

BANKIGA DHEXE EE
SOOMAALIYA



البنك المركزي الصومالي

CENTRAL BANK OF SOMALIA

Licensing and Supervision Department

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Guidelines on Financial Reporting for Islamic Commercial Banks in Somalia

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A. Introduction

1. These Guidelines on Financial Reporting sets out the Central Bank of Somalia's (CBS) expectations in relation to the requirements for financial reporting by all Islamic Commercial Banks (hereinafter referred to as "ICBs"), and therefore forms part of the standard used to account, disclose, and report the financial position of the ICBs' Islamic operations and business activities. This will contribute to a greater alignment between financial reporting and prudential frameworks.
2. All ICBs are expected to prepare their financial statement according to the International Financial Reporting Standards (FRS). Whilst the FRS are developed based on conventional accounting principles, concepts or practices, its application on Islamic financial transactions may be perceived to be insufficient.
3. These Guidelines sets out minimum disclosure requirements specific to Islamic banking activities that should be observed by the ICB as reporting institutions. The Guidelines also seeks to explain some issues, though not exhaustive, in applying FRS to Islamic financial transactions.
4. The ICBs are encouraged to disclose additional information on the accounting policies, new banking products and services, and other material activities of the ICBs. This is to ensure that all the above activities are reported and well understood by readers of the financial statements.
5. These Guidelines must be read together with other relevant regulations and instructions that have been issued by the CBS, in particular the Regulation on Audited Annual Financial Statements 2016, CBS/BS/REG/06, and Guidelines on Shari'ah Governance Framework 2020 (as revised from time to time).
6. If there is any conflict between these guidelines and the above-mentioned regulation and guidelines, the regulation and guidelines mentioned in subsection 5 shall take precedence on the matter.

B. Authority

7. These Guidelines is made by the Central Bank of Somalia (CBS) pursuant to its authority set forth in (a) 52(1) and 60(2) of the Central Bank of Somalia Act, 2012 and (b) Sections 19 — 28, 32 and 34 of the Financial Institution Law (FIL) No. 130,2012.

C. Applicability

8. These Guidelines is applicable to the licensed Islamic banks, licensed branches or subsidiaries of international banks and licensed Islamic banking windows of conventional bank that are granted under Section 6 (2) of the FIL to carry out Islamic banking business activities.

D. Scope

9. Pursuant to Section 19 of the FIL, the ICB shall prepare its financial statements in accordance with the FRS.
10. These Guidelines sets out specific requirements on information to be disclosed in the financial statements pursuant to Section 21 (4) of the FIL to better facilitate the assessment of ICB's financial position and performance

11. Except for the minimum disclosure for the Shari'ah Committee Report, this Guidelines does not deal with other disclosures provided by ICB as part of the Annual Report (e.g., Director's Report, Statement on Corporate Governance).

12. The terms and expressions used in this Guidelines shall have the same meanings assigned to the FIL, regulations, instructions (as revised from time to time), unless otherwise defined in this Guidelines.

A. Objectives

13. This Guidelines aims to:

- a. Provide basis for presentation and minimum disclosure of the financial statements on the operations of the ICB in carrying out its Islamic banking business activities.
- b. Ensure consistency and comparability of the financial statements among the ICBs in complying with the provisions of the CBS' laws and regulations, FRS and Shari'ah requirements; and
- c. Facilitate CBS in its evaluation and assessment of ICBs financial position, performance and Shari'ah compliance.

B. Effective Date

14. This Guidelines shall apply to financial statements with the financial year beginning on or after 1 January 2022.

Part II: Regulatory Requirements

A. General Requirements

15. In accordance with Sections 19(1)(c) of the FIL, an ICB shall ensure that all accounts and financial records are prepared in accordance with the FRS and with all applicable laws.

16. An ICB should consider both the economic and Shari'ah effects of Islamic financial transactions which arise due to the application of specific Shari'ah contracts to determine the most appropriate accounting treatment. An appropriate accounting policy must be disclosed in the financial statements (see paragraph 29(a)(ii) of these guidelines) in the event an ICB departed from IF-RS requirement due to Shari'ah prohibition, thus, ensure a fair presentation of financial information.

