

BANQUE DU LIBAN

Basic Circular No 96 to Banks

Attached is a copy of Basic Decision No. 8870 of October 20, 2004 on Murabaha operations carried out with or through Islamic banks.

Beirut, October 20, 2004

The Governor of the Banque du Liban

Riad Toufic Salamé

BANQUE DU LIBAN**Basic Decision No 8870****on Murabaha operations carried out with or through Islamic banks**

The Governor of the Banque du Liban,

Pursuant to the Code of Money and Credit, particularly Article 70,

Pursuant to Law No 575 of February 11, 2004 on the Establishment of Islamic banks in Lebanon, particularly Article 4;

Pursuant to Basic Decision No 8828 of August 26, 2004, on the Practice of Islamic Banking in Lebanon; and

Pursuant to the Decision of the Central Council of the Banque du Liban, taken in its meeting of October 14, 2004

Decides the following:

Article 1: Definitions:

For the purpose of implementing the provisions of this Decision, the following expressions shall mean:

Murabaha: Sale of an asset at the initial cost plus an agreed mark-up.

Ordering Party: The customer of the Islamic bank.

Ordered Party: The Islamic bank.

Asset: Any movable or immovable asset being the object of a Murabaha operation and fulfilling the required conditions set by the provisions of Article 5 of Law 575 of February 11, 2004.

Murabaha to purchase
for the Ordering Party:

A sale negotiated between two parties or more who promise each other to execute an agreement whereby the Ordering Party requests the Ordered Party to purchase and acquire an asset, with a promise from the Ordering Party to repurchase the said asset from the Ordered Party at a price including a profit through a subsequent sale agreement.

Hamesh Al-Jiddiya
(Seriousness
Guarantee):

The amount paid by the Ordering Party at the Ordered Party's request as a guarantee for the seriousness of his purchasing intention. Thus, if the Ordering Party declines to purchase the asset even though the purchase promise is binding, the actual loss incurred by the Ordered Party will be covered by this guarantee. If

the value of the guarantee is inferior to the value of the damage suffered by the Ordered Party, the latter may ask the Ordering Party to settle the remaining uncovered loss. But in case the guarantee exceeds the damage, the Ordered Party must return the remaining balance to the Ordering Party.

Assets for
Murabaha
Operations:

All assets that are the object of Murabaha operations.

Assets from
Uncompleted
Murabaha
operations:

Assets acquired for the purpose of executing Murabaha operations that will not take place because of the Ordering Party's failure to fulfill his/her purchasing promise.

Provisions against
Asset Value Losses:

An amount allocated to cover the losses in the value of Murabaha operation's assets and reconstitute the value of these assets at cost value or at market value, whichever is less.

Unrestricted
Investment
Accounts:

Accounts which, upon authorization from their holders, may be invested by the bank on the basis of a Mudaraba contract, as deemed appropriate by the bank which is not bound to invest them on its own behalf or in a specific project, or for a specific purpose or in a given manner. The bank is also authorized to commingle these accounts with its own funds, therefore the investment results are shared by all parties participating in the Mudaraba either through their money or their effort.

Restricted
Investment
Accounts:

Accounts which, upon authorization from their holders, may be invested on the basis of a Mudaraba or investment-by-proxy contract. The bank, however, is bound by specific conditions such as investing the funds in a specific project, or for a specific purpose, or not commingling them with its own funds, etc.

Article 2: The provisions of this Decision govern all Murabaha undertaken by the Ordering Party and including a binding promise to purchase by the latter, whether the Islamic bank acquires the asset with its own funds or with the unrestricted or restricted funds it has the right to use.

Article 3: The Islamic bank must apply to the customer the binding purchase rule in all Murabaha sales. Accordingly, it must not enter into any Murabaha where the customer does not promise to purchase the asset meeting the required specifications.

Article 4: The Murabaha contract for the Ordering Party must at least, expressly and accurately include the following elements:

- 1- The rights and obligations of the parties, proving that the operation is a Murabaha for the Ordering Party.
- 2- The asset being the object of the contract.
- 3- The expected price, all expenses, fees and taxes paid by the Ordered Party in addition to those due by the Ordering Party particularly the agreed upon profits.
- 4- All guarantees submitted by the Ordering Party.
- 5- The Hamesh Al-Jiddiya to be paid in advance and in cash by the Ordering Party. The said guarantee should be at least equivalent to 15% of the total amount expected to be settled by the Ordered Party.
- 6- The method for settling by the Ordering Party both the sale price and the penalty on arrears.

Article 5: The Murabaha accounts must be recorded according to the rules prescribed in the Annex attached to this Decision.

