

Financial reporting differences of profit and loss sharing investment deposits in Islamic banks:  
A cross-country study

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## 1. Introduction

Today, Islamic finance represents a small but growing segment of the global finance industry estimated at 1% to 2% of the global financial assets worldwide. The market size of Islamic finance assets held under Islamic finance is estimated at US\$1.7 trillion suggesting an annual growth of 17.6% over the last four years. Besides, Islamic finance also represents more than 300 Islamic banks & windows that are present in at least 60 countries and more than 750 Islamic funds worldwide with assets under management of more than US\$60 billion (Deloitte).

Investment deposits customers of the Islamic bank are different from the conventional bank investment deposits customers. Islamic banks are based on profit and loss sharing venture or partnership and the conventional banking is based merely loans given to the bank which needs to be returned by the bank with periodic interest payments. Investment deposit of Islamic bank's customer considered as an equity holder of the bank who requires a transparent and fair financial reporting for decision making regarding his or her investment. These investment deposits customers are quasi-equity investment holders of the banks. The equity investment investor's money is used for financing the project (asset side) together with stockholders funds in order to earn profit or return.

In general, Islamic banks maintain three types of deposits as conventional banks specifically current account or demand deposit, savings account, and investment deposits. Current account deposits of the customers are considered as a liability by Islamic banks as they need to be returned whenever demanded. The current account is marinated by Islamic banks based Al Wadia contract or Qard Al Hassan. According to the Al Wadia contract, the money deposited by the customers is considered as safekeeping. If the Islamic banks use Qard Al Hassan contract for deposits then it considered as interest- free loan given by the depositors to the Islamic bank. Islamic bank does not need to pay any returns to the current account holders. The accounting treatment for current account is not an issue for Islamic bank as it is placed under the liability in the statement of financial position same as conventional banks do.

Conventional banks receive fixed- term deposit from the customers and investment deposit customers are paid fixed periodic interest rate with guaranteed principle. Therefore, the

relationship between the conventional banking customers and the conventional bank with regard to the investment is considered as borrower and lender relationship.

Customers invest in the Islamic bank's fixed term deposit accounts expecting a periodic return for their investment as conventional banking customers but the periodic returns or principal at the maturity is not guaranteed in an Islamic bank. Besides, the customer's investment in Islamic banks are considered as an equity investment based on trust contract and the return or principle is not guaranteed. Most of the time, Islamic banks offer the fixed term deposit investment accounts based on Mudarabah contract. Mudarabah contract is based on a joint venture between the financier and the manager or working partner.

In Mudarabah investment deposits of Islamic banks, the depositors are considered as investors and the bank is the fund manager or working partner. Both parties share the profit and according to the agreed ratio. Therefore, the Mudarabah investment depositors need to be considered as Financier or Fund provider and Islamic bank is the working partner or fund manager. The relationship between the Islamic bank and customer is basically a joint venture or a partnership.

In the statement of financial position of the Islamic banks, the equity investment should not be disclosed as a liability as conventional banks, since their relationship with the Islamic bank is based profit and loss sharing as stockholders. The disclosure of fixed term or equity investment in the statement of financial position should be different from the conventional bank's disclosure of fixed term deposits.

Sunadi(2017) mentioned that the accounting dilemma arises from PSIA's (Profit Sharing Investment Account) partly sharing the characteristics of liability, and partly those of equity. It is widely known that "conventional" accounting only explicitly mentions two classifications of elements on the right-hand side of the statement of financial statements: the claim of creditors or lenders on the company's assets is shown as liabilities, while shareholders' equity represents the company's net assets that belong to the shareholders.

All the Islamic banks are facing the problems of disclosing the Mudarabah investment account in the statement of financial position since it can be neither considered as debt nor equity as this account have characteristics of both debt and equity partially.

*The research aims to examine how the Mudarabah investment accounts are classified and disclosed in financial statements of Islamic banks across different regions and countries and to investigate the reasons for the differences in classification and what are the other Islamic contracts used by Islamic banks for investment deposits. Further, this research also investigates the disclosure of Profit smoothing reserve and Investment risk reserve in the Islamic bank.*

The paper has used the term Mudarabah investments to represent all the profit and loss sharing investment fixed deposits of the customers including both the restricted or unrestricted investment. Some journal papers and authors have referred the customer's investment deposits as profit sharing investment account (PSIA) which can include Mudarabah, Musharakah and, Murabaha contract. Since this research is purely about the Mudarabah investment deposits by the customers, the term Mudarabah Investment has been used throughout the paper.