17. The board of the ICB is responsible for ensuring that the financial statements are drawn up to give a true and fair view of the situation and of the results of the business of the ICB. The board should satisfy itself that a sound financial reporting structure is in place to ensure the integrity and credibility of the financial statements.

18. An ICB should have documented the policies and procedures for the production of financial reports, which should inter alia reconciliation process for all data contained in audited financial statements against regulatory returns, where appropriate; and a checklist to ensure that the ICB's capital is calculated in accordance with regulatory requirements.

B. Application of FRS

19. Compliance with Shari'ah requirements is a fundamental requirement to ensure the legitimacy and permissibility of Islamic financial products and services. In the case of financial reporting, it is important for an ICB to ensure proper due process is undertaken to determine and accord appropriate accounting treatment to a particular Shari'ah compliant product or transaction to attain faithful representation of financial information.

20. In relation to paragraph 18, an ICB shall establish an internal policies and procedures and well define processes that is approved by the board to identify and assess the application of relevant accounting standards under the FRS to recognize, classify or measure Islamic financial transactions taking into consideration among others the:

- a) substance of the arrangement as well as the underlying contractual form.
- b) elements of control and nature of returns associated with the contracts.
- c) risk and rewards of ownership of financial assets¹; and
- d) components of the cash flow.

¹ Financing and investment assets

21. An ICB shall apply the methodologies as outlined in the relevant accounting standards under the FRS to ascertain the applicable accounting treatment for financial assets, liabilities, income or expenses.
22. In line with paragraph 20, an ICB shall assess the profile and characteristic of a financial asset structured based on:
- a. Sale-based contract, such as the Murabaha would fall within the scope of accounting standard for Financial Instruments by assessing the business model for managing financial assets and performing the SPP1¹ test on the contractual cash flow to ascertain whether the profit or mark-up represents time value of money or compensation for credit risk.
 - b. Lease-based contract that is the Ijarah, would be subject to accounting standard on Leases by ascertaining whether the arrangement involves a transfer of right to control the use of Ijarah asset from the lessor to the lessee for a period of time in exchange for consideration.
 - c. Construction-based contract that adopts the Istisna', would be subject to the accounting standard on Revenue from Contracts with customers given that the underlying asset is yet to be constructed or the standard on Construction Contracts where ICB assumes the construction risk of the asset under development.
 - d. Equity-based contract that adopts the Mudarabah or Mushārah, would be subject to the accounting standard on Joint Arrangement, Investments in Associates and Joint Ventures, Consolidated Financial Statements, or other standard in the event that the ICB undertake the role of capital provider (Rabbul mal) under the contract. Under such an arrangement, the recognition would depend on the nature of whether the transactions represent an "equity interest" in another entity or an investment with contractual rights to future cash flow.²
23. Similar assessment should be undertaken to determine the accounting treatment for financial liabilities that may be structured based on loan contract, sale-based contract, or equity-based contracts, which adopts the Qard, Murabaha or Mudarabah contract respectively.
24. With regards to the disclosure, an ICB should present the carrying amount and income and expenses related to Shari'ah compliant deposit and investment account in separate line items in its separate financial statements and consolidated financial statements.
25. The Regulation on Asset Classification and Provisioning 2018 (as revised from time to time) and relevant instructions are applicable to the treatment of Islamic financial assets.

² Solely for payment of principal and profit

² See Appendix II on general description of each contract

26. Transactions in foreign currencies are converted into US dollars at rates of exchange ruling at the date of transaction. Monetary assets and liabilities in foreign currencies at the balance sheet date are translated into US dollars at the rates of exchange ruling at the balance sheet date. All exchange differences are recognized in the income statement.

C. Minimum Disclosure Requirements

27. An ICB shall ensure the disclosure of information comply with the following key principles:

- a. information should be timely and up to date to ensure the relevance of the information being disclosed.
- b. the scope and content of information disclosed, and the level of disaggregation and detail should be sufficient to provide comprehensive, and relevant information to the users; and
- c. adequate disclosures should be provided on areas of uncertainty, in particular information on key estimates and if sensitivity analysis is used, a discussion on the assumptions and the probabilities of the occurrence of various scenarios.

