (PMBUH) that we would listen to and obey him both at the time when we were active and at the time when we were tired and that we would not fight against the ruler or disobey him, and would stand firm for the truth or say the truth wherever we might be, and in the Way of Allah we would not be afraid of the blame of the blamers²⁸.
- 2- Amer narrated: I heard An-Nu`man bin Bashir on the pulpit saying, "My father gave me a gift but `Amra bent Rawaha (my mother) said that she would not agree to it unless he made Allah's Messenger (PMBUH) as a

²⁶ Quran 16:90

²⁷ Quran 38:24

²⁸ Albukhari, 7199

witness to it. So, my father went to Allah's Messenger (PMBUH) and said, 'I have given a gift to my son from `Amra bent Rawaha, but she ordered me to make you a witness to it, O Allah's Messenger (PMBUH)!' Allah's Messenger (PBUH) asked, 'Have you given (the like of it) to every one of your sons?' He replied in the negative. Allah's Messenger (PMBUH) said, 'Be afraid of Allah, and be just to your children.' My father then returned and took back his gift²⁹.

The Quran and Sunnah emphasize the crucial role of justice in all human endeavors. Justice is of utmost significance in Islam, deeply ingrained in its teachings and beliefs. It is not only a legal or sociological notion, but rather a fundamental element of the religion, firmly grounded in the Quran, the Sunnah, and the teachings of Islamic scholars. The fundamental principle of the Islamic faith is the belief in the absolute justice and fairness of Allah, which is seen in all aspects of Islam, including its ethical, legal, financial, and social systems.

Justice revenues to individuals and society are many according to Justice in Islam, Dr. lakhdar, eddakhira journal 2017:

- 1- Security ensures the well-being of its owner in this life and the hereafter.
- 2- The love of Allah and acceptance in heaven and earth and the feeling of trust, stability, strength, dignity, and reliance on Allah, excluding everything else, and the continuity of power and its sustainability.
- 3- Achieving stability and tranquility in society and enhancing the sense of equality eliminates strife, conflicts, and destructive problems of energy and resources and opens up horizons for ideas, creativity, and innovations.

²⁹ Albukhari, 2587

- 4- Leads to the optimal utilization of the energies and efforts of individuals in society and promotes a culture and spirit of love, cooperation, and solidarity.
- 5- The strength and cohesion of the social and political structure and the crowds around its leaders which is key to inclusive development and advancement

Justice must be applied through financial transactions especially in Islamic financial institutions, as Islamic instructions are clear regarding applying justice and avoiding inequality in all aspects. Islam has ensured justice in financial transactions through various means such as the prohibition of ribba to prevent unfairness, the prohibition of gharrar to prevent unfairness, and the implication of zakat is to establish justice among various social groups. When taking culture, norms, and the Sharia greater intents and goals into account, it is important to guarantee risk sharing and fair treatment between parties in participation contracts.

This research will analyze the concept of justice as it applies to financial transactions. In mudharaba transactions, fairness is upheld by assuring the implementation of profit and loss sharing. Justice is upheld in a mudharaba contract from the moment the contract is formed, as it determines the ratio of profit-sharing between the capital provider and the mudharib. The loss will result in financial detriment for the capital provider and a loss of effort for the mudharib. Thus, the contract ensures the attainment of justice. The main question raised here is what is the measurement of applying justice in Islamic financial transactions? (Alqari, 2023)³⁰: the measurement of ensuring justice application in financial transactions is that the institution is committing to Sharia principles and the standards and fatwas issued by fatwa committees and Sharia supervisory boards.

³⁰ Alqari, AAOIFI conference 2023

2.1.2.2: Consent between contracting parties

When examining the general principles and fundamental philosophies upon which financial transactions, products, and contracts are based, one finds that the principle of consent is considered one of the greatest principles and most important foundations upon which wise Sharia has built the legitimacy of exchanging money and rights. It is through this principle that the transfer of benefits and assets between contracting parties in exchange for contracts or donations is permitted. Allah says:

(يَا أَيُّهَا الَّذِينَ ءَامَنُوا لَا تَأْكُلُوا أَمْوَالَكُمْ بَيْنَكُمْ بِالْبَاطِلِ إِلَّا أَنْ تَكُونَ تِجَارَةً عَنْ تَرَاضٍ مِّنْكُمْ)

"O you who have believed, do not consume one another's wealth unjustly but only [in lawful] business by mutual consent."³¹ And He SWT says:

(فَإِنْ جَفْتُمْ إِلَّا بِقِيَمَا حُدُودِ اللَّهِ فَلَا جُنَاحَ عَلَيْهِمَا فِيمَا افْتَدَتْ بِهِ)

"But if you are prevented, then offer what can be obtained with ease of obtaining."³² And the Prophet Muhammad, peace be upon him, said: "Verily, transactions are only valid with mutual consent."³³ Also hadith of Anas ibn Malik, may Allah please him, reported that the Messenger of Allah, PMBUH, said: "The wealth of a Muslim is not permissible except with his consent."³⁴ These texts explicitly indicate that the legitimate transfer of money and rights is based on the consent and agreement of the contracting parties. The wealth of a Muslim is not permissible except with his consent and choice.

The reason behind requiring consent is obvious. The default rule regarding wealth is prohibition and restriction. It is not permissible, according to Islamic law, to dispose of a Muslim's wealth without permission from the legislator or the owner. Disposing of it without permission is a form of transgression, violence,

³¹ Quran 4:29

³² Quran 2:229

³³ Ibn majeh: 2185

³⁴ Ahmed: 20695

and consumption unlawfully, which is a crime that entails punishment and condemnation. This is a well-established matter in Islam without any doubt. The requirement of consent in transactions prevents disputes and resolves conflicts while ensuring fair and compassionate exchanges based on justice, kindness, known customs, and mutual benefit. It discourages deceit, fraud, manipulation, falsehood, and any other actions that may lead to animosity and hostility between parties. Islam has explicitly prohibited all of these behaviors.

Mudharaba contracts in Islam, as part of the financial transactions in Islamic financial institutions, have three pillars which are mentioned earlier, first the form of the contract, second capital and last the parties of the contract. Each of those pillars has conditions to meet for the contracting parties, an important condition is the consent between the parties, and the contract is nullified if the parties' consent is not mutual.

The application of such transactions is reflected in the Islamic financial institutions through their various products, an example of it is the mudharaba-based deposits in retail banks, where a customer approaches the bank to open a specified period account based on mudharaba. This account is based on a mudharaba contract where the bank represents a mudharib role in the customer's money who is the capital provider. This account has a pre-assumption of consent between parties (customer and the bank) as the customer signs an account opening form contains the terms and conditions of the contract. Those terms and conditions include how the money will be invested and the profit-sharing ratio between the capital provider and mudharib. The main question raised here is: is the implied consent between parties in the establishment of the contract enough to imply justice even if the terms and conditions are in favor of one party over the other? And the main part is the different rates of profit given to different customers based on their investment amounts.

To answer this question the transaction must be understood from Sharia scholars' point of view, as it was clarified by Sharia scholars as follows:

- 1- Malikis and Shafeis scholars: the profit must be distributed between the parties based on their capital contribution because the parties are entitled to their share of profit based on their capital contribution only. In mudharaba, it is divided in half as one party provides capital and the other effort³⁵.
- 2- Hanafis and Hanbalis: the profit is distributed based on the parties' agreement because the parties are entitled to their profit based on one of three items which are: capital, work, or guarantee³⁶.

Therefore, Islamic financial institutions have adopted the opinion of Hanafis and Hanbalis where they can apply different rates of profit distribution to each category of their investors based on the investment amounts and period. There is clear consent in the contract as customers agree on terms and conditions, indicating the rates of return on the day of signing the contract.

³⁵ Mawahib Jaleel p5:140, Alnawwi p4:284,

³⁶ Ibn Nujaim p5:197, Ibn Qodama p5:26

2.1.3 Investment pools and weights system in Islamic financial institutions

2.1.3.1 Investment pools

Mudharaba investment pools represent the fundamental principles of collaboration in applying profit and loss-sharing investments in Islamic financial institutions. Mudharaba plays a crucial role in Islamic finance, representing the values of justice, sharing of risks, and fair distribution of wealth. Establishing an investment pool based on mudharaba principles contributes to the adherence to Islamic financial rules and guidelines. The formalization and institutionalization of Mudharaba investment pools took place throughout the contemporary era with the development of Islamic Financial Institutions in the second half of the 20th century. Islamic financial institutions, such as Islamic banks and investment companies, aim to provide Shariah-compliant alternatives to conventional financial goods and services. This included offering investment opportunities that are compatible with the mudharaba principles.