Article 6: Assets resulting from uncompleted Murabaha operations may not be held by the Islamic bank for more than six months from the date of their recording within the Murabaha accounts. The Central Council may impose on the Islamic any measure deemed necessary for the liquidation of these assets.

Article 7: Islamic banks are governed by the provisions of this Decision and, unless otherwise provided for, by all the provisions, regulations and principles applicable to non-Islamic banks.

Article 8: This Decision shall be effective upon its issuance.

Article 9: This Decision shall be published in the Official Gazette.

Beirut, October 20, 2004

The Governor of the Banque du Liban

Riad Toufic Salamé

Accounting Treatment of Murabaha Operations

a- *Promise to Purchase (first contract executed in a Murabaha operation)*

The contract is recorded as an off-balance sheet item at its face value, under “Commitments”. Then upon the fulfillment of the promise (that is the second contract executed in the Murabaha operation) or upon failure to fulfill, it is credited as an off-balance sheet item at the same value and under “Accounts for memorandum”.

b- *Assets related to Murabaha operation:*

b-1 Murabaha operation assets.

These assets are recorded at their historical cost as on and off-balance sheet items, at the purchase agreement date and in accordance with financing ratios, with any other cost borne by the bank for acquiring, owning or receiving the assets. Before pursuing the purchase promise, any subsequent material change will be deducted from this cost and will be charged to the Ordered Party and/or investors’ accounts, in accordance with financing ratios.

b-2 Uncompleted Murabaha operations assets.

These assets are re-classified at their book value under “Assets from uncompleted Murabaha operations” item. This value will be subsequently modified in case of any material change and this change will be charged to the Hamesh Al-Jiddiya. Any financial change resulting from a discrepancy between the market price and the book value (the modified cost) will be recorded under “Asset value losses” item.

c- *Provisions for asset value losses*

If the market price falls below cost, a provision equivalent to the value of such decrease must be set aside. However, if the market price rises again, an amount equivalent to the value of the increase will be released from the provision. These assets must be re-evaluated in order to set aside or release the provision in the course of preparing monthly financial statements.

d- *Hamesh Al- Jiddiya*

d-1 The cash guarantee is recorded on the balance sheet, under “Commitments”.

d-2 Upon execution of the second Murabaha contract, the Hamesh Al-Jiddiya recorded under “Commitments” (d-1) will be credited to “Murabaha term-sales receivables” account.

d-3 Upon liquidation of the assets of uncompleted Murabaha operations, losses will be charged to the Hamesh Al-Jiddiya and the remaining balance will be restituted to the Ordering Party. In case of deficit, it will be charged to “Receivables”.

e- *Murabaha operations’ receivables*

e-1 Upon fulfilling the purchase promise, the face value of the second contract is charged to the Ordering Party’s account, under “Murabaha term-sales receivables” on and off balance sheet, in accordance with financing ratios. The value of provided guarantees, if any, will be recorded off-balance-sheet, under “Material or financial guarantees received in kind”. Later on, such guarantee will be credited when it is no more needed or when acquired.

- e-2 In case the customer ceases to pay the amounts due, his/her account will be classified under “Doubtful term-sales receivables”, on and off balance sheet, in accordance with financing ratios. The Ordering Party’s share will be offset by a provision for doubtful receivables, after taking into account the guarantees held by the latter.

f- *Deferred profits*

- f-1 Upon fulfillment of the promise to purchase through a future sale, profits will be recorded in a deferred profits account under “Murabaha term-sales receivables”. They will be qualified as revenues of the Ordered Party and/or returns to investors, in accordance with financing ratios and on an accrual basis (i.e. periodically).
- f-2- Upon classifying the Ordering Party’s account under “doubtful receivables”, deferred profits will be classified accordingly. Upon the collection of each installment, these profits must be qualified as revenues of the Ordered Party and/or returns to investors, in accordance with financing ratios.

g- *Discount obtained after purchase/discount granted after sale*

- g-1 Discount obtained after purchase
The discount obtained after the purchase of the asset by the Ordered Party and before its resale is qualified as a reduction in the asset value. However, if the discount is applied after selling the asset, it will be qualified by the Sharia board.
- g-2 Discount granted after sale
When the Ordering Party is granted a discount by the Ordered Party due to the early settlement of an installment or more, as agreed, the Ordering Party’s account as term-sales receivables will be reduced in exchange for an equal reduction in the deferred profits not yet qualified as revenues. Otherwise, revenues of the Ordered Party and/or returns to investors will be reduced in accordance with ratios.

h- *Unrestricted investment accounts/Restricted investment accounts*

- h-1 Unrestricted investment accounts will be recorded on the balance sheet.
- h-2 Restricted investment accounts will be recorded off-balance sheet.