International Journal Of Economics, Management & Accounting, Supplementary Issue 19: 81-100
© 2011 by The International Islamic University Malaysia

A Case Study on the Implementation of *Qardhul Hasan* Concept as a Financing Product in Islamic Banks in Malaysia

Ahmad Zainal Abidin[a], Norhayati Mohd Alwi[b] and Noraini Mohd Ariffin[c]

[a]*Graduate School of Management, International Islamic University Malaysia, Jalan Gombak, 53100 Kuala Lumpur, Malaysia. (ahm6789@gmail.com)*
[b] *Department of Accounting, International Islamic University Malaysia, Jalan Gombak, 53100 Kuala Lumpur, Malaysia. (mhayati@iium.edu.my)*
[c] *Department of Accounting, International Islamic University Malaysia, Jalan Gombak, 53100 Kuala Lumpur, Malaysia. (norainima@iium.edu.my)*

ABSTRACT

Qardhul Hasan is a zero-return financing that Al-*Quran* urges Muslims to make available to those who need it. In addition, *Qardhul Hasan* is an example of a unique instrument offered by Islamic Financial Institutions ("IFIs") due to non involvement of interest. The objective of this paper is to study the implementation of *Qardhul Hasan* concept, as a financing product in an Islamic bank in Malaysia. This study adopted a single case study research. This is the best approach and appropriate to answer the research questions and to achieve the research objectives. In addition, this is a pilot case study which can be extended for multiple case studies later. This study reveals that CALF Berhad offers *Qardhul Hasan* financing only to its employees. In addition, the facility is limited for certain purposes like marriage, birth of a child, study and other relevant purposes. The study also offers guidelines on the implementation process of the *Qardhul Hasan* financing in IFIs. Hence it is also believed that this study can be used by the regulatory body like Bank Negara Malaysia or Malaysian Accounting Standard Board, as a basis for setting up the accounting and reporting guidelines, specifically on *Qardhul Hasan*.

JEL Classification: G20, G21

Key words: *Qardhul Hasan*, Case study, Malaysia, Financing

1. INTRODUCTION

Qardhul Hasan[1] is a zero-return loan that Al-*Quran* urges Muslims to make available to the needy. In other words, the borrower only needs to pay back the principal amount without any obligation for an additional amount. However, the borrower is encouraged and may pay an additional or extra amount at his/her absolute discretion as a token of appreciation, so long as it is not stated in the contract between the two parties. In addition, *Qardhul Hasan* is an example of a unique instrument offered by Islamic Financial Institutions ("IFIs") as compared to their counterparts, the conventional financial institutions. In addition, it is believed that *Qardhul Hasan* is an effective means of economic development and poverty alleviation. Moreover, as emphasized in the *Quran (64:17)*, *Qardhul Hasan* is one of the main elements, (beside *Sadaqah* (charity), *Zakat* and *Waqf*), concerning the redistribution of income and wealth and, therefore, is needed for the welfare of the society.

The prohibition of *Riba* is very significant and is always brought into any discussion of Islamic Finance contracts. As such, generally, *Qardhul Hasan* is urged in Islam not just because of its uniqueness and flexibility but also because of the prohibition and, therefore, no involvement of *Riba*. This shows the spirit of cooperation (*ta'awun*) and brotherhood (*ukhuwah*), which will improve the welfare of society as a whole. Therefore, in order for the Islamic banks to achieve certain socio-economics objectives, it is important for Islamic banks to provide *Qardhul Hasan* products. Moreover, this will enhance the corporate social responsibility ("CSR") of the Islamic banks. This concern over CSR is of relevance in the Islamic banking industry, which regards social responsibility as being more enduring since the practices are based on divine revelation.

Despite the role that *Qardhul Hasan* could have played in society, the financial product has been so far neglected by the Islamic banks in Malaysia, as compared to other products or services. Very few Islamic banks offer this product – as confirmed by the study made by Mohd. Ariffin and Adnan, (2009). Based on the study, only 23.1% (3 out of 13) of Islamic Banks in Malaysia offer *Qardhul Hasan* as a mode of financing. In addition, the total amount of *Qardhul Hasan* only captured less than 0.2% of the total net financing amount reported during the year, as shown in Table 1.