This research paper has been divided into five sections. Background and research objectives have been discussed in the first section. In the second section, previous studies on disclosure of Mudarabah investment are discussed. The third section describes the research methodology and

followed by data analysis in the fourth section. The last section concludes the research with recommendation and implication.

## 2. Literature review

The principles guiding Islamic banks are significantly different from those for conventional banks. Islamic banks are organized under and operate upon principles of Islamic law (the Sharia) which requires risk sharing and prohibits the payment or receipt of interest (riba). In contrast, conventional banks are guided mainly by the profit maximization principle. If the differences between the two types of banks are not just semantic (as some critics of Islamic finance have maintained), Islamic and conventional banks should be distinguishable from one another on the basis of financial information obtained from company balance sheets and income statements. However, since all banks operate in the same competitive environment and are regulated in the same way in most countries, it is possible that Islamic and conventional banks display similar financial characteristics (Olson and Zoubi, 2008).

On the assets side, Islamic banks have more choice of instruments with different maturities and risk-return profiles. For short-term maturities, trade financing or financial claims resulting from a sales contract—that is, *Murabahah*, *salaam*, and so forth—are available. For medium-term investments, leasing (*Ijarah*), manufacturing contracts (*Istisnah*), and various partnerships are possible; for long-term investments, partnerships in the form of *Musharakah* can be undertaken. An Islamic financial intermediary may also engage an external entrepreneur on a *Mudarabah* basis in which the bank acts as principal and the entrepreneur (user of the funds) acts as agent. (Van Greuning and Iqbal, 2008).

The Islamic banks receive sources of funds from the liabilities such deposits and Sukuk (Islamic bond), equity investments and stockholders funds in order to finance the assets side of the balance sheet. Unlike the conventional banks, investment deposits of Islamic banks are based on the partnership where both Islamic bank and equity holders share the profit and loss. These equity investments products are structured based on *Mudarabah* contract.

*Mudarabah* is an equity trust contract where the owner of the capital will be financing the project or venture and the other party will be a working partner who will run the business, project or venture. Both parties will be sharing the profit according to the agreed ratio. When there is a loss in the in the venture, project or business, the financier or owner of the capital will losses the capital while the working partner losses his or her time and effort.

According to one of the leading scholar in Islamic finance Taqi Usmani (2001), *Mudarabah* is a special kind of partnership where one partner gives money to another for investing it in a commercial enterprise. The investment comes from the first partner called "Rabhu-UI-Mal" while the management and work is the exclusive responsibility of the other who is called "Mudarib".

According to AAOIFI's Shari'ah Standards (2015), Sharia standard No.13. *Mudarabah* is a partnership in profit whereby one party provides capital (Rab al-Mal) and the other party provides labor (Mudarib). Further, the section 4/4 of standard No. 13 states that "A *Mudarabah* contract is one of the trust-based contracts. Therefore, the Mudarib is investing *Mudarabah* capital on a trust basis in which case the Mudarib is not liable for losses except in case of breach of the requirements of trust, such as misconduct in respect to the *Mudarabah* fund, negligence

and, breach of the terms of Mudarabah contract. In committing any of these, the Mudarib becomes liable for the amount of the Mudarabah capital.

Equity investment account depositors of Islamic banks are Raab al Maal (Owner of the capital) and the bank acts as Mudarib (working partner). The return for the capital invested in the asset of the Islamic bank is shared between the equity investment depositor and the bank based on the agreed ratio which is decided when the investors open the investment account in an Islamic bank. The equity investment depositor loses his or her capital if there is a loss in the project, venture or business and the bank loses its time and effort unless if the bank did not involve in any misconduct or negligence.

The Mudarabah investments are divided as restricted Mudarabah investment and unrestricted Mudarabah investment. When the customers open the account the customers are given the option to select either investment in restricted or unrestricted Mudarabah investment deposits. The restricted Mudarabah investment allows the Islamic banks to invest the funds in specific project or industry mentioned by the customer or bank at the time of the opening the account. The Islamic bank is not allowed to invest restricted investment deposit in any other investment other than specified in the contract. The unrestricted investment gives the Islamic bank freedom to invest in any projects or amalgamate with bank's common fund for financing project.