28. The disclosures illustrated in Appendix I, (1) Statement of Financial Position and (2) Statement of Profit and Loss and other Comprehensive Income set out a minimum requirement and are not meant to be templates that must be adopted by the ICB. Additional information may be required, depending on each ICB's circumstances, to ensure fair presentation.

Accounting Policies for Recognition and Measurement

29. An ICB shall disclose the recognition and measurement accounting policies on the following:

- a. each main class of Shari'ah contract e.g. Murabaha, Ijarah, Mudarabah, Istisna':
 - i. an ICB has to develop the accounting policy for each Shari'ah contract or group the Shariah contracts according to the nature of the transactions e.g. Murabaha financing, ijarah financing, Murabaha deposit; and
 - ii. where an ICB has departed from FRS requirement due to Shari'ah prohibition and to achieve a fair presentation, the following shall be disclosed:
 - title of the FRS from which an ICB has departed.
 - nature and reason of the departure; and
 - financial effect of the departure on each item in the financial statements that would have been reported in complying with the FRS requirement.

- b. description of the methodology adopted by an ICB to compute its obligation on zakat as approved by the Shariah Committee e.g., growth method, working capital method; and ICB may disclose its responsibility on Zakat payment under the Director's Report. Meanwhile, an ICB that does not pay zakat must also disclose a statement to that effect in the Director's report. ICBs that pay zakat shall disclose additional information regarding:
 - i) its responsibility towards zakat payment either on the business, and/or behalf of the shareholders.
 - ii) the beneficiaries of zakat fund e.g., Baitul Mal, the poor, etc.; and
- c. for income derived from Shari'ah non-compliant activities, an ICB may disclose the criteria for the recognition of such income e.g., upon confirmation by the Shari'ah committee. Following the recognition of Shari'ah non-compliant, the ICB shall disclose additional information under either the Director's Report or Shari'ah Committee's Report. the following:
 - i) nature of Shari'ah non-compliant activities.
 - ii) amount of Shari'ah non-compliant income.
 - iii) number of non-Shari'ah compliant events occurring during the year; and
 - iv) rectification process and control measures to avoid recurrence of such Shari'ah non-compliant activities.

Financial Assets

30. An ICB shall disclose financial assets with a breakdown by:
- a. measurement basis (e.g. amortized cost, fair value):
 - i) for fair value through profit or loss, show separately those designated as fair value upon initial recognition.
 - b. types of financing (e.g. house financing, business, personal, microfinance) and further breakdown by main Shari'ah contracts in table format:
 - i) an ICB shall disclose the classification of main Shari'ah contracts; and ii) significant subclasses of the main contracts.
 - c. geographical distribution.
 - d. profit rate sensitivity (e.g. fixed rate, variable rate);
 - e. economic sector; and
 - f. residual contractual maturity (e.g., up to 1 year, 1-5 years, > 5 years)³.
 - g. Other information the Central Bank of Somalia may require.
31. An ICB shall disclose (a) a movement of non-performing financing for special mention provision and specific provisions (for substandard, doubtful and loss), which includes opening and closing balances; and (b) non-performing financing by sector.
- 32.

³ Refer to illustration in Appendix I, No (3) (b)

33. An ICB shall disclose a movement schedule of the qard (loan) or financing which includes opening and closing balances, sources, and uses of the fund.
34. An ICB shall disclose for transactions that reflect acquisition or transfer of ownership prior to its subsequent sale, the carrying amount held for the purpose of Murabaha (cost plus sale) which can be transacted on a spot or deferred basis.
35. An ICB shall disclose for ijarah (leasing that does not lead to transfer of ownership at the end of the leasing period) ⁴, in the following manner:
- a. carrying amount of assets held for the purpose of ijarah; and
 - b. extent of the transfer of usufruct (in percentage terms) from the ijarah asset to the lessee over the ijarah period under the terms of the ijarah contract.
35. An investment in equity-based contract held by an ICB requires judgment and consideration of all facts and circumstance of the contract. This investment may be accounted for either as one of the three categories:
- a. a financial instrument under FRS 9 Financial Instruments (at fair value or amortized cost)
 - b. an investment in Associates and Joint Ventures as per IAS 28; or
 - c. an investment in subsidiary as per FRS 10 Consolidated Financial Statements.