Mudharaba investment pools are formed by entering into mudharaba agreements between the Islamic Financial Institution (acting as the Mudharib) and the clients (acting as capital providers). These contracts specify the terms and conditions that govern the partnership, such as the ratio for sharing profits, investment objectives, duration of the partnership, and the rights and duties of each member. The mudharaba contract outlines the extent of the investment pool, the categories of assets that adhere to Shariah principles in which money will be allocated, and the standards for choosing investments. Islamic financial institutions (IFIs) have an essential role in overseeing and controlling the mudharaba investment pools as a mudharib. They utilize their specialist expertise in Shariah-compliant investments, market experience, and risk management to distribute funds across different types of investments. They have the responsibility of completing due diligence on possible investments, guaranteeing

adherence to Shariah standards, and overseeing the performance of the investment portfolio³⁷. Investors contribute funds to the mudharaba investment pool, which is then overseen by the institution. Investors have the option to contribute varying amounts of cash, and they have the freedom to adjust their investment up or down over time and that would affect their profit share. The profit derived from the investments is distributed between investors and the Islamic financial institution by certain profit-sharing percentages specified in the mudharaba contract. The profit-sharing ratio is commonly determined by considering criteria such as the capital contribution of each investor and the level of risk associated with the investments as well as considering the average market rate of return in addition to the period.³⁸

Islamic banks generate revenue from many sources, with a portion of this revenue being allocated to the joint mudharaba pool, while the remaining portion is distributed only to the shareholders. The following are some items:

- 1- Self-generated revenues: those revenues are generated through shareholders' investments, such as creating SPVs or commercial papers or trading in real estate. Those revenues are delivered to shareholders' accounts only and investors cannot benefit from them.
- 2- Joint investment revenues: such as mudharaba investment pools, and those revenues are divided between shareholders and investors based on their agreement.
- 3- Restricted investment revenues: those are the contract between the institution and the investor for a certain project of investment type and those revenues are divided based on their agreement.
- 4- Banking services revenues: it is the revenues generated from different banking activities such as banking transfers, exchange services, letters of

³⁷ Understanding Islamic finance, p325

³⁸ Islamic banking essentials, Dr, Ali Mohamed 2019

credit and guarantees, card services, and any other banking services that generate revenue. This kind of revenue is delivered to shareholders only.

Recording revenues is essential in financial statements, and there are multiple ways to record revenue. Here is what AAOIFI (Accounting and auditing organization for Islamic financial institutions) stated in their Sharia standard no. 40: 3/2/2: Due to the fact that unrestricted investment account of continuous participatory mudharaba lack coincidence in the beginning and end of the process of depositing funds in the accounts, the profit from the operations which extend to succeeding periods has to be distributed over the whole period of such operation in proportion to the duration of each operation³⁹.

Parties of mudharaba are entitled to profit from the contract while certain conditions must be met, the sharia standard of AAOIFI set four of them: (Shariah-Standards-ARB, 2015.)

- 1- Safety of the capital and any profit distributed before that is considered an advance payment.
- 2- Liquidation of mudharaba assets, even if it is constructive liquidation.
- 3- Covering all mudharaba expenses.
- 4- Deduction of all allocations and reserves.

Central banks conduct a regulatory role by stipulating the related rules for the financial sector, In addition to the central bank role, there is a regulatory role conducted by standards issuing authorities such as AAOIFI which is responsible for issuing sharia and accounting standards relating to the treatment of the financial transactions within the instructions of sharia. Regarding the investment accounts, it was clearly stated regarding the allocations and reserves in AAOIFI Sharia standards no. 40: Deduction of the allocations and reserves relating to the investment, from investment income so as to arrive at distributable profit. In this

³⁹ AAOIFI sharia' standard no.40 p:999

case, allocations for bad debts and reserve for rate of returns have to be deducted from gross profit, whereas reserve for investment risks has to be deducted after deduction of the Mudharib's share⁴⁰. Provisions can be defined as: 'The funds deducted from a certain account or company's income; to compensate certain or potential expenses or losses.' Provisions are also referred to as allocation as well in some institutions. Reserves Funds derived from the pool or company's profits; to maintain the pool or company's financial stability, development work, and compensate unsustainable expenses or losses. Provisions and reserves apply to investment pools as the Islamic financial institutions apply AAOIFI accounting standard no. 27 which stated in 5/3: the following provisions and reserves shall be disclosed in the financial statements of Islamic financial institutions:

(c) Profit equalization reserve to help maintain a certain level of income for investment account holders.

(d) Investment risk reserve for future investment losses for investment accountholders⁴¹.

The accounting standard defines the profit equalization reserve as the amount that is deducted from mudharaba revenue before deducting the mudharib share of profit, in order to maintain a specific level of revenue for investment account holders. And it defines the investment risk reserve as the amount that is deducted from investment account holders' revenues after deducting mudharib shares, in order to protect them from future loss.

Central banks as a regulatory authority for Islamic financial institutions may require these institutions to maintain a specific proportion of their total deposits as a legal reserve, which can be as high as 20% in some jurisdictions or require them to keep a reserve equal to the investment amount. In addition to

⁴⁰ AAOIFI sharia standard, p: 1000

⁴¹ AAOIFI accounting standard, p:802

requiring them to maintain specific levels of liquidity or semi-liquidity of investors' deposits. Consequently, Islamic financial institutions are not allowed to employ the entire sum of investors' deposits. Instead, they allocate a specific proportion to be invested based on the principle of mudharaba, which is then merged with shareholders' funds. The remaining funds are held in designated accounts that provide minimal or no profits.

Islamic financial institutions specify the percentage of investment based on several variables, such as the market size, liquidity levels, and the finance demand. (Dr. Ali mohamed Ahmed, 2019): Islamic banks should not be given the freedom to specify those percentages, but central banks must specify those percentages based on subjective standards.

AAOIFI sharia' standard no: 40 (Distribution of Profit in Mudharaba-Based Investment Accounts) stated that: The ratios of the amounts deposited in the investment accounts which the institution retains for liquidity purposes - may be stated in the conditions of the accounts - have to be treated as follows:

4/10/1 The case could be that the bank never invests such amounts because they are withheld in the accounts of the central bank or the bank's treasury for the sake of meeting requests for withdrawal from investment accounts, hence there is no return for which a ruling can be indicated here.

4/10/2 Or the case may be that the bank utilizes such funds in short-term or easy-to-liquidate investments to cater for applications for withdrawal from investment accounts - although the bank sometimes stipulates in the conditions of the accounts that such funds are allocated for liquidity purposes. In this case, it is permissible for the bank to invest such funds without obtaining the consent of the holders of the accounts, because the bank is authorized for any disposition that serves the interest of the two parties of the unrestricted Mudharaba contract. When a return is earned from such investment it should be added to the

investment base. The holders of the account will be entitled to a share in this profit in their capacity as Arbab al-Mal, and the bank is entitled to its share as a Mudharib, subject to the ratios agreed upon. If, instead, a loss is incurred from investment of the amounts, without any transgression or negligence from the side of the bank, it should be borne by the holders of the accounts in their capacity as Arbab al-Mal.⁴²

It is worth mentioning that the Sharia standard also stated what would be the investment priority for Islamic financial institutions and their investors, in Sharia standard no 40 as well: 2/1/3 Equality in investment opportunities: In principle, equality in investment opportunities should be ensured between shareholders' funds and the funds of the holders of the investment accounts in participatory Mudharaba. In case a different policy is to be adopted, the institution should disclose that before disposition, with due consideration to the relevant regulatory restrictions and the conditions of opening the accounts⁴³. It must be mentioned that investors, like any capital provider in the mudharaba contract, give their money to mudharib on the pre-assumption that all capital will be invested and mudharib will not prioritize investing his money before capital provider money. This assumption is based on scholars' opinions regarding mudharaba as mentioned before mudharib is allowed to combine his own money with mudharaba money on the condition that he can invest both funds together, and if he does not comply with the condition then the capital provider is allowed to get compensation⁴⁴.

⁴² AAOIFI Sharia standard, p:1001-1002

⁴³ AAOIFI, sharia standards, p:995

⁴⁴ Mawaheb Aljaleel, p5:367

2.1.3.2 Weights system in Islamic financial institutions

The weights system, which may be referred to as a scoring system as well, has been adopted since last century in Islamic financial institutions for the calculation and distribution of profit in mudharaba-based accounts between the institutions and their clients. In this part of chapter two, the research will discuss the details of the weights system and how it works in investing shareholders' and investors' funds and its mechanism of distributing profit among them.

The weights system is a method that assigns certain weights to an investment based on defined criteria, considering the given amount of money and the duration. This approach is utilized to ascertain the allocation of weightage for shareholders' and investors' funds to be utilized in the institution's investment. The weights assigned to each shareholder and investor are established using quantitative criteria. For investors, the weight is based upon many elements that differ from one institution to another. The primary component that is commonly used is the contribution amount since any increase in this quantity results in a proportional increase in the weight and the other determinant is the duration of the investment since an increase in the period leads to a corresponding rise in weight. Another significant factor to consider is the investment's associated risk. Furthermore, there are additional elements that may be utilized to ascertain the weightage, such as regulatory compliance. In some countries, institutions may be permitted to set aside a specific proportion, which could be up to 20% of URIA, before allocating the remaining funds for investment purposes. Other jurisdictions mandate that the institution maintains a reserve that is equal to the investment amount.