Further, AAOIFI's Shari'ah Standards (2015), No 13 classifies Mudarabah investments as unrestricted and restricted Mudarabah investment. Section 5/1 of Standard No 13 states that an unrestricted Mudarabah contract is a contract in which the capital provider permits the Mudarib to administer a Mudarabah fund without any restrictions. In this case, the Mudarib has a wide range of trade or business freedom on the basis of trust and the business expertise he has acquired. An example of unrestricted Mudarabah is when the capital provider says, "Do business according to your expertise". However, such unrestricted business freedom in an unrestricted Mudarabah must be exercised only in accordance with the interests of the parties and the objectives of the Mudarabah contract, which is making a profit. Therefore, the actions of the Mudarib must be in accordance with the business customs relating to the Mudarabah operations: the subject matter of the contract.

Section 5/2 of Standard No 13 states, A restricted Mudarabah contract is a contract in which the capital provider restricts the actions of the Mudarib to a particular location or to a particular type of investment as the capital provider considers appropriate, but not in a manner that would unduly constrain the Mudarib in his operations. Most of the Islamic banks offer this restricted and unrestricted investment deposit as fixed term deposit with the maturity of 3 months, 6 months, 12 months and 5 years same as conventional banks.

## **2.1 IASB and AAOIFI**

International Financial Reporting Standards (IFRS) are a set of accounting standards that govern how particular types of transactions and events should be reported in financial statements. They were developed and are maintained by the International Accounting Standards Board (IASB). IFRS are now used by more than 100 countries, including the European Union and by more than two-thirds of the G20 (CFA Institute).

AAOIFI, established in 1991 and based in Bahrain, is the leading international not-for-profit organization primarily responsible for the development and issuance of standards for the global

Islamic finance industry. It has issued a total of 100 standards in the areas of Shari'ah, accounting, auditing, ethics and governance for international Islamic finance. It is supported by a number of institutional members, including central banks and regulatory authorities, financial institutions, accounting and auditing firms, and legal firms, from over 45 countries. Its standards are currently followed by all the leading Islamic financial institutions across the world and have introduced a progressive degree of harmonization of international Islamic finance practices (AAOIFI).

## **2.2 Accounting treatment for Mudarabah Investments Deposits**

The inherited debt and equity features of Mudarabah investment have complicated the Islamic bank's disclosure in the financial statement. The theories of Islamic finance concludes that since Mudaraba equity investment is based on profit and loss sharing should not be disclosed as the liability and also it cannot be disclosed as stockholders equity since the Mudarabah investment holders are not the real owners of the Islamic banks. It should take the intermediary position between liability and equity. In practice, not many Islamic banks have disclosed the Mudarabah investment between the liability and stockholders equity. Atmeh *et al.*, (2012 ) explained that the Mudarabah as an important contract in Islamic bank imposes accounting challenges when disclosing Unrestricted Investment Account in the statement of financial position. Wibowo *et al.*, (2013) argued that the business model of the Islamic bank is to invest deposits and share the profit with the holders and that the bank is not obliged to repay these amounts in case of loss; hence, equity classification for UIAHS is more appropriate.

As interest-bearing deposits are not permitted by the rules and principles of the Islamic Shari'ah, Islamic banks typically raise deposits in the form of profit-sharing investment accounts. These accounts differ from conventional deposits not merely by virtue of the profit-sharing nature of the returns they offer, but also because the contract between the depositors and the bank is not a debt contract, and the deposits are in consequence, not 'capital certain' (that is, the depositors are required to accept negative returns or losses). This latter characteristic leads to serious regulatory problems in jurisdictions where bank deposits are required by legal definition to be 'capital certain'. More generally, the presence of such 'puttable instruments' in the capital structure of Islamic banks leads to complications in assessing their capital adequacy. In addition, the fact that the profit-sharing investment account holders are a type of equity investor without the governance rights of either creditors or shareholders raises a major problem of supervision (Archer and Karim, 2009)

AOIFIs revised Accounting Standards on FAS No. 27 with effect from 1<sup>st</sup> January 2016, on Investment Account, "Equity of on-balance sheet investment accountholders shall be presented as an independent category in the statement of financial position of the Islamic Financial Institution between liabilities and owners' equity."