Deposits from Customers and Investment Account of Customers

36. An ICB shall disclose the following information —
- a. deposits from customers with a breakdown by:
 - i. types of Islamic deposits (e.g. savings, current and term deposits) and further breakdown by Shari'ah contracts (e.g. Wadi'ah, qard, and tawarruq);
 - ii. types of customers (e.g. individuals, government, business enterprises); and
 - iii. maturity structures of term deposits (e.g. < 6 months, 6-12 months, 1-3 years);
 - b. investment accounts of customers with a breakdown by —
 - i. types of investment account (e.g. unrestricted or restricted investment account) and further breakdown by Shari'ah contracts (e.g. Wakalah and Mudarabah).
 - ii. types of customers; and
 - iii. maturity structures of investment account with maturity; and
 - c. deposits and placements of banks and financial institutions with a breakdown by —

⁴ For example, property leasing

- d. types of investment account and further breakdown by Shari'ah contracts; and
- e. types of domestic or overseas.⁵

Income and Expenses

37. An ICB shall disclose income and expenses with a breakdown by types of financing and investment, and source of funds e.g. deposit, investment account and shareholder's funds.⁶ Profit income recognized for credit-impaired exposures shall be disclosed separately.
38. An ICB shall disclose non-profit income and other operating expenses with a breakdown of major items of income or expense e.g. fees or commission.
39. An ICB shall disclose sources of donations/charities funds (e.g. gharamah amount, SharT'ah non-compliance income, shareholder's funds) and uses of such funds (e.g. distribution to the poor, education fund).

⁵ Refer to illustration in Appendix I, No (3) (c)

⁶ Refer to illustration in Appendix I, No (3) (d)

Shari'ah Committee Report

40. In meeting the requirement in Section 7(5) of the Guidelines on Shari'ah Governance Framework ICBs 2020 with respect to the state of compliance with Shari'ah principles, an ICB should disclose the Shariah Committee's Report as part of the Annual Report, signed by not less than two Shariah Committee members. The Shari'ah Committee's Report shall contain the following information:

- a. the purpose of the Shariah Committee's engagement;
- b. a clear statement of management's responsibility in ensuring compliance with Shari'ah principles;
- c. a statement describing the nature of the work performed;
- d. confirmation that the Shariah Committee has performed appropriate tests, procedures and review work as appropriate;
- e. Shariah Committee's opinion on the Islamic banking institution's compliance with Shariah in respect of contracts and related documentation used;
- f. appropriateness of Shari'ah basis for the allocation of profit between shareholders and investment account holders;
- g. disposal of any earnings from prohibited sources/means to charitable causes;
- h. zakat computation; and any known non-compliance with Shariah and action taken to remedy such non-compliance.

Other disclosures

41. An ICB shall disclose capital with a breakdown by:
 - a. capital structure; and
 - b. capital adequacy showing separately Common Equity Tier 1 Capital Ratio, Tier 1 Capital Ratio and Total Capital Ratio, and express as percentage to three decimal places.
42. An ICB shall disclose reserves with a breakdown by type and purpose of reserves maintained. A movement schedule shall also be disclosed.
43. An ICB shall disclose liquidity risk information incorporating an analysis of assets and liabilities in the relevant maturity tenures based on remaining contractual maturities. In addition, an ICB may also provide the analysis of assets and liabilities in the relevant maturity tenures based on their behavioral profile.
44. An ICB shall disclose commitments and contingencies with a breakdown by types and amount distinguishing between contingent liabilities and commitments.