The *Shari'ah* Advisory Council of Bank Negara Malaysia is of the opinion that it is improper to implement *Qardhul Hasan* in commercial transactions with profit orientation since the *Qardhul Hasan* concept is essentially benevolent in nature. Hence, based on the Resolution of the *Shari'ah* Advisory Council of Bank Negara Malaysia, the Council in its 51st meeting, held on 28 July 2005/21 *Jamadil Akhir* 1426, resolved that

the word "*Hasan*" should be removed after the word *Qardh* implying that *Qardh* is an obligation for borrowers to pay back their financing to lenders.

TABLE 1
Review of Annual Reports

No.	Full–fledged Islamic Banks	*Qardhul Hasan* (Y/N)	***Amounts Reported*** 2007 RM '000 *Qardhul Hasan* Amount	2007 RM '000 Total Net Financing
1	Affin Islamic Bank Berhad	N	-	-
2	Al Rajhi Banking & Invesment Corporation (Malaysia) Berhad	Y	2,841	1,866,779
3	AmIslamic Bank Berhad	N	-	-
4	Asian Finance Bank	N	-	-
5	Bank Muamalat Malaysia Berhad	Y	5,652	5,585,247
6	Bank Rakyat Malaysia Berhad	N	-	-
7	BIMB Holdings Berhad	N	-	-
8	CIMB Islamic Bank Berhad	N	-	-
9	EONCAP Islamic Bank Berhad	N	-	-
10	Hong Leong Islamic Bank Berhad	N	-	-
11	Kuwait Finance House (Malaysia) Berhad	Y	33	3,162,310
12	Maybank Islamic Berhad	N	-	-
13	RHB Islamic Bank Berhad	N	-	-

(Source: Mohd. Ariffin & Adnan, 2009)

1.1 DEFINITION OF QARDH

In defining the term "*Qardh*" and "*Qardhul Hasan*", there are several opinions from the scholars and from the various sources including books, and internet sources, etc. These differences in opinions will be provided and discussed in this section, and, at the end, only one source of definition will be used for the entire paper. The term *Qardh* and *Qardhul Hasan* will be used interchangeably in this paper to provide a better understanding and for achieving the objectives of the research concerning the implication of *Qardhul Hasan* rather than arguing about the different terms used by different organizations or different scholars.

The word *Qardh* in Arabic literally means "cutting off". When the moneylender lends to someone, he actually cuts off some of his money and gives it to the borrower. Meanwhile, the word *Hasan* in Arabic means splendid or beautiful. Thus, combining these two words together means a "beautiful loan". In other words, in general, *Qardh* means to give money

to someone that may benefit from it and pay back the same (the principal amount only). In general, most of the authors define *Qardhul Hasan* as charitable loans with no interest, or a zero-interest bearing loan, with low expectations of return of capital (Iqbal and Abas, 2007; Askari et al., 2008; AAOIFI, 2008). On top of that, the meaning of *Qardhul Hasan* can be added in which it is purely a benevolent act, and it is extended to others without interest or any other compensation from the borrower and can be expected a reward only from God (Askari et al.,2008; Saleem and Abozaid, n.d.).

Qardh has also been explained as the transfer of an asset or money from the original owner to others on condition that the asset or money will be returned to the owner in the same condition/form/value as when it first received by the other party from the owner (Abdul Rahman, 2007). Furthermore, few authors added that borrowing or *Qardh* in Islam is based on the concept of mutual help (*tabarru'*) and contemplation for others' well being especially the people in need (Rosly, 2005; Abdul Rahman, 2007). Meanwhile, in term of the execution of the contract, *Qardh* contract is concluded through offer and acceptance by the use of the word *Qardh* and *Salaf* or any other word or act that conveys the same meaning as *Qardh* (AAOIFI, 2008).

Although many definitions are given, in relation to this paper, the term *Qardh* is defined and used in accordance with the definition in the Annual Report 2008 of Calf Berhad (for reason of confidentiality, the name of the original company is disguised as "CALF"). The company defines Qardhul Hasan as: "The *Qardh* is another gratuitous contract which is a benevolent loan. This could be referred to a financing given by a person (lender) to the borrower without any expectation of extra returns or also be referred to a non-interest bearing financing. The borrower is only obliged to pay the *Qardh* at its original amount to the lender within the agreed or stipulated period of time." (Annual Report CALF, 2009).