## **2.3 Profit smoothing and Investment Risk Reserves**

One of the major challenges faced by Islamic bank regarding the Mudarabah investment deposit is displaced commercial risk due to the lower rate of return. There is not much literature have discussed the relationship between the Mudarabah investment and displaced commercial risk. According to Hichem and Hamza (2016), the displaced commercial risk, related to the loss of competitiveness and the lack of liquidity, is due to a greater uncertainty regarding the investment

deposit return. This can occur when during a period of time; the actual rate of return is lower than returns expected by the IAH or return offered by the other banks.

Van Greuning and Iqbal (2008) mentioned that the experience gained from the attempt to mitigate displaced risk has led to the development of two standard practices in the industry. The first practice is for the financial institution to maintain a profit equalization reserve (PER). This reserve is funded by setting aside a portion of gross income before deducting the bank's own share (as agent). The reserve provides a cushion to ensure smooth future returns and to increase the owners' equity for bearing future shocks. Similar to PER, an investment risk reserve (IRR) is maintained out of the income of investors-depositors after allocating the bank's share, in order to dampen the effects of the risk of future investment losses.

Most of the investment deposits in the Islamic banks are based on Mudarabha contract. The profit smoothing technique of PER and IRR is related with the Mudarabah Investment account. Accordingly, both these IRR and PER gained significance and their disclosure is important for the equity investment holder according to the fair view of accounting principles. The literature on practice and disclosure of profit smoothening techniques such as PER and IRR are few and not many discussion has been done on this part.

#### **2.4 Previous studies on Mudarabah investment disclosure**

Few attempts have been made to investigate issues of the disclosure of Mudarabah based investment deposit in the financial statements. Zainab and Ysserie (2009) studied Malaysian banking practice regarding disclosure of Mudarabah investment deposit in the balance sheet. This studied tried to study the difference between the recommendation of AAOIFI and practice of Malaysian Islamic banks. The study reveals that AAOIFI recommendations are not followed by Malaysian Islamic Banks. This is a qualitative analysis focusing only Malaysian Islamic banking industry.

Atmeh *et al.*, (2012), examined the accounting treatment for the Mudarabah contract by comparing AAOIFI accounting standards with other financial reporting frameworks. This paper has established that in practice Mudarabah investment disclosure imposes challenges in presenting the position of Mudarabah investment and related provisions and reserves. The study has compared AAOIFI with IFRS financial reporting framework regarding their reliability and fairness of financial statements. This study has analyzed the problem from the theoretical point of view and disclosure practices have not been discussed.

Rosman *et al.*, (2015), investigated the available different options on the reporting of Mudarabah contracts based profit sharing investment account (PSIA). The research has established that PSIA needs to be reported as liability or quasi-equity. Suandi (2017), surveyed the classification of profit sharing investment account (PSIA) with a sample of 63 Islamic banks from South East Asia, South Asia, and West Asia. Results show that heterogeneity of classification for the profit sharing investment account.

### **3. Methodology**

Accounting and financial reporting standard setters and capital market regulators of a country play the major role in the disclosure of the financial statement of public companies at the interest of public thus, the disclosure of Mudarabah investment account of Islamic banks also affected by the decision of these influencers. The existence of Islamic bank all the continents, it was decided

to include the samples from all the regions including Africa, Europe, Middle East, Central Asia, South Asia and South East Asia due to differences in regulation of different regions. In some of the Middle Eastern countries, it is mandatory to adopt Islamic financial standards such as AAOIFI by the regulators. Therefore, it is important to study all the regions regarding the disclosure requirement for Mudarabah Investment to conclude the research. The relevant data was gathered from fifty fully- fledged Islamic banks from all the continents except for Australia and America. Samples from Australia and America were not taken due to either non-availability of the bank or the relevant data in their financial statement. There are few Sharia-compliant Islamic investment companies operating in North America and Australia but omitted as the research focus on fully-fledged Islamic banks.

A maximum of two to three Islamic banks was selected for the samples where Islamic banking industry highly developed and the researcher has decided that samples of two to three banks are sufficient to make the conclusion regarding the entire Islamic banking industry of the country.

The data has been collected from the annual report of the Islamic banks at least for a year from 2016 and to make sure the data is the latest. Bank's website was also accessed to cross-check the investment products that are mentioned in the financial reports are based on Mudarabah. The following information was extracted from the financial statements;

- a. Accounting and financial reporting standards followed by the country and the bank
- b. Disclosure of Mudarabah Investment account in the statement of financial position
- c. Disclosure of profit smoothening ratio and Investment risk reserve.