Interim Financial Report

45. An ICB is required to prepare a financial report that contains a condensed set of financial statements on a quarterly basis. Such report should be made available not later than 15 days after the end of the interim period. The Central Bank of Somalia may change the frequency of the reporting when deemed necessary,
46. The explanatory notes to be disclosed in the interim financial report of an ICB shall include the following information, as applicable:
- a. deposits from customers;
 - b. investment account of customers and breakdown of the underlying assets funded through investment account;
 - c. financing, receivables and other qard loans;
 - d. a movement schedule of impairment allowances;
 - e. financing, receivables and other qard loans classified as impaired;
 - f. income and profit distributed
 - g. Swift Inward and Outward
 - h. Capital; and
 - i. Other information the Central Bank of Somalia may require.
47. The breakdown for the above explanatory notes shall be consistent with that specified for annual financial statements.
48. An ICB shall also disclose items that are material to the understanding of the interim financial report.

Islamic banking window

49. An ICB offering Islamic banking services through Islamic banking window is required to disclose in its annual financial statement:
- a. Whether or not the Islamic banking window commingled funds related to Islamic banking business with funds relating to conventional banking business;
 - b. Sources and application of funds mobilized and invested through the Islamic banking window and the sources of funds used to cover a deficit;
 - c. Any revenues prohibited by Shari'ah and the disposition of any such revenues in accordance with the guidelines endorsed by the SharT'ah Committee;
 - d. Any allocation of reserves from funds that are mobilized according to Shari'ah, the purpose of such reserves and to whom the reserves shall revert in case the activities in respect of which the reserves were deducted have ceased; and
 - e. Percentage amount of funds relating to Islamic banking business in comparison with the percentage amount of funds relating conventional banking business.

Appendix I: Illustration of Presentation of Financial Statements

1. Statement of Financial Position

	Note	Date
Assets		
Cash on Hand		
Balances with Central Bank		
<i>Bank Security Deposits (Restricted)</i>		
Other Deposits		
Balances due from Head Office & Other Affiliates Abroad		
Deposits and Placements with Banks and other Financial Institutions	3(a)(b)	
Financing assets	3(c)(d)(e)(f)	
Investment in security		
Investment in a associates and join ventures	3(g)	
Investment in property	3(h)	
Fixed assets	3(i)	
Intangible assets	3(j)	
Other assets	3(k)	
Total assets		
Liabilities		
Deposits from customer	3(i)	
Investment accounts of customer	3(m)	
Due to head office, branches & Affiliates aboard		
Deposits and placements of banks, mobile money Services and other financial institutions	3(n)	
Provision for zakat and taxation		
Financing liabilities	3(o)	
Other liabilities	3(p)	
Total Liabilities		
Shareholder's equity		
Share capital		
Reserves		
Retained earnings/loss		
Total Shareholder's equity		
Total liabilities and Shareholder's equity		
Commitment and contingency		

2. Statement of Profit and Loss and Other Comprehensive Income

	Note	Date
Income		
Income from Financing and Investing Assets		
Income from Financing Assets		
Income from Investment in Securities		
Income from Investment in Associates and Joint Venture		
Income from Investment in <u>Property</u>		
Fee and Commission income		
Other Income	3(q)	
Total Income		
Staff Expenses		
General Administrative Expenses		
Amortization		
Depreciation		
Provision for Bad Debts		
Other expenses	3(s)	
Total Expenses		
Net Income before Zakat and Taxation		
Zakat		
Taxation		
Profit for the Year		

3. Notes to the Financial Statement

a. Deposits and Placements with Banks and other Financial Institutions

Deposits and Placements with Banks and other Financial Institutions	Specific Period
a. Domestic Banks and other Financial Institutions	
Interbank Mudarabah	
<i>Interbank Mushārah Interbank Wakalah</i>	
<i>Interbank Wakalah</i>	
Others (see Note)	
b. Overseas Banks and other Financial Institutions	
<i>Interbank Mudarabah</i>	
<i>Interbank Mushārah</i>	
<i>Interbank Wakalah</i>	
Others	
Others	
Total Deposits and Placement with Banks and other Financial Institutions	

b. Deposits and Placements with banks and Other Financial Institutions

Bank Name	Country	Amount
Total		

c. Classification of financing assets base on shariah Contract

Shariah contract	No. Of Customers Financed	Amount (USD)
Murabaha Financing		
Istisna' Financing		
Ijarah Financing		
Qardhu Hassan Financing		
Others (please specify)		
Total	0	\$_____