The most used factors are the investment amount and the investment period. The research discusses how the weights system works considering those two factors. The following tables and shapes explain how the system works, as the example considers three different products in a single retail bank through

different percentages of weights. The products are a savings account, a 6-month fixed deposit, and a 12-month fixed deposit. In this example, the shareholders' funds will be combined with investors' funds in a single pool. The shareholder's funds are \$10,000,000, and the mudharaba-based account holders' fund is \$30,000,000, which is three times the shareholders' funds. All the amounts are in United States dollars (USD-\$) the example determines three important factors for the weights system which are the mudharib to capital provider share between the bank and the investors, the expected rate of profit, and the weightage of each type of account.

Table 1: Banks products and their profit and weightage – Example 1

Product	amount	Bank share ⁴⁵	Investor share ⁴⁶	Expected profit	weightage
Saving account	10,000,000	99%	1%	1%	40%
6-months deposit	10,000,000	80%	20%	2%	50%
12 months deposit	10,000,000	60%	40%	2.5%	60%

As per this example, the investors expected profit to be equal to \$0.550 million. Therefore, the bank has to allocate the appropriate weightage of investment to generate the expected profit. A condition that is agreed upon in the contract is that if the bank as mudharib generates profit greater than the expected profit in the contract, then the bank is eligible to take the exceeding amount.

⁴⁵ The bank share as mudharib

⁴⁶ The investor shares as capital provider

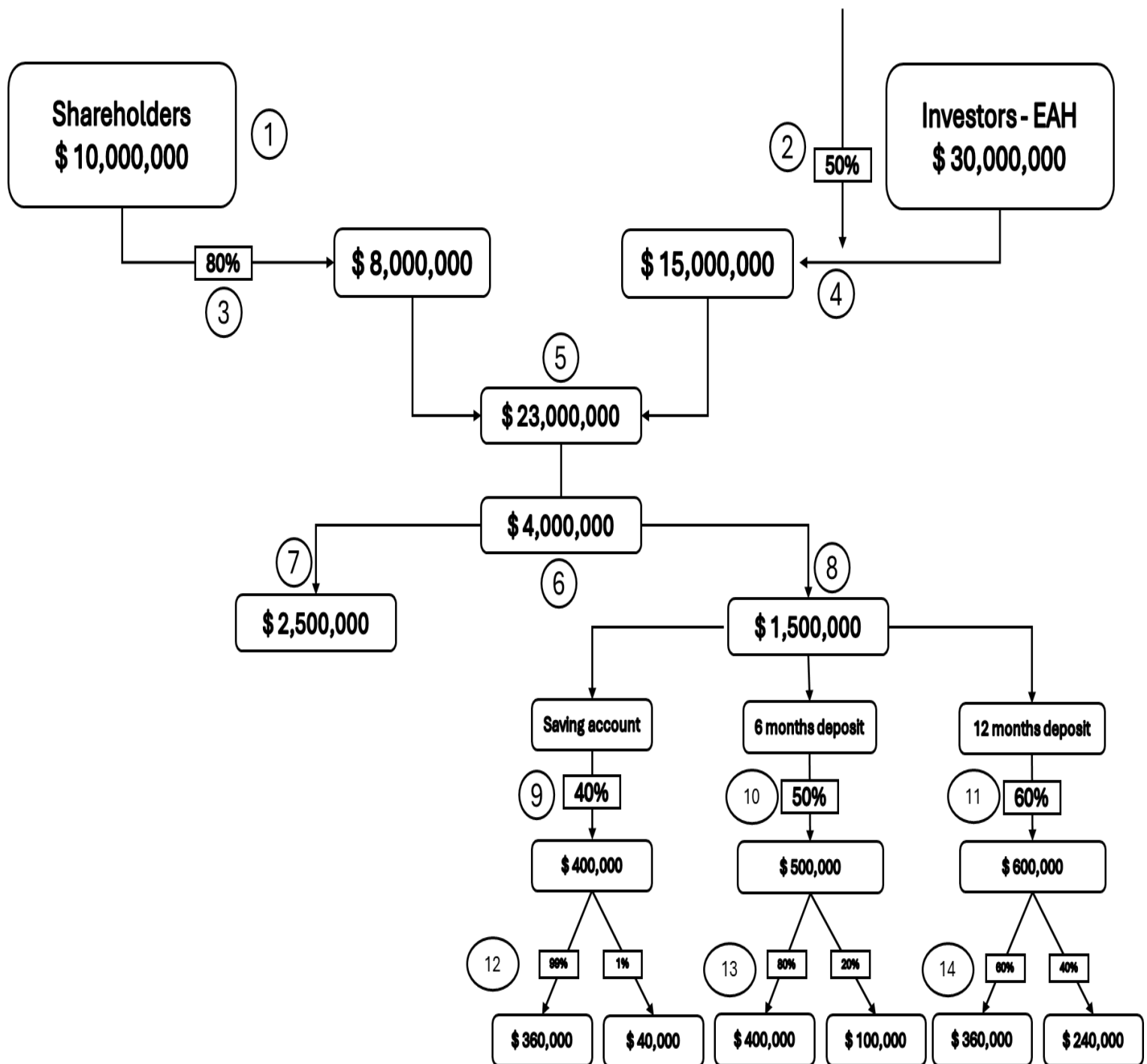


Figure 1: Weights system example 1

- 1- The shareholders of the bank funds
- 2- The investor's (EAH) funds
- 3- The bank invests 80% of shareholders' funds into the pool
- 4- The bank invests 50% of investors' funds into the pool

- 5- The joint mudharaba pool fund is \$23 million
 - 6- The mudharaba pool generate \$4 million profit (the profit after deducting profit equalization reserve and investment risk reserve)
 - 7- The shareholder's share of profit is $61.5\% = \$2.5$ million of the pool's profit
 - 8- The investor's share of profit is $38.5\% = \$1.5$ million of the pool's profit
- The bank shares the profit with the investors based on the mudharaba contract between them as the investors are considered capital providers and the bank is mudharib.
- 9- 10- 11- these are the weights of each type of account (product) shared in the pool.

12- 13- 14- these are mudharib to capital provided profit distribution ratio between the bank and the investors.

At the end of the investment period as per the example, the bank profit from this operation is \$3.620 million while the investor's profit is \$0.380 million. In this case, the bank did not generate the expected profit in the contract with their investors which was approximately equal to \$0.550 million, which is feasible and any generated profit should be distributed to the investors based on their shares as multiple capital providers. However, the banks usually meet the expected profit rate for their investors by deducting the amount from the reserves or by gifting part of their profit to the investors. This approach may trigger a red flag investigation if it is perceived as a guarantee of profit, which might result in the cancellation of the mudharaba contract. Such a point may be discussed further by understanding the permissibility of a party gifting or giving away part of his share of profit. This point has been discussed by Sharia scholars from the major schools of thought, as the gift (Hiba) is permissible between parties of the contract once the profit is realized and distributed between them without any former agreement. So, it is permissible for Islamic financial institutions to gift part of their profit to

their investors to maintain the profit level within expectations and the market price⁴⁷.

The presented example is based on multiple meetings with several experts in the financial sector, such as investment department employees, sharia coordinators and auditors, as well as external auditors. Even though there are some differences in the practice between an Islamic financial institution to another.

There are some notes derived from the figure which are:

- 1- The bank's share of profit is seven times the investor's share, while the investor's funds were three times the bank's funds.
- 2- The investment period is the key to increasing the investor's share of profit, as any increase in the period increases the percentage of the investor's share of profit.
- 3- In the case that the bank gifts part of its proportion of the profit to meet the expected profit for the investor, if this practice is conducted every period, is it considered a guarantee of profit?

Example 2: here is another example of the weights system where the expected rate of profit is fixed but the weightage of each account changed and the mudharib to capital provider ratio changed.

Table 2: Banks products and their profit and weightage – Example 2

product	Amount	Bank share	Investor share	Expected profit	weightage
Saving account	10,000,000	95%	5%	1%	50%

⁴⁷ Aforementioned in chapter 2.1.1

6-months deposit	10,000,000	60%	40%	2%	50%
12 months deposit	10,000,000	50%	50%	2.5%	50%

As per this example, the investors expected profit to be equal to \$0.550 million. Therefore, the bank has to allocate the appropriate weightage of investment to generate the expected profit. A condition that is agreed upon in the contract is that if the bank as mudharib generates profit greater than the expected profit in the contract, then he is eligible to take the exceeding amount.