#### **4. Analysis and findings**

The analysis of fifty banks studied in the research has concluded there are major differences in the disclosure of Mudarabah investment in the Islamic bank and reason is due to the difference in the adaptation of Accounting and financial reporting standards of the regulators. Few banks have been identified which are making profit smoothening reserve and investment risk reserve. Further, there are some Islamic contracts also used by Islamic banks for investment deposits.

##### **4.1 Classification of Mudarabah Investment Account in Islamic banks**

The analysis of fifty banks studied in the research has concluded as in figure 1, the Mudarabah investment has been classified and disclosed into six different methods in the statement of financial position. Figure 2 describes individual bank classification of Mudarabah investments.

The first category of classification is an intermediary item between liability and stockholders' equity as a third-party fund. Two Indonesian Islamic banks examined have disclosed as third-party fund between liabilities and stockholder equity. The banks did not differentiate restricted and unrestricted investment account.

The second category is an item between liabilities and stockholder equity as equity investment holders. Banks from Oman, Qatar, and Bahrain have disclosed that the Mudarabah investment as an intermediary item between stockholder equity and liabilities. The disclosure name is equity investment accountholders. This item in the statement of financial position does not specify whether it is restricted or unrestricted Mudarabah investment.

Off-Balance sheet item is the third type of classification found in the investigation. Al Rajhi Bank of Saudi Arabia and two Islamic banks from Kazakhstan have disclosed Mudarabah investment as an off-balance sheet item. The fourth type of classification found in the research is the disclosure of unrestricted Mudarabah investment as liabilities and restricted Mudarabah investment as an off-balance sheet item. Bank Islam Malaysia and two banks from Jordan classified as the fourth type.

Fifty category of classification is an intermediary item between liability and stockholders equity as Unrestricted Equity investment Holders. Nothing has been mentioned about restricted investment account and its disclosure in the statement of financial position. Finally, 60% of the Islamic bank investigated has classified the Mudarabah investment as a liability item in the balance sheets same as conventional banks do. This includes both restricted and unrestricted Mudarabah investment accounts.

Al Rayan Bank of United Kingdom disclosed profit sharing and not profit sharing investment and deposit under the liability. None of the bank studied in this paper has mentioned as profit sharing or not profit sharing term deposits in their statement of financial position. Bank of London and the Middle East, Al Amanah Islamic Investment Bank of the Philippines and Bank Al Jazeera have mentioned neither the Mudarabah investment deposits nor disclosure in the statement of financial position.

#### **4.2 The Possible reason for the difference in the disclosure of Mudarabah Investment Account**

The second objective of this paper is to investigate the reasons for the difference in the disclosure of Mudarabah investment. According to figure 3 and 4, the banks differ in the disclosure of Mudarabah investment accounts are also differs in the adaptation of financial reporting standards. IFRS Standard 9 has been adopted by all the Islamic banks which disclosed the Mudarabah investment as a liability in the statement of financial position. IFRS Standard No. 9 on financial instruments which replaced IAS 32 describe the treatment of liabilities in the financial intuitions (IFRS). The rest of the banks studied either following their own local standards with special reference to Islamic finance or AAOIFI. AAOIFI FAS 27 have recommended to disclosing Mudarabah investment as an intermediary item, off-balance sheet item or unrestricted in the liabilities and restricted as off-balance sheet.

Restricted and unrestricted Mudarabah investment has been categorized as an intermediary item between liabilities and stockholder's equity according to the AAOIFI FAS 27 by 26% of the total banks examined. The rest of the banks have reported in different ways as mentioned in section 4.1. According to the study, banks from Bahrain, Oman, Nigeria, Qatar, Sudan and, Jordan are adapting AAOIFI FAS 27 as recommended and requested by the regulators. It is not mandatory in Bangladesh to follow AAOIFI FAS, but the banks have voluntary adapted some of the AAOIFI standards with long with their local standards.

Indonesian banks are required to follow their local financial reporting standards for disclosure of financial statements and exceptionally, Islamic banks need to follow Sharia accounting standards which is a part of their local standards. The Indonesia Islamic banks disclosed the Mudarabah investment as a third party item between liability and stockholder equity.

Malaysian Islamic banks follow local standards MFRS (Malaysian financial reporting standard) and IFRS for financial reporting. Bank Islam Malaysia Berhad has reported their unrestricted



investment in liability and restricted investment in an off-balance sheet item and rest of the bank investigated disclosed as a liability.