d. Sectoral Distribution of Financing Assets

Economic sectors	No. Of Customers Financed	Amount (USD)
agriculture		
Auto mobile and vehicles		
manufacturing		
Building and construction		
Mining and Quarrying		
Energy and water		
Trade		
Tourism, Restaurant and hotels		
Communication		
Real estate		
Financial service		
Education		
Personal/household		
Others		
Total net financing	0	\$ _____

e. Geographical Distribution of financing assets

Geographical Distribution	No. Of Customers Financed	Amounts (USD)
Benaadir Region		
South West State		
Puntland State		
Jubaland State		
Hirshabelle State		
Galmudug State		
Somaliland State		
Total Net Financing		

f. Financing Assets Profit Rate yield

Financing Assets Duration	Profit Rate (%)	Financing Assets Amount (\$)
< 12 Month	0%	\$
12 Month	0%	\$
18 Month	0%	\$
24 Month	0%	\$
36 Month	0%	\$
>36 Month	0%	\$

g. Classification of Investment in Associates and Joint Ventures

Inv. Associates and Joint Ventures	Shariah contract type	Amount (USD)
		\$
		\$
		\$
		\$
		\$
Total		\$

h. Classification of Investment in Property

Investment in Property	Shariah contract type	Amount (USD)
		\$
		\$
		\$
		\$
Total		\$

i. Classification of Fixed Assets

Fixed Assets	Amount (USD)
	\$
	\$
	\$
	\$
	\$
	\$
	\$
Total	

j. Classification of Intangible Assets

Intangible Assets	Amount (USD)
	\$
	\$
	\$
	\$
	\$
	\$
	\$
Total	

k. Classification of Other Assets

Other Assets	Amount (USD)
	\$
	\$
	\$
	\$
	\$
	\$
	\$
Total	

I. Customer Deposit Accounts

A/c type	No. of accounts	Amount (USD)
SAVING ACCOUNTS	0	\$
CURRENT ACCOUNTS	0	
CORPORATE A/C	0	\$
INDIVIDUAL A/C	0	\$
Total	0	\$

m. Deposits from Customers and Investment Account of Customers

Deposits from Customers (see Note)	Amount (USD)
Current	
<i>Qard</i>	
<i>Others (please specify)</i>	
Saving	
<i>Qard</i>	
Others (please specify)	
Others (please specify)	
Total Deposits from Customers	

Investment Accounts of Customers	Amount (USD)
Unrestricted Investment Account without maturity	
Mudarabah	
Wakalah	
Others (please specify the type of Shari'ah contracts)	
Unrestricted Account with maturity	
Mudarabah	
Wakalah	
Others (please specify the type of Shari'ah contracts)	
Restricted Investment Account	
Mudarabah	
Wakalah	
Others (please specify the type of Shari'ah contracts)	
Others (please specify)	
Total Investment Account of Customers	

Deposits from Customers and Investment Accounts of Customers by Residual Contractual Maturity	Amount (USD)
Less 3 months	\$
>3 to 6 months	
>6 to 1 year	\$
>1 Year	\$
Total Deposits from Customers and Investment Accounts of Customers by Residual Contractual Maturity	

- n. Deposits from other banks, Mobile Money Services and Other Financial Institutions

Banks, mobile money and other financial institutions name	Country	Amount (USD)
		\$
		\$
		\$
		\$
		\$
		\$
Total Deposits from and Placement of Banks and other Financial Institutions		\$

Deposits from and Placements of Banks and other Financial Institutions	Amount (USD)
a. Domestic Banks and other Financial Institutions	
Interbank Mudarabah	
Interbank Mushārah	
Interbank Wakalah	
Others (see Note)	
b. Overseas Banks and other Financial Institutions	
Interbank Mudarabah	
Interbank Mushārah	
Interbank Wakalah	
Others (see Note)	
c. Others	
Total Deposits from and Placement of Banks and other Financial Institutions	

o. Financing liabilities

[illegible]

p. Other liabilities

[illegible]

q. Other income

[illegible]

r. General Administration Expenses

[illegible]

s. Other expenses

[illegible]

Appendix II: Islamic Banking Contracts Definitions

1. Islamic financial contracts mainly fall into these categories: sale, lease, construction or equity-based contracts. While each category covers a wide variety of instruments, this appendix gives a brief description of the main contracts that are most frequently used by Islamic banks globally.

Sale-based contract

2. Murabaha (cost-plus financing) contract refers to an agreement whereby the Islamic bank sells to a customer, at acquisition cost plus an agreed profit margin, a specified asset that is already in its possession (such as a manufactured good). The customer has an obligation to settle the selling price or the amount of receivable that arises following delivery of the asset by the bank. The main features of this contract are: (a) the cost and the mark-up must be both known to the bank and the client; (b) the bank must assume the ownership of the goods prior to reselling them to the client (bearing all the ownership risks in the interim); (c) the client's promise (either binding or non-binding) to buy the goods purchased on his order by the bank; (d) no interest is levied for late payments but the bank could require a collateral; and (e) the Murabaha contract cannot be sold except at par.
3. Salam (purchase with deferred delivery) is a purchase contract with deferred delivery of goods (opposite to Murabaha) and is mostly used in agriculture finance. The contract is used to purchase, at a predetermined price, a specified kind of commodity which is to be delivered on a specified future date in a specified quantity and quality (such as an agricultural or a manufactured product). As the buyer, the bank makes full payment of the purchase price upon execution of the Salam contract. To mitigate price risk (as a debt contract it cannot be sold to a third-party except at par), the bank enters, in certain cases, into a "Parallel Salam" to sell a commodity with the same specification as the purchased commodity under a Salam contract to a party other than the original seller.

Lease-based contract.

4. Ijarah (lease) contract refers to an agreement whereby the bank leases to a customer an asset (such as a ship, aircraft, or telecom equipment) for an agreed period against specified installments of lease rental. The contract commences with an agreement to lease that is binding on the part of the potential lessee and requires the bank to purchase or lease an asset prior to entering into the contract. An Ijarah contract could offer the lessee the option to purchase the asset either at the end of the lease period by means of a gift or a token consideration, or by installments of a specified amount. During the lease period, the bank, as the owner of the asset bears all the risks associated with ownership. The Ijarah contract can be sold at a negotiated market price, effectively resulting in the sale of the leased asset.

Construction-based contract

5. Istisna' is a contract in which a buyer purchases an item for deferred delivery. The item must be described in detail and construction must fit the specifications. For example, the item delivers it on a specific date in return for a specific price to be paid in one lump sum or instalments. Usually, an istisna contract is made for specially made items. For example, one may make a contract to build a house for a client.

Equity-based contract

6. Mushārah (equity financing) contract is an agreement whereby the 1B and a customer contribute capital to an enterprise, whether existing or new, or to the ownership of real estate or a moveable asset, either on a permanent basis or on a diminishing basis where the customer progressively buys out the share of the 1B ("diminishing Mushārah"). Profits generated by the enterprise, or the asset/real estate are shared in accordance with the terms of the Mushārah agreement, while losses are shared in proportion to the respective contribution to capital.
7. A Mudarabah (participation or trust financing) is a contract that refers to an agreement whereby the bank contributes capital to an enterprise or activity which is to be managed by the customer. Profits generated by that activity are shared in accordance with the terms of the Mudarabah agreement, while losses are to be borne solely by the bank unless they are due to the customer's misconduct, negligence, or breach of the contract terms. Mudarabah could be restricted to a specific transaction, or unrestricted.
8. Profit Sharing Investment Account (PSIA) is a contract by which an investor/depositor opens an investment fund with an Islamic bank on the basis of Mudarabah. The bank could have restricted (restricted investment account), or full discretionary power in making investment decisions (unrestricted investment account). Both parties agree on a ratio of profit sharing, which must be disclosed and agreed upon at the time of opening the account. Profits generated by the 1B are shared with the PSIA holder in accordance with the terms of the Mudarabah agreement while losses are borne solely by the PSIA holder, unless they are due to 1B's misconduct, negligence, or breach of the contract terms.



CBS

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Licensing and Supervision Department