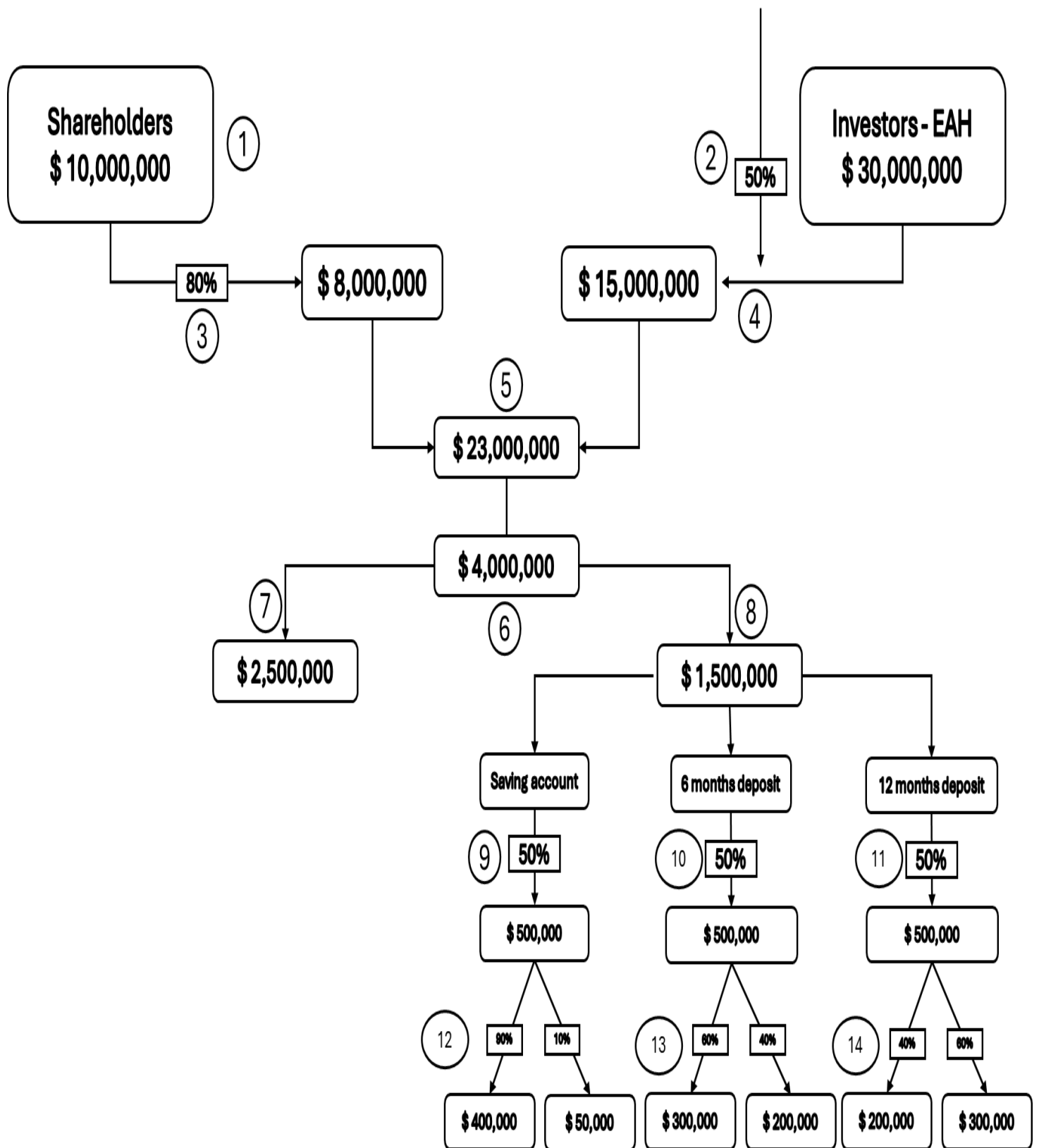


Figure 2: Weights system example 2

- 1- The shareholders of the bank funds
 - 2- The investor's (EAH) funds
 - 3- The bank invests 80% of shareholders' funds into the pool
 - 4- The bank invests 50% of investors' funds into the pool
 - 5- The joint mudharaba pool fund is \$23 million
 - 6- The mudharaba pool generate \$4 million profit (the profit after deducting profit equalization reserve and investment risk reserve)
 - 7- The shareholder's share of profit is $61.5\% = \$2.5$ million of the pool's profit
 - 8- The investor's share of profit is $38.5\% = \$1.5$ million of the pool's profit
- The bank shares the profit with the investors based on the mudharaba contract between them as the investors are considered capital providers and the bank is mudharib.
- 9- 10- 11- these are the weights of each type of account (product) shared in the pool.

12- 13- 14- these are mudharib to capital provided profit distribution ratio between the bank and the investors.

At the end of the investment period as per the example, the bank's profit from this operation is \$3.4 million while the investor's profit is \$0.6 million. In this case, the bank exceeds the expected profit in the contract with their investors which was approximately equal to \$0.550 million, therefore the bank is eligible to take the surplus of \$0.05 million or to give to the investors and such action requires regulatory approval.

2.2 Literature Review:

2.2.1 Controls of justice in the distribution of profits of investment accounts in Islamic banks - Dr. Muhammad Ali Al-Qari, AAOIFI conference, Bahrain, 2023

The research was presented at the twenty-first annual AAOIFI Sharia Board Conference in 2023. The paper began by differentiating Islamic banking from conventional banking through its adherence to Shariah law, which prohibits ribba and emphasizes risk-sharing between the bank and its clients. The paper examines the complicated issues that Islamic banks encounter while striving to achieve justice in the distribution of profits among investment account holders. Theoretical framework:

Islamic banking functions are based on profit-sharing methods such as Mudharaba and Musharaka. These contracts are fundamental for comprehending the distribution of profits and losses in Islamic finance. Justice is a fundamental principle in Islam that governs financial dealings. The Quran and Hadith firmly promote justice and transparency, which are essential in the allocation of profits. Profit distribution in Islamic banks poses challenges due to the dual system they operate in, where they must adhere to both Islamic values and conventional regulatory frameworks. This can result in disputes or compromises in profit distribution procedures. The utilization of Mudharaba and Musharaka in contemporary financial systems has complications that may not conform with normal Islamic standards. However, the timing and computation of profits, which are generally based on expected rather than real returns, and the pooling of assets, provide substantial difficulties in guaranteeing equitable treatment of each investor based on their contribution and risk.

The paper discussed justice in seven different aspects which are: investment pool, using benchmark as expectation of profit, constructive

liquidation, using weights in distributions, early exit, provisions and reserves, and compound profit.

- 1- Investment pools are an effective method for ensuring justice, with the condition that the profits created from banking services must be distributed to the pool and divided among the investors and shareholders.
- 2- The use of an indicator that is not directly related to the actual realized profit, such as an interest rate indicator, is an indication of justice in distribution. The profit may be higher or lower than this indicator. If the return on investment is linked to the indicator it is tied to, financial operations require measures to ensure alignment with this indicator in investment returns. Therefore, Islamic banks have stipulated in their investment account terms and conditions that the client must relinquish any excess above the indicator (i.e., any excess above the expected profit) to the bank. If the investment achieves a profit higher than that indicator, the owner of the capital does not receive it, but the bank appropriates it, which undermines justice.
- 3- Constructive liquidation raises the issue that financial institutions rely on accounting standards, including the prudence concept, which requires recording assets at a value lower than both the book value and the market value. Applying this standard involves considering potential losses, even if they are only probable. Relying on book value means that some investors miss out on deserved profits and bear costs unrelated to their investments. This contradicts the valuation stipulated by fatwas. The intended valuation in the fatwa refers to estimating the market value of assets or what is known in accounting as the replacement value. The accounting standards necessitate a value that is certainly lower than this value.

- 4- The weight system is approved by fatwa committees and sharia boards. However, upon closer examination, among is found that the questions presented on this matter, when conducted by Sharia committees, were divided and detached from the overall structure of distribution. For example, the committee has been asked whether it is permissible for a mudharib to enter into mudharaba contracts with more than one capital provider, with differing profit-sharing arrangements between them. The answer to this question, which is undoubtedly permissible, does not provide a comprehensive and complete picture. It should have included justifications for differentiating between one capital provider and another. This has had an impact on fairness in distribution among the participants. The principle is that every owner of capital must receive a share of the actual profit generated during the period of its investment. Since the bank does not differentiate between the use of funds in the investment, every dinar should be equal to another in terms of entitlement to profit. Any deviation from this principle would imply a lack of justice in profit distribution.
- 5- In early exit cases the Islamic financial institutions conduct some practices that lack justice This issue can be addressed through various methods, such as implementing a notice period before withdrawing the invested amount. The bank can effectively manage any negative impacts resulting from the early withdrawal of the invested funds.
- 6- If any reserves or provisions are taken It is a fact that the bank invests these funds for its benefit in most applications. The correct practice is that any returns generated from these investments should be returned to the same reserves. Therefore, some fatwa authorities have concluded that it is not permissible for the bank to invest these balances for its benefit.

- 7- Regarding compound profit The practice in Islamic banks is that when the agreed term of an investment account ends or when the periodic distribution time comes, the profit share of the owner of the capital is determined through calculation and division. This share is then deducted from the pool and deposited into a separate suspended account specifically designated for this purpose, for those who requested reinvestment and do not wish to reinvest it in the account. Standard number 40, which is the profit distribution standard issued by the Shariah Board of AAOIFI, states that "the profit earned from its investment after the investment period is considered part of the subsequent period."

The paper validates the role of Sharia boards and all related fatwa in this regard and that all Islamic financial institutions are performing within Sharia rules. It suggests that while Islamic banks strive to adhere to Islamic principles, there are significant practical challenges in achieving truly just and equitable profit distribution. Ongoing research and regulatory improvements are needed to bridge the gap between theoretical ideals and practical implementation.

2.2.2 Distribution of profits of investment accounts in Islamic banks - Prof. Dr. Ashraf Muhammad Hashem and Dr. Faris Jafari, AAOIFI conference, Bahrain, 2023.

Islamic finance is a rapidly growing sector within the global financial market, characterized by its adherence to the ethical principles and laws prescribed by Islamic Sharia. Unlike conventional banking, Islamic banking eschews ribba and gharar, focusing instead on asset-backed financing and risk-sharing. This distinct approach not only caters to the financial needs of Muslim populations by aligning with their religious beliefs but also appeals to non-

Muslims seeking ethical financial solutions. The primary purpose of this literature review is to delve deeper into the mechanisms and ethical frameworks that govern the distribution of profits in Islamic banking, particularly within investment accounts. The review aims to evaluate how these mechanisms ensure compliance with Islamic law, address ethical banking standards, and manage to remain competitive and attractive to investors globally. It seeks to understand the balance between religious adherence and economic viability in Islamic finance.

This paper focuses on Islamic financial institutions worldwide, with a special emphasis on Malaysia. The paper consists of five parts as follows:

- 1- Islamic bank funding sources: Islamic banks rely on two types of funding sources. The first type is internal resources, also known as self-resources, which are generated through banking services funded by shareholders' investments. The second type is external resources, which include various types such as customer deposits and investment accounts.
- 2- The study primarily examines the process of estimating expenditures in the investment pool, specifically with profit calculation and distribution in Islamic banks. While certain banks merge shareholders' money with investors' funds in a unified pool, other banks segregate each fund source into distinct pools. Next, it examined the Malaysian experiment conducted in 2001 on profit distribution. This experiment had three objectives: first of all, establishing the minimal threshold for determining the criteria used in calculating the amount of profit. 2- Ensuring equal opportunities and circumstances in the calculation and distribution of profit. 3- Offering Islamic banks an improved system for assessing profitability and ensuring fairness in the sharing of profits among all parties involved in the contract.
- 3- The study demonstrates the use of Malaysian Islamic financial instruments to minimize the necessity of creating certain reserves in investment pools.

- 4- Alternative recommendations for investment accounts (IAP): The investment account platform (IAP) was established in Malaysia to facilitate genuine economic activities and direct investors towards new possibilities. The institution is backed by various Islamic financial institutions and is anticipated to offer superior long-term profit rates compared to traditional investment accounts.
- 5- The study proposes recommendations to enhance fairness in profit sharing in Islamic banks:
 - 1- One option is to segregate mudharaba deposits from non-mudharaba deposits.
 - 2- Isolate the depreciation of shareholders' assets from the overall cost of the pool.
 - 3- Divide the revenues of the current account into three different parts.
 - 4- Regulatory bodies are required to give guidelines on the appropriate treatment of investors' funds.

The conclusions suggest that Islamic banking is not only a viable alternative to conventional banking but also a pioneering force in ethical finance. The implications extend beyond the Muslim population, offering insights into how financial institutions can integrate ethical considerations into their business models. The review also underscores the potential for Islamic finance to expand its influence in global markets, advocating for more rigorous and standardized regulatory practices to foster this growth. Then, the research concludes that the story lies in Profits are distributed according to shares or agreements, and the adoption of a reserve allowance for profit rate is based on necessity. Therefore, the principle of adopting a reserve profit rate is essentially a temporary measure to alleviate difficulties and hardships. The bank is responsible for providing competitive interest rates based on general need while considering the

opportunities to eliminate the process of creating reserves and provisions which may lead to advanced commitment towards sharia principles.

2.2.3 A proposed accounting approach to measuring and distributing profits in Islamic banks - Ali Abdullah Shaheen, Islamic University of Gazza, 2005.

This research was published in Islamic University Journal 13, v1, p: 297-341, January 2005. This research aims to investigate and analyze the allocation of funds in the Islamic Bank, as well as establish and interpret objective criteria for measuring and distributing profits generated from these funds. This is a significant issue in the Islamic Bank, as it relates to the nature of the contractual agreement governing the relationship with depositors. Due to the mixing of funds received from shareholders and investors, it is necessary to determine how these funds are specifically allocated to investments, and whether they are secured by collateral or not.

The research examines the problem's nature, the factors that influence it, and the associated reasons. It analyzes concepts and rules to establish an accounting framework for measuring and distributing profits in Islamic Banks. The objective is to enhance the efficiency and effectiveness of accounting data in these banks, thereby increasing trust and reliability within the community.

The research problem can be identified as the shortage of current accounting mechanisms to provide a compatible measurement for the calculation and distribution of profit. Therefore, the research focuses on finding a practical framework for profit calculations and distribution.

The research's significance lies in its serious intellectual attempt to build a comprehensive accounting framework for measuring profits in Islamic banks.

This framework is based on sound accounting concepts, assumptions, and principles, while also relying on the foundations and principles of Islamic banking thought. This enables the enhancement of efficiency and effectiveness of the accounting system in these banks, thereby increasing confidence in the work of Islamic banks and reinforcing their role in society. The research relies on descriptive and inductive methods. The descriptive method aims to survey and collect information related to the problem under study, followed by analyzing and interpreting the results to determine their generalizability. The inductive method in this research focuses on formulating the overall framework for the distribution of profits between the bank as a representative of shareholders and depositors from an accounting perspective.

The research was divided into three chapters, the first Chapter discussed the accounting perspective of profit measurement in Islamic banks. Then chapter 2 was about The framework of profit distribution between the bank and depositors. The last chapter introduced an applied model for profit measurement and distribution in an Islamic bank.

The research results initially were:

- 1- suggesting profit measuring methodology, viewed from an accounting standpoint, differentiates and ascertains. The sources of actual earnings that are attributed to the participants involved in the mudharaba contract, such as shareholders or depositors to ascertain the rights of each party.
- 2- The present controls and accounting methods for assessing profits are inadequate for a quantitative assessment of the allocation of earnings among shareholders and depositors in the Islamic Bank.
- 3- An integrated accounting input is essential for measuring and distributing earnings in banks the foundations and principles upon which they are established to attain the goals of impartiality, synergy,

and fairness are derived from the legal principles governing valid financial dealings in the banking industry.

The three literature reviews mentioned have been quite helpful in guiding the research, the reviewed research was Written by esteemed experts and scholars, and these reviews provide a comprehensive perspective on the topic and enhance the understanding of the many complexities and subtleties within the field of Islamic finance and Mudharaba-based profit distribution schemes. Although these evaluations may not have directly addressed the core of the study's topic, they have nevertheless established a solid foundation by exploring relevant themes, theories, and empirical evidence. By placing the research subject within the wider academic conversation, they have highlighted the interconnections between different concepts and offered a detailed framework to frame the topic of research.

Moreover, these literature evaluations have been crucial in emphasizing the importance and applicability of the project that is being conducted. They have emphasized the significance of addressing matters of justice, fairness, and openness in the field of Islamic finance through their detailed study and perceptive observations. They have emphasized the importance of examining current practices and suggesting significant changes by clarifying the ethical and Sharia-compliant foundations that support profit distribution schemes. Furthermore, these literature evaluations have not only clarified the boundaries of the study subject, but they have also provided a guide for traversing the field of the research. By identifying crucial discussions, obstacles, and potential advantages in the discipline, they have offered valuable guidance to direct the research and influence the direction of the study.

These literature reviews have been essential in refining the research focus, improving the analytical approach, and guiding the understanding of the complexities involved in the justice of weight systems in Mudharaba-based profit

distribution. They are more than just intellectual exercises; they are indispensable tools. As to begin the research journey, these assessments will continue to provide valuable insights and knowledge, directing the progress and enhancing the intellectual contributions to the research subject. The literature did not illustrate a real example of how the weights system works, therefore this research attempts to give an example of the weights system's working mechanism.

Chapter Three:

Methodology

3.1 Interviews

3.2 EAH Return

Chapter Three: Methodology

The research is based on qualitative methods, using exploratory and analytical approaches. The research data consists of two parts the first was conducting interviews with experts in the field to get their insights about the weights system and the other part was illustrating an example of Islamic financial institutions' performance regarding their EAH and the share percentage between them, in addition to presenting the average rate of profit achieved for the EAH for the years 2022 and 2023.

3.1 Interviews

The data was collected through four interviews with experts who have experience in Islamic financial institutions, some of them are Sharia supervisory board members, Sharia advisors, and Sharia controllers in various Islamic financial institutions. The interviews consisted of 6 questions which are:

- 1- Taking into consideration both profitability and minimization of risk, is it better for Islamic financial institutions to combine shareholders' and investors' money in one pool to imply justice? Or to separate them into two different pools?
- 2- Does Islamic financial institutions reach the expected ratio agreed with the investor when profit is realized? Or it is given as a gift from shareholders' funds?
- 3- Is it better to have a unified standard from central banks to indicate a mechanism for Islamic financial institutions to invest using the weights system?

- 4- How is justice measured in the banking sector? and is consent between parties considered sufficient proof of justice?
- 5- Does adjusting the expected profit rate based on the interest rate in the market sufficient to imply justice?
- 6- Is it required to have a supervisory role in the calculation and distribution of profit? Such as central bank or external auditor?

There was a total of 4 interviews conducted with experts from 2 segments two of them were Sharia supervisory board members, and two of them were Sharia coordinators in Islamic banks.

The first interview was with Dr. Mohamed Ali Elgari, who was a Former Professor of Islamic Economics at King Abdulaziz University, Jeddah, Saudi Arabia, and Former Director of the Center for Research in Islamic Economics, in the same university as well as a member of numerous Shariah Boards of Islamic Banks and Takaful Companies worldwide. The interview was held on the 27th of April 2023, in Manama, Kingdom of Bahrain.

- 1- Taking into consideration both profitability and minimization of risk, is it better for Islamic financial institutions to combine shareholders' and investors' money in one pool to imply justice? Or to separate them into two different pools?

The Dr. stated that applying the method of mixing both shareholder's and investors' funds into a single pool of funds rather than separate pools is better for all the parties of the contract which are the Islamic financial institutions and their investors.

- 2- Does Islamic financial institutions reach the expected ratio agreed with the investor when profit is realized? Or it is given as a gift from shareholders' funds?

The interviewed Dr. mentioned that there are three cases:

- 1- If the bank reaches the expected profit rate, then it is given to the investors equally as expected.
- 2- If the bank exceeds the expected profit rate, then the investors will receive the expected rate, and then the excess amount of profit is collected in the bank's accounts based on a prior agreement in the contract.
- 3- If the bank does not reach the expected profit rate, then the bank gifts part of its share of profit to the investors to meet the expected rate for them.

- 3- Is it better to have a unified standard from central banks to indicate a mechanism for Islamic financial institutions to invest using a weights system?

Yes, it is better to have a unified standard from central authorities for the benefit of all parties.

- 4- How is justice measured in the banking sector? and is consent between parties considered sufficient proof of justice?

We can agree that committing to Sharia instructions and guidelines is a measurement of justice in the financial sector.

- 5- Does adjusting the expected profit rate based on the interest rate in the market sufficient to imply justice?

No, it does not imply justice and there must be a different method of calculating the expected rate of return.

6- Is it required to have a supervisory role in the calculation and distribution of profit? Such as central bank or external auditor?

Yes, absolutely in addition to the Sharia supervisory board an external governance will enhance the implementation of sharia into financial transactions.

The second interview was with Dr. Fareed Hadi, former Professor of Islamic Economics, at the College of Business Administration, Department of Islamic Banking at the University of Bahrain and Founder of the Bachelor and master's programs in Islamic Banking and Finance at the same university. He is a Board of Trustees Member of the Waqf Fund at the Central Bank of Bahrain and chairman and member of Shari'a Supervisory Boards in several Islamic Banks and Takaful companies. The interview was held on the 7th of May 2024 in Busaiteen, Kingdom of Bahrain.

1- Taking into consideration both profitability and minimization of risk, is it better for Islamic financial institutions to combine shareholders' and investors' money in one pool to imply justice? Or to separate them into two different pools?

Combining the funds into a single pool generates both parties' interest.

2- Does Islamic financial institutions reach the expected ratio agreed with the investor when profit is realized? Or it is given as a gift from shareholders' funds?

Banks reach the expected profit if it was a gift from shareholders. Such practice must get the approval of an annual general meeting or board of directors and sharia supervisory board.

- 3- Is it better to have a unified standard from central banks to indicate a mechanism for Islamic financial institutions to invest using a weights system?

Yes, it is better but there must be flexibility for the bank in determining the system.

- 4- How is justice measured in the banking sector? and is consent between parties considered sufficient proof of justice?

The acceptance from the investor is proof of his consent and the contract is sharia compliant. It must be considered if the client is ignorant of the contract details or misunderstands the contract conditions. If justice is measured by committing to sharia principles, then there must be clear consensus about the sharia principles applicable to this transaction.

- 5- Does adjusting the expected profit rate based on the interest rate in the market sufficient to imply justice?

Yes.

- 6- Is it required to have a supervisory role in the calculation and distribution of profit? Such as central bank or external auditor?

Yes, in case there is a specific standard that must be applicable from the regulatory authority.

The third interview was conducted with Dr. Abdalnasser Al Mahmood, head of Sharia coordination and implementation at Khaleeji Bank, kingdom of Bahrain. He is also a member of Sharia supervisory boards in several institutions inside and outside of Bahrain. The interview was held on the 6th of May 2024 in Manama, Kingdom of Bahrain.

- 1- Taking into consideration both profitability and minimization of risk, is it better for Islamic financial institutions to combine shareholders' and investors' money in one pool to imply justice? Or to separate them into two different pools?

The bank has the right to decide whether to separate or combine the fund in one pool, It was separated originally as shareholders fund and investors fund are in separate pools. It is combined for investment purposes considering the central bank regulations and standard for the limit of investment for each type of account. Then the bank studies the market and decides the weights for each type of account and shareholders' funds. Generally speaking, all the banks apply the separation of funds and combination as well.

- 2- Does Islamic financial institutions reach the expected ratio agreed with the investor when profit is realized? Or it is given as a gift from shareholders' funds?

It depends on the bank's financial performance and its investment activities, if the bank sets the expected rate of profit for the investors based on the actual rate of profit from previous periods, then the bank might achieve it or not. As the bank may achieve the expected rate of profit for some types of accounts while he does not for others, even though he did not achieve the expected rate of profit, the bank will sacrifice part of its profit to achieve the expected rate of profit for investors. It must be mentioned that if the customer keeps their funds for a longer period, then it will raise the stability of these accounts and support the rate of profit achieving progress. So, the two cases happen for banks, either to achieve the expected rate of profit or sacrifice part of the shareholders' profit. And the bank has to do that to maintain the market price. There are regulations regarding the distribution of the profit from central banks, as in the case of

the bank achieving a higher rate of return than expected then it must get central bank approval for either distribution or transfer of the surplus into reserves and allocations, taking into consideration the reserves for future investments.

- 3- Is it better to have a unified standard from central banks to indicate a mechanism for Islamic financial institutions to invest using a weights system?

No, there cannot be a single standard, because there might be better and more justiciable mechanisms to follow. While there must be guidelines for the banks to work within. The main point is to have multiple mechanisms rather than a standard that provides justice for both parties of the contract.

- 4- How is justice measured in the banking sector? and is consent between parties considered sufficient proof of justice?

Achieving justice is a relative concept that cannot be achieved 100%, but the main purpose is to achieve the maximum level of equity and equality to achieve investor satisfaction without any exploitation. To achieve that there must not be any prejudice for investing shareholders' funds in the high return project, rather than equality in the investment opportunities. Although the regulations may forbid the bank from investing the investor's funds in some projects and opportunities based on their risk level. Such equality is logical and reasonable because the investor's fund is much higher than the shareholder's fund, as it is in some institutions could be three times or five times the shareholder's fund or even higher. So, it is the main resource of profit for the institution. There must be collaboration between the Islamic financial institutions and governmental agencies and authorities to utilize the investment in a way of enhancing the country's economy. There must be a platform that helps this purpose between the

governmental and private sectors to fulfill the investment goals for both sectors.

- 5- Does adjusting the expected profit rate based on the interest rate in the market sufficient to imply justice?

The rate in the market is the interest rate, and the Islamic financial institutions set their expected rate based on it. There are points to be considered in this practice one of them is that the central bank restricts Islamic financial institutions from committing to it and any surplus to that cannot be distributed to investors because it will exceed the market rate. The issue arising here is that Islamic financial institutions cannot be compared to conventional institutions because they work oppositely. Conventional institutions have a sole investment product which is accepting deposits and giving loans based on interest, while Islamic financial institutions have multiple products that vary in nature. So, there must be equality between different systems and the conventional should not be the origin that Islamic financial institutions must follow. Therefore, there must be an independent benchmark for Islamic financial institutions to follow rather than the interest rate of the market.

- 6- Is it required to have a supervisory role in the calculation and distribution of profit? Such as central bank or external auditor?

It exists today in several countries and it is applicable today by the Abu Dhabi Central Bank.

The fourth interview was with Dr. Hamad Farooq Alshaikh, Head of Sharia Coordination and Implementation and Sharia supervisory board secretary at

Bahrain Islamic Bank, Kingdom of Bahrain. The interview was on the 6th of May 2024 in Manama, kingdom of Bahrain.

- 1- Taking into consideration both profitability and minimization of risk, is it better for Islamic financial institutions to combine shareholders' and investors' money in one pool to imply justice? Or to separate them into two different pools?

Justice can be achieved in either system as long as there are controls, standards, and legal and credit bases, and perhaps mixing shareholders' funds with depositors will achieve greater benefit for depositors, as well as a higher level of caution due to the bank's keenness on the mixed account because the shareholders' accounts are located in it.

- 2- Does Islamic financial institutions reach the expected ratio agreed with the investor when profit is realized? Or it is given as a gift from shareholders' funds?

There is no general rule in this regard, some banks may reach the expected rates and distribute them without having to gift them, while some banks may not reach these percentages due to the high cost of financing they have, which forces them to increase those profits through donations provided by shareholders to equalize profit with the market price.

- 3- Is it better to have a unified standard from central banks to indicate a mechanism for Islamic financial institutions to invest using a weights system?

This question can be answered by financial professionals more accurately, but certainly, a standard that sets the foundations and general controls for these weights will be better while allowing space for banks to diligence and innovation and consider their reality and solvency.

- 4- How is justice measured in the banking sector? and is consent between parties considered sufficient proof of justice?

Contracts signed between the bank and customers may be considered within the compliance contracts, but due to the presence of a supervisory body such as the Central Bank, Sharia boards, and others, compliance contracts remain valid, realistic, and suitable for everyone, and the customer's signature on the terms and conditions or contracts is evidence of consent because he signed the bank's choice and the type of investment. As for achieving justice, there is no absolute justice, but it is relative justice as much as possible in proportion to all parties and considering reality and economic and other conditions. I believe that equity in the distribution of profits should be as measured and controlled as possible and human interventions should be minimized.

- 5- Does adjusting the expected profit rate based on the interest rate in the market sufficient to imply justice?

This method may be one way to achieve relative justice, but other things such as the bank's position, the number of customers, and the type of investment should also be considered, as the investment may make a higher profit while the bank provides a lower profit rate due to market consideration.

- 6- Is it required to have a supervisory role in the calculation and distribution of profit? Such as central bank or external auditor?

Certainly, there must be an effective supervisory role by central banks on the one hand, as well as by internal audit departments and external audit companies, in addition to Sharia supervision represented by Sharia

supervisory boards and their internal bodies (Sharia compliance and internal Sharia audit) in addition to external Sharia audit.

After conducting the interviews, here is the researcher's insight:

There have been varying viewpoints on several topics based on the perspectives and impressions of each individual interviewed. Regarding the first inquiry on whether to combine or segregate the shareholder's and investors' funds, the prevailing consensus favors combining both funds into a unified pool, which is advantageous for both parties. The researcher fully supports the choice to combine, as it results in mutual benefits for both sides, maximizing profit and a higher likelihood of achieving justice.

The second concern pertains to the performance of Islamic financial institutions, namely whether they can attain the expected rate of profit as outlined in the contract, or if they must allocate a portion of their share of profit to meet the desired outcome. Typically, there are two possible scenarios, with a third one being rather uncommon. In this uncommon situation, the bank achieves the precise predicted return for the investors and thereafter distributes it to them. Either the bank surpasses or falls short of the predicted outcome in both circumstances. In both scenarios, the bank will allocate an equal portion of the anticipated profit from the contract, while any excess will be retained by the bank as a result of their successful performance as *mudharib*. Conversely, if there is a shortfall, the bank will relinquish a portion of its share to the investors. The researcher contends that there is a need for more precise criteria to achieve the anticipated rate of return for investors while ensuring that no part of their profit is compromised. Islamic financial institutions, with over 50 years of experience in dealing with *mudharaba*, should possess sufficient expertise to effectively handle this situation using the weights system.

The third question in this interview, consisting of six questions, was the establishment of a uniform criterion by central banks to facilitate the investment of Islamic financial institutions through a system based on weights. The interviewee expressed enthusiasm for implementing a structured approach to the weights system, whether through guidelines or a mechanism that establishes a framework for its usage. This approach would provide each institution with the ability to apply the framework. The researcher supports this viewpoint and suggests that the weights system should be established by recognized issuing authorities or regulatory bodies to govern the implementation of this system in Islamic financial institutions, thereby ensuring the presence of flexibility in its application to promote competitiveness in the market.

The fourth question which consisted of two parts pertained to the measurement of justice within the financial system and the possibility of establishing a method for its measurement. The second half of the question focused on the significance of consent between contractual parties, specifically examining its inclusion in a fair and unbiased manner and its effectiveness in attaining justice. The respondent regards adherence to Sharia principles as a manifestation of fairness; however, the implementation of Sharia regulations may vary across different institutions. The customer's acceptance of the contract is an indication of their consent. Justice is a relative term that differs from person to person. As a result, it is not possible to establish a precise measurement of justice. These contracts, which may be seen as compliance contracts, can raise concerns regarding the consent of investors. However, they are approved by central banks and the Sharia supervisory board to ensure their adherence to Sharia rules.

Question five pertains to the adequacy of linking the expected profit rate to the market interest rate in achieving justice. The respondents' opinions on this matter were inconclusive, with some believing that it did not accomplish justice, while others deemed it to achieve justice to some extent. The suggestion calls for

applying a benchmark specifically designed for Islamic financial institutions, rather than relying on the market rate. This is because Islamic financial institutions have certain characteristics that set them apart from conventional ones. The researcher argues that central banks and regulatory agencies should implement segregation in the handling of Islamic and conventional financial institutions. This is because each kind of organization requires a specific benchmark that aligns with its unique characteristics.

The last question of the interview was about the need for the supervision of a central bank or external auditor in the process of calculating and distributing profit. The respondents were conclusive about this role of supervision as it must be applied by the regulatory authority such as the central bank or by the external auditor or sharia supervisory board.

3.2 EAH Return

The Islamic financial institutions that apply the weights system may or may not reach the expected rate of profit for the investors, therefore the research tracked the performance of some of them to get a clear vision about their capability of achieving the expected rate in the past year. A sample of 4 Islamic financial institutions was taken to demonstrate the application of the weights system in the Islamic financial institutions in the kingdom of Bahrain, the demonstrated information is the return of Investors as EAH and the bank share as mudharib and the ratio between mudharib and capital provider (EAH and Bank) and another data as if the bank announced the achieved rate of profit for their clients in their financial system. The data was for the years 2023 and 2022 and per the institution's financial statements.

Table 3: EAH return and bank return 2023

Institution name	Return for EAH before bank share ⁴⁸	Bank share	EAH return after deducting bank share	Bank to EAH share ratio ⁴⁹	The average rate of profit for EAH
Salam Bank - Bahrain	168,658	68,571 ⁵⁰	100,087	40:60	3.6%
Kuwait Finance House – Bahrain	8,973	7,992	981	88:12	1.44%
Bahrain Islamic Bank - Bahrain	20,613	18,083	2,530	87:13	N/D ⁵¹
Khaleeji Bank – Bahrain	28,364	6,806	21,558	24:76	N/D

Table 4: EAH return and bank return 2022

Institution name	Return for EAH before bank share ⁵²	Bank share	EAH return after deducting bank share	Bank to EAH share ratio ⁵³	The average rate of profit for EAH
Salam Bank - Bahrain	110,403	62,412	47,991	57:43	2.4%
Kuwait Finance House – Bahrain	9,343	8,107	1,236	87:13	1.13%

⁴⁸ Bank's share as mudharib or wakil - all amounts are in millions

⁴⁹ Bank share as mudharib and EAH as capital provider

⁵⁰ Alsalam bank take its share as mudharib and wakeel

⁵¹ It either nondisclosed or the researcher could not obtain it

⁵² Bank's share as mudharib or wakil - all amounts are in millions

⁵³ Bank share as mudharib and EAH as capital provider

Bahrain Islamic Bank - Bahrain	23,362	19,306	4,056	83:17	N/D
Khaleeji Bank – Bahrain	29,862	15,517	14,345	52:48	N/D

The table shows the return between equity account holders who are considered capital providers and the bank is considered mudharib, the contract governing their relationship is mudharaba and hereby the elements of mudharaba exist. The profit-sharing ratio between mudharib and the capital provider is clear as per mudharaba contract validation requirements. The last column of the table shows the average rate of profit distributed to all equity account holders (investors) of all account types in the institution. Such data was derived from the financial statement of the institution. The data show differences in the profit-sharing ratio between the institution and their client which represents the freedom of each institution in determining its weightage policy. While there was not a clear disclosure of the weights of each type of account or even the whole equity account holders' accounts. The data shows consistency in each institution's numbers, which represents how the institution established its relationship with its equity account holders.

Chapter Four:

Results and Recommendations

4.1 Research Results

4.2 Research Recommendations

Chapter Four: Results and Recommendations

The research titled: Justice of weights in the profit distribution for mudharaba based accounts in Islamic financial institutions. The research discussed mudharaba in Islam, and then how it is applied in Islamic financial institutions. The concept of justice was clarified among the consent between contracting parties. After that, the investment pools were illustrated to get into the main topic of the research which is the weights system. The researcher interviewed experts in multi-Islamic financial institutions to get their insights about the system and here are the results and recommendations of the research.

4.1. Research Results

After investigating the justice application in the profit calculation and distribution in Islamic financial institutions, this research reached some findings as follows:

- 1- Mudharaba is the basis for establishing Islamic financial institutions and it is driven by Sharia rules written in the Quran and Sunnah.
- 2- Islamic financial institutions have developed new types of mudharaba to meet the financial needs of the institutions and their investors.
- 3- The joint mudharaba is a developed form of mudharaba driven by its rules from Sharia rules from different scholars' opinions.
- 4- Among the most important mudharaba rules applicable in those contracts are:
 - 4-1- The permissibility to have multiple mudharibs work for the same capital provider.
 - 4-2- The permissibility to have multiple capital providers dealing with the same mudharib.

- 4-3- The permissibility for mudharib to combine his funds with capital provider funds.
- 4-4- The permissibility to assign any profit-sharing ratio between the parties as long as it matches their consent.
- 5- The Islamic financial institutions are linked with the market interest rate which does not pursue the Islamic rules as the regulatory authorities treat Islamic financial institutions like the conventional where their nature is different which may lead to breaks of Sharia rules.
- 6- The weights system is a system developed to meet the requirement of Islamic financial institutions and their EAH investment targets.
- 7- The weights system is compatible with Sharia rules and approved by multiple Sharia supervisory boards and central Sharia boards and fatwa committees.
- 8- It is permissible for institutions to set different weights of profit for different EAH (investors).
- 9- The weights system mechanism is not unified among financial institutions and must be more clarified to EAH, especially the weightage of investment in every type of account.
- 10- The profit-sharing ratio and the investment weightage vary from one Islamic financial institution to another based on each institution's standard and operating strategy.
- 11- The weight system has been applied for several years between the institutions and their EAH without assured complaints as justice is satisfied in the weight system on the condition that it meets Sharia rules, while the applicable Sharia rules may differ between institutions according to their Sharia supervisory board.
- 12- In some jurisdictions, the central banks supervise the calculation and distribution of profit using a weight system and the external auditor is in charge of auditing the use of the weight system.

- 13- The customer's expected rate of profit is always achieved either by the performance of the institution or by a scarification from the shareholder's profit. Therefore, there might be in the EAH perspective some kind of guarantee in the profit distribution if it is always given to them even if the institution did not achieve it, as a guarantee of profit nullifies the mudharaba contract.

The research was conducted to answer this question: Does reliance on weights as a fair system in distributing profit in Mudharaba-based deposit accounts between the Islamic Bank and its customers provide justice for both parties of the contract?

After investigating the weights system and its application in Islamic financial institutions and its compatibility with Sharia rules and determining justice and the measurement of it in the financial sector, the researcher believes that the weights system is achieving relative justice based on the EAH consent when they signed their contract with the institution. However, the researcher recommends having more transparency and disclosures about the weightage of each account type in Islamic financial institutions.

Based on the main research question, other subordinate questions needed answers and it was answered through the research where the concept of justice in Islam was clarified and the measurement of it in the financial sector is the commitment to Sharia rules while there must be clear agreement on the applicable sharia rules to ensure justice. The applicable system in determining profits for customers in various financial institutions is the weights system and the current system in Islamic financial institutions is achieving relative justice. And any condition in the contract agreed upon by the parties is proof of their consent. Therefore, consent is sufficient to adopt the weights system or other system in the calculation and distribution of profit.

4.2. Research Recommendations

After discussing the results of this research, there are several recommendations to be mentioned as follows:

- 1- There must be more studies on the weight system and its sufficiency to imply justice in the calculation and distribution of profit in Islamic financial institutions.
- 2- A vivid representation is necessary for clarifying the operational mechanism of the weight system.
- 3- There should be studies conducted to provide a uniform framework for the weights system by the standards and regulation authorities. This framework should also ensure the freedom of Islamic financial institutions.
- 4- Transparency and disclosure are required regarding the applicable weightage of investment during the investment period in the financial statement of Islamic financial institutions.
- 5- There must be a benchmark for Islamic financial institutions' expected rate of profit for their EAH, rather than depending on the current market interest rate.
- 6- Islamic financial institutions and related governmental authorities should increase awareness about the banking products and provide specific workshops for whom is interested in details of the products such as mudharaba-based products that use a weights system.
- 7- The risk associated with the investment must be taken into consideration for the expected rate of profit rather than depending on the investment amount and the period.
- 8- There must be more innovation to create more sufficient products that provide justice for the institutions and their investors (EAH).

- 9- In case the institutions fail to achieve the expected rate of profit for their clients, they must inform the EAH of the sacrificed part of their profit or state it in their financial reports.
- 10- Ensuring the absence of a promise for the anticipated rate of profit is necessary to avoid a guarantee of profit.

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Appendices:

The conducted interviews framework:

Research Topic: Justice of weights in calculating profits for mudharaba-based accounts in Islamic financial institutions

Research problem: The problem of the study is there is a probability that the desired justice is not achieved through using the weighting system and the need to work on developing the mechanism of approval and distribution of profits in Islamic financial institutions.

The research topic was dealt with on several topics:

- The concept of justice in Islam
- The system of work of investment pools in Islamic banks
- The mechanism of work of the system of weights in the calculation and distribution of profit.

Questions:

- 1- Taking into consideration both profitability and minimization of risk, is it better for Islamic financial institutions to combine shareholders' and investors' money in one pool to imply justice? Or to separate them into two different pools?
- 2- Does Islamic financial institutions reach the expected ratio agreed with the investor when profit is realized? Or it is given as a gift from shareholders' funds?
- 3- Is it better to have a unified standard from central banks to indicate a mechanism for Islamic financial institutions to invest using a weights system?
- 4- How is justice measured in the banking sector? and is consent between parties considered sufficient proof of justice?
- 5- Does adjusting the expected profit rate based on the interest rate in the market sufficient to imply justice?
- 6- Is it required to have a supervisory role in the calculation and distribution of profit? Such as central bank or external auditor?

المخلص

تبحث هذه الدراسة عدالة توزيع الأرباح في المؤسسات المالية الإسلامية من خلال تطبيق نظام الأوزان. تهدف إلى تقييم ما إذا كان نظام الأوزان يحقق العدالة بفعالية في حساب وتوزيع الأرباح بين المؤسسة وعملائها في العقود القائمة على المضاربة. تتضمن أسئلة البحث ما إذا كان الاعتماد على الأوزان كنظام عادل في توزيع الأرباح في حسابات الودائع القائمة على المضاربة بين البنوك الإسلامية والعملاء يوفر العدالة لكلا طرفي العقد. كما تبين الدراسة مفهوم العدالة في الإسلام وكيفية قياسها في القطاع المصرفي. تركز هذه الدراسة بشكل حصري على الحسابات القائمة على المضاربة داخل المؤسسات المالية الإسلامية بينما تستبعد الحسابات غير المستندة إلى المضاربة. الإطار النظري يتكون من ثلاثة مكونات: المضاربة في الإسلام والنظام المالي، العدالة والرضا بين الأطراف، والأوعية الاستثمارية ونظام الأوزان في المنظمات المالية الإسلامية. استخدمت الدراسة مناهج نوعية، وهي النهج الاستكشافي والتحليلي، لجمع رؤى حول نظام الأوزان في المؤسسات المالية الإسلامية. تم جمع البيانات من خلال مقابلات مع متخصصين من مختلف المؤسسات المالية الإسلامية. أحد النتائج الرئيسية للدراسة هو وجود العدالة في تطبيق نظام الأوزان، والذي تدعمه الهيئات الشرعية الرقابية في المؤسسات المالية الإسلامية وعدة لجان فتوى، وكذلك معايير الشريعة الصادرة عن هيئة المحاسبة والمراجعة للمؤسسات المالية الإسلامية (أيو في). علاوة على ذلك، يجب أن يكون نظام الأوزان مفصلاً من قبل الجهات المعنية مثل المؤسسات المالية الإسلامية (IFIs) والهيئات التنظيمية كالمصارف المركزية. تقترح الدراسة تعزيز الشفافية والإفصاح عن الأوزان المعتمدة في المؤسسات المالية الإسلامية، وتوفير إطار عمل من قبل المؤسسات الرقابية لنظام الأوزان يعزز العدالة ويضمن استقلالية المؤسسات المالية الإسلامية.

جامعة البحرين



قسم الصيرفة الإسلامية

كلية إدارة الأعمال

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