Islamic banks in Saudi Arabia follow IFRS for disclosure of financial statements according to the regulations. The recent agreement with AAOIFI expected for Islamic banks to adapt AAOIFI FAS partially or fully (Arab News). In this study, only Al Rajhi bank of Saudi Arabia has disclosed unrestricted as a liability and restricted investment held by the group in a fiduciary capacity as off-balance sheet item.

#### **4.3 Disclosure of profit smoothing reserve and investment risk reserve**

The third objective of this study is to investigate profit smoothing reserve and investment risk reserve. This reserve is a vital part of risk management to mitigate the displaced commercial risk. The examination demonstrates that only 10 Islamic have reported to having both profit smoothing reserve or profit equalization reserve and investment risk reserve and rest of the banks have not disclosed regarding the existence of these risk reserves.

The other possibility of the nonexistence of profit smoothing reserve and investment risk reserve in the Islamic banks as the reserves are not retained by the Islamic bank since they follow their local standards or IFRS. The adaptation of IFRS, AAOIFI or local standards has not influenced the reporting profit smoothing reserve or investment risk reserve.

#### **4.4 Contracts used by Islamic banks other than Mudarabah**

Most of the Islamic bank examined have used Mudarabah contract for investment deposits. Few Islamic banks examined in the research have also used other contracts such as Murabaha, Musarakah and *Wakalah bi Al-Istithmar term investment deposits*.

### **5. Conclusion**

The main objective of this study is to find the Mudarabah investment disclosure Islamic bank's financial statements. The cross-country study has found that Mudarabah Investment has been classified and disclosed in the statement of financial position of Islamic bank in six different methods. Further, the investigations have revealed that difference is due to the different accounting and financial reporting standard followed by the regulators. Principally the relations between the Islamic bank and Mudarabah investment customer is a basic partnership and AAOIFI's FAS 27 disclosure requirement in accordance with the theory. The research reveals that Islamic banks which followed AAOIFI have disclosed Mudarabah investment as an intermediary item between stockholder equity and liability.

Farizal Rosman *et al.*, (2015) research found that another challenging factor in applying the AAOIFI accounting standards is different from Islamic schools of thought in understanding the Islamic principles. Malaysia has been said to be very liberal in the interpretation of Islamic law since all the four madhabs (Islamic school of thoughts) have been referred in formulating the IFIs' products. In that case, the IFIs products vary among the Muslim countries depending on the approval of SAC in that particular country, resulting in the launching of many IFIs' products in Malaysia.

The Islamic banks as any other public corporation have to follow the regulatory requirement of the regulators. IFRS or the local standards have been followed by the majority of the country studied and few countries have adapted AAOIFI standards. Exceptionally Pakistan and Indonesia have included include financial reporting standards specifically for Islamic financial institutions.

Financial statements are important sources of information for the stakeholder to make a decision regarding the industry. The disclosure dissimilarity of Mudarabah investment accounts in the statement of financial position hampers its stakeholder to compare and make the decision on investments, efficiency and transparency and also can influence the liquidity, profitability and leverage ratios. Islamic banks are operating in most of the countries parallel to conventional banking and having a dual system of disclosure for banking can also hinder the stakeholder to compare and make the decision regarding the return of equity etc.

This paper suggests standard setters and regulators to initiate to harmonize the Mudarabah investment disclosure of Islamic banks by engaging in negotiations with the international standard-setting organization and local standard setting organization. Further, the paper suggests the regulator let the Islamic banks to decide to adaptation AAOIFI standards voluntarily. Regulators also can develop a local standard in line with AAOIFI standards specifically applicable for Islamic financial intuitions where the country's regulations don't let the use of international standards. The other possibility is that Islamic banks can adapt certain standards such as disclosure of statement of financial position along with their local or international standards where the complete adaptation for Islamic financial institutions is not possible.

Alternatively, if the Islamic banks could not find a way to adapt AAOIFI standards with regard to Mudarabah disclosure because strict regulation, the Islamic banks could voluntarily include an alternative statement of financial position in the annual report with Mudarabah as an intermediary or as an off-balance sheet item in the statement of financial statement according to AAOIFI recommendation. Moreover, PER and IRR can also be included a voluntary statement of financial positions

This research adds to the existing literature on treatment and disclosure of Mudarabah investment account, practices of disclosing profit smoothing reserves and investment return risk. Further researches can be done on disclosure of Mudarabah investment account by investigating its impact on liquidity, leverage and profitability ratios.

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