2. LITERATURE REVIEW

Literature on *Qardhul Hasan* is very limited as compared to other products (for instance; *Murabaha, Mudharabah, Bai' as-Salam, Ijarah* and so forth) offered by IFIs. So far few research which have been conducted on Qardhul Hasan focus on the perceptions of bankers on *Qardhul Hasan* (Mohd. Ariffin and Adnan, 2009), examining the association between non performing loan and Qardhul Hasan (Adnan and Firdaus, 2006) and understanding the practice of Qardhul Hasan in Iran (Sadr, 2008)

A recent study related to *Qardhul Hasan* by Mohd. Ariffin and Adnan, (2009) seeks to gauge the perceptions among bankers in Islamic Banks in

Malaysia on *Qardhul Hasan* practices. In addition, this study also aims to identify the problems faced by Islamic Banks with regard to *Qardhul Hasan* and to determine any differences in perceptions on *Qardhul Hasan* in Malaysian Islamic Banks. The study reviews thirteen full-fledged Islamic banks' annual reports for the years 2006 and 2007. It emerges clearly that only 23.1% or three out of thirteen (3 out of 13) Islamic banks offer *Qardhul Hasan* as a financing product. The empirical findings show that the majority of the Islamic bankers in the study are familiar with *Qardhul Hasan* and agreed that Islamic banks should offer *Qardhul Hasan* to enhance corporate social responsibility. In addition, *Qardhul Hasan* is offered to help the needy people, particularly needy students as the most important group and the staff of the Islamic banks as the second most important group. However, interestingly, Islamic bankers perceived the issue of low profitability as not the biggest drawback in offering *Qardhul Hasan*. This shows a lack of understanding concerning the definition of *Qardhul Hasan* itself. In essence, Qardhul Hasan is not supposed to earn profit but rather to help the needy. For profit making organisation, this noble objective seems contradict to their current objective i.e. to maximise the financial return to their shareholders. In addition, the study revealed no significant differences among the top management, middle management or lower level management on two perceptions; *Qardhul Hasan* enhances corporate social responsibility and *Qardhul Hasan* is less popular due to no return to Islamic banks. In addition, the majority of the respondents agreed that *Qardhul Hasan* should be applied to financing.

Another study was made by Adnan and Firdaus (2006), in Bank Negara Indonesia ("BNI") *Syariah*, Yogyakarta branch, specifically, on the evaluation of non-performing loans ("NPL").One of the findings of the study is that, the BNI *Syariah,* in general, and the Yogyakarta branch, in particular, has applied the *Qardhul Hasan* as a mode of financing.

It is reported that the bank allocated 175,077,500 rupiah (Indonesia), 247,317,000 rupiah (Indonesia) and 249,817,000 rupiah (Indonesia) from 2003 to 2005, respectively. This amount is approximately 15-16% of the total *Qardhul Hasan* funds allocated by the BNI *Syariah* nationally. Unfortunately, the yearly increase in the amount of funds loaned on the basis of *Qardhul Hasan* was also followed by the increase of its NPL. The research has reported that the NPL was also increasing from 21% to 25% and 26% in 2003 to 2004 and 2005, respectively. Among the important findings of that research is that the bank has not managed the product well, as no specific person or group of employees are assigned to plan and control the operation of the product. It is also interesting to note that the main factor related to the high rate of NPL is the character of the borrowers or customers. Hence, it

is proven statistically that the two variables (character of the borrower and NPL) are significantly related.

An Iranian study by Sadr (2008) noted that the characteristics of *Qardhul Hasan* financing comply to *Shari'ah* principles that is anyone who borrows from another has to return the full amount of the financing. However, the *Qardhul Hasan* is very versatile in nature and can be used for financing for all sorts of consumption, production, services and debt activities, unlike the other products that may only suit certain types of contract. Because of its versatility, the *Qardhul Hasan* contract is complementary to other financial contracts. The study also found that in Iran, the applicants (customers) always prefer *Qardhul Hasan* financing to the other types of financing to finance their activities. Given such a state of demand on one side, and preferences of suppliers to offer *Qardhul Hasan* financing on the other side, there will be room for intermediaries to be formed in order to lower the contract cost between the two sides. In fact, *Qardhul Hasan* funds and organizations were established in Iran to cater for this purpose. The management of the *Qardhul Hasan* funds varies very much according to their purpose and location. In addition, each fund also has a board of trustees, which are mostly selected from local well known and trustworthy persons, among whom the board of directors will be chosen. Some of the employees are paid and some are volunteers. It is also interesting to note from the study on the sources of the revenues of *Qardhul Hasan* funds that almost 71% of the revenue is restored by charging for the services of the *Qardh*. This rate of charge differs among various fund units since their cost of operation is different. This is because, as mentioned, some have voluntary employees and others have paid workers. It is worth noting that despite the fact that much can be learnt from the Iranian experience, there are no Islamic Banks that offer *Qardhul Hasan* financing to the public in Iran. The difference between the Islamic Banks and the non-profit organizations that offer *Qardhul Hasan* financing is that it is the main activity of the organization. The latter specifically concentrates on *Qardhul Hasan* financing while the former is treating *Qardhul Hasan* as one of the products (and not the main activity). Therefore, the general requirements and the purposes of the *Qardh* might be different from the mentioned study.

Literature on *Qardhul Hasan* is limited. Even lesser number of literatures has been published on the implementation process of the Qardhul Hassan in a commercial setting such as in a banking industry. Therefore, the study attempts to add value to the literatures on *Qardhul Hasan*. It seeks to provide an understanding on the whole process of the implementation of *Qardhul Hasan* concept as a financing product in an Islamic bank in Malaysia. Based on the objectives of the study, the main research question has been formulated as: "How does an Islamic Bank implement *Qardhul*

Hasan as a mode of financing to the various stakeholder(s)?" There are a number of specific issues that the study attempts to highlight. Firstly, it specifically examines the the relationship between *Qardhul Hasan* financing and Non Performing Financing (NPF) in the company. Secondly, the study also tries to identify some motivational factors that could promote the offering of *Qardhul Hasan* in CALF. The study also seeks to identify the relevant *Shari'ah* issues that have been raised by banks during the implementation process of *Qardhul Hasan.* Fourthly, the study also discusses the reporting mechanism and accounting issues pertinent to *Qardhul Hasan.* Lastly, it also offers explanation on the procedures of disbursement and repayment of *Qardhul Hasan* in CALF.

3. CASE STUDY METHOD

The study has a main objective, which is to study the implementation of the *Qardhul Hasan* concept in relation to Islamic Finance, as a financing product in an Islamic bank in Malaysia.In order to achieve the objectives of this paper, a single case study research on CALF has been conducted. CALF has been chosen as the subject matter of the study, as it is among the three banks (Mohd. Ariffin and Adnan, 2009) that have implemented *Qardhul Hasan* as a mode of financing.

Case study method has been adopted to collect the data as it is believed to be the appropriate approach to answer the research questions (Yin, 1994; Scapens, 2004). This research is considered as an exploratory case study as it attempts to explore the details practices of *Qardhul Hasan*. As mentioned earlier, this research concentrates on one subject matter, which is an organization. As such, given the fact that this research is focusing on the specific case and attempting to explain the reason for observed practices, this approach, exploratory case study, has been selected. In this study, three methods of collecting data have been used. These methods include using documents, interviews and observations of meetings. Data was collected from August 2009 until January 2010. In the early stage, internal documents were reviewed to written procedures. In the latter stage, personnel from the Human Resource Department, Product Development Department, Risk Management Department, *Shari'ah* Division, Internal Audit Division and Financial Control Division have been interviewed. The interviews lasted between half an hour to one hour each. Table 2 shows the link between the research questions and methods that have been used for collecting data:

TABLE 2

The Link Between The Research Question and Methods of Collecting Data

Research Question	Data Sources and Methods	Justification	Ethical Issues
How Islamic Bank implement *Qardhul Hasan* as a mode of financing to the various stakeholder(s)?	Standard Operating Procedures ("SOP") on benevolent loan. (Artifacts)	The SOP explains in detail about the process from beginning till the end.	The SOP is strictly confidential and cannot be photocopied and printed. It can be viewed via intranet in the bank.
	Interviews with HR staff. (Interviews)	The interview is made in order to confirm that the current process is agreed with the process explained in SOP.	-
	Observation of Interview between Head of HR and the applicant (staff). (Observation of Action and Meeting)	This interview is held to ensure that the staff is really in need of the financing. This interview only held for the application of inopportune.	The interview is confidential in nature. Special request need to be made in order to get into the interview session.

Research Question	Data Sources and Methods	Justification	Ethical Issues
What motivates the Islamic Banks to promote / offer the *Qardhul Hasan*?	Interview with Head of Rewards & Benefits. (Interviews)	Head of Rewards & Benefit has been more than 5 years with the bank, thus, it is relevant to interview on the history of the product.	-
What are the *Shari'ah* issues arised prior to implement the *Qardhul Hasan* concept in any product?	Interview with the Chief Officer of *Shari'ah* Division	The information can best be obtained from the highest person in *Shari'ah* Division. The Chief Officer joined the bank since 2004.	-
Who are the recipients of *Qardhul Hasan*? Why restricted to that recipients only? Why the recipients were given the loan (*Qardh*)?	Interview with Head of Rewards & Benefits. (Interviews)	Head of Rewards & Benefit has been more than 5 years with the bank, thus, it is relevant to interview him about the product.	-
What are the accounting entries for *Qardhul Hasan*?	Interview with Head of Financial Reporting. (Interviews)	Head of Financial Reporting is the one who determine the accounting entries. He joined since 2004.	-
How the *Qardhul Hasan* being reported?	Annual Report of CALF. (Artifacts)	The most relevant evidence since it shows how the product being reported.	-
	Interview with Head of Financial Reporting. (Interviews)	Further justification can be obtained from the Head of Financial Reporting for any concern related to annual report.	-

4. FINDINGS

4.1 QARDHUL HASAN IN CALF

CALF is a foreign Islamic bank that was granted a licence under the Islamic Banking Act (Malaysia) 1983. The parent company (BULL) set up an office in Malaysia soon after the decision of Bank Negara Malaysia ("BNM") to open up the country's Islamic banking industry to qualify foreign players as recommended under BNM's Financial Sector Master Plan. As the regional headquarters of BULL in the Asia-Pacific region, CALF's main role is to provide innovative *Shari'ah*-based financial solutions to the customers. In addition, CALF acts as the intermediary and facilitator to promote two-way investments and trade between Malaysia, Asia-Pacific and the Middle East. CALF offers a complete range of *Shari'ah*-based financial products and services under Corporate and Investment, Commercial, and Retail and Consumer Banking, as well as Treasury and International Business Division. In addition, CALF also offers services related to real estate, and established CALF Asset Management Sdn Bhd to provide asset and fund management activities, encompassing private equity, alternative investments and unit trusts.

Having created several new landmarks in Islamic banking and finance in Malaysia, CALF has set up subsidiaries in Singapore and Australia as part of its plan to become a financial force in the Asia-Pacific region. CALF (Singapore) is involved in fund management activities and will undertake the management of regional funds promoted by BULL. Apart from being the regional distribution network for products and services sponsored by BULL in the Asia-Pacific region, it also acts as the centre of excellence for BULL's Islamic private banking and wealth management services.

CALF also has subsidiaries in Australia. The Australian office deploys the full scale Islamic financial services capability, which includes origination and execution of investment opportunities, treasury and investment products, as well as other marketing initiatives for the group. As such, the Australian office also plays an important role in fostering greater economic linkages between the Gulf Cooperative Council ("GCC") countries, the Asian region and Australia through foreign direct investments. Currently, the total number of clerical, executive and management staff in CALF is approximately six hundred people.

Qardhul Hasan financing was introduced since CALF started its operation in Malaysia in 2005. Since then, it has not faced any major problem in managing this benevolent loan. In fact, given the simplicity of *Qardh*, it is easier to manage, especially in terms of documentation and calculation. In terms of documentation, this *Qardh* only involves a contract

between CALF and its staff, and no other extra documentation is needed, and with regard to calculation, *Qardhul Hasan* is known as being zero interest in nature. Therefore, in the event that the staff resigns or their employment is terminated, it is not difficult or complex to calculate the repayment amount or the outstanding amount of *Qardh*. As compared to any other financing or conventional loan, *Qardhul Hasan* is the simplest and easiest financing as there is no involvement of interest or profit amount.

The motivation for the bank to implement or introduce *Qardhul Hasan* is generally to help the needy. However, CALF only caters for the needs of its staff since this *Qardh* is only offered to the staff. This practice agrees with a study made by Rosly (2005), that the *Qardhul Hasan* facility is only accessible to the banks' employees. It is regarded as one of the benefits given to the staff. In addition, CALF does not extend the facility to the public, which may be due to the possibility of an increase in the amount of NPL as per the study made by Adnan and Firdaus (2006).

As mentioned by the Head of Rewards and Benefits in CALF, "Since the benevolent loan is limited only for certain circumstances (marriage, birth of child, study and inopportune), this *Qardh* is believed can help the staff who encounter the circumstances mentioned. It is also as a trend, since the parent company, BULL, is also offering this facility to the staff there". The Head further added that, at the moment, there is no planning by management to extend the benevolent loan to the other stakeholders. However, CALF believes that although it is not helping the whole society, at least, part of the society is benefitting.

4.2 FINANCIAL PERFORMANCES AND *QARDHUL HASAN* FINANCING

Since its business was incorporated in Malaysia in 2005, CALF has shown a significant increase in growth in its overall business, year by year. As such, CALF recorded a net profit after *Zakat* and tax of, approximately, RM2 million, RM9 million, RM37 million and RM56 million, for the financial years ended 2005, 2006, 2007 and 2008, respectively. This was attributable, basically, to the strong growth in its operating revenue. Compared to operating revenue, the costs rose at a slower rate. Similar to CALF's profit and total assets, the total net financing increased as well from approximately RM0.8 million in 2006 to RM6,157 million in 2008.

Comparing the percentage of non-performing financing with the percentage of *Qardhul Hasan* financing to total net financing, it shows that it has a direct relationship. Based on the figures, the percentage of *Qardhul Hasan* financing increased from 0.01% to 0.02%, in 2007 and 2008,

respectively. At the same time, the non-performing financing increased from 0.0001% to 0.005%, in 2007 and 2008, respectively. The increase in non-performing financing is more than the increase in *Qardhul Hasan* financing. However, the increase in non-performing financing may be due to the non-performance of other types of financing (other than *Qardhul Hasan* financing). Hence, to conclude that the increase in *Qardhul Hasan* financing causes the increase in non-performing financing is not relevant and cannot be proven due to limited information.

4.3 THE *QARDHUL HASAN* PRACTICES

4.3.1 THE APPICATION AND THE DISBURSEMENT

In general, there are two parties involved in the application process of *Qardhul Hasan* – the employee of CALF ("Staff") and the Human Resources Department ("HR"). Basically, there are four qualifying reasons for applying for *Qardhul Hasan* financing – marriage, birth of child, study and inopportune. The application process of *Qardhul Hasan* begins with the staff submitting the application form and relevant documents to HR. Once the application form and the supporting documents are received, HR will record the application in the "Application Register Record" and immediately verify the completeness of the documents submitted. If the documents are not complete, HR will notify the staff and specify the outstanding documents. Then, the staff needs to resubmit the application together with the full set of supporting documents.

Once the documents are complete, HR will further process the application by checking the *Qardh* eligibility and calculate the repayment amount for the *Qardh*. In general, the eligibility to apply for the benevolent loan is that the staff must be permanent staff of CALF. After checking the *Qardh* eligibility and calculating the repayment, HR will check whether the repayment amount exceeds the debt service ratio or not. If the repayment amount exceeds the ratio, HR will notify and advise the staff to amend the *Qardh* amount. Then, the staff needs to resubmit the application to HR. If the repayment amount does not exceed the debt service ratio, verification will be obtained from the Head of Rewards and Benefits Administration and the application will be forwarded to the Head of HR for approval. If the application is not approved, HR will notify the staff and the process ends there without any disbursement of *Qardh*.

Upon approval, HR will issue an offer letter to the applicant (staff). The offer letter contains all the details including the terms and conditions of the *Qardh*. If the staff accepts and agrees with the offered *Qardh*, the staff needs to revert to HR for confirmation of acceptance. Later, HR will prepare

a memo with approval from the Head of HR for disbursement of the *Qardh*. The signed memorandum will then be forwarded to the Finance Department ("Finance") for disbursement of the *Qardh*.

In general, the disbursement process of *Qardhul Hasan* in CALF involves three departments – HR, Finance and Branch Operations ("Branch"). After receiving the memo from HR, Finance will issue an instruction to the Branch to credit the said *Qardh* amount, to the staff's account. Upon receipt of the instruction from Finance, the Branch will credit the *Qardh* to the respective staff's account. As a matter of control, Finance will later check and ensure that the amount credited by the Branch agrees with the amount approved by the Head of HR earlier and instructed by Finance.

Later, Finance will advise HR on the crediting date. This crediting date will determine the effective date to deduct the respective staff's salary. If the crediting date is before the 15th of the month, then the deduction will start from that month's payroll cycle. However, if the crediting date is on or after the 15th of the month, the deduction will commence from the following month's payroll cycle.

4.3.2 THE SETTLEMENT PROCESS

As mentioned, the settlement of *Qardhul Hasan* is through the salary deduction of the respective staff commencing from the nearest or next payroll cycle. While the duration of paying back the *Qardh* is dependent on the duration chose by the staff. However, the management of the CALF gives the maximum period to pay the *Qardh*, according to the type of *Qardh* applied for. In general, it is only the application for birth of child which must be paid in two years time or twenty four months. While for other applications, the maximum period of repayment is within three years time. Although there is a maximum period to settle the *Qardh*, the staff can still appeal for an extension, providing that he/she has a valid reason. Every appeal for extension will be reviewed and subject to the approval of the HR Committee.

In the event that the staff resigns or is terminated from the employment in CALF, HR will calculate the outstanding balance of the *Qardh*. Then, HR will notify the staff of the outstanding amount of *Qardh*. In order to make the full settlement of the outstanding *Qardh*, the first option is to pay via a bank draft. If this option can settle the entire amount, HR will prepare a memo and forward it together with the bank draft to Finance. Then, Finance will issue an instruction to the Branch to credit the bank draft to the HR cost centre. Later, the Branch will notify Finance and HR once the bank draft is credited.

However, if the bank draft cannot settle the outstanding *Qardh*

amount fully or the staff does not want to settle it via bank draft payment, the second option is to recover the amount due from the salary withheld by HR. If the salary withheld by HR can settle the *Qardh* fully, HR will later release the balance of the salary to the employee and notify the staff concerning its calculation. Furthermore, if the salary withheld by HR cannot settle the *Qardh* fully, the other option is to obtain another source of financing to settle the amount due.

4.4 THE ADMINISTRATIVE/SERVICE CHARGES ISSUE

The technical definition of *Qardhul Hasan* refers to an interest-free loan; this means that the borrower is required to repay the principal amount borrowed without any value. Islam has strongly recommended this practice and recognizes it as an *ibadah* (good deeds), as it serves to release the needy people from difficulty without oppressing the borrower. However, it is observed that the implementation of *Qardhul Hasan* seems to contravene its benevolent objective, and that it has been transformed into a dual-purpose financial instrument, which is meant as a welfare service as well as for profit-taking behind the label of administrative/service charges, so as to make it lawful in the eyes of the public. This kind of practice actually contradicts the principles of *Shari'ah* concerning *Qardhul Hasan* (AAOIFI, 2008).

Pursuant to that, AAOIFI (2008) has further stated in its Accounting, Auditing and Governance standard that all direct expenses in relation to services rendered in *Qardh* are permitted to be charged as administrative or service charges. In other words, any charge in excess of the actual cost is prohibited. Thus, it is unanimously agreed that the formula used to calculate the cost must be appropriate, exact and accurate. Moreover, indirect expenses cannot be included in charging the administrative or service charges to the customer. The example of indirect expenses has also been stated in the Standard No. 19 on *Qardh*. Among these are the salaries of the employees, the rental of space, assets and means of transport as well as other management and general expenses of the institution. However, in Iran, the source of income for *Qardhul Hasan* is mostly derived from charges on *Qardh* services. This rate differs among fund units since their cost of operation is different (Askari et al., 2008).

Although there is a difference between the current practice in Iran and the standard ruled by AAOIFI, the nature of the organization justifies the different practice. Standard No. 19 on *Qardh* is applicable to Islamic Financial Institutions, which includes Islamic Banks (AAOIFI, 2008) and the nature of the business is not exclusively on managing the *Qardhul Hasan* fund like the study made by Sadr (2008) and Askari et al. (2008). Hence, it

is permissible that the organization in Iran charges on the *Qardh* services to its customers.

In relation to *Qardhul Hasan* practice by CALF, the bank does not charge any extra cost to the staff. The staff only need to payback the amount rendered to him/her. According to the Chief Officer of the *Shari'ah* Division, the administrative cost is among the concerns of the division before approving any contract related to *Qardhul Hasan*. The division will ensure that there is no extra charge or cost charged to the other party.CALF views the giving of *Qardhul Hasan* financing as a means of achieving social objectives.

4.5 REPORTING STRUCTURE ISSUE

In Malaysia, the preparation of the annual report for Islamic Banks is guided by the Guidelines on the Specimen Reports and Financial Statements for Licensed Islamic Banks ("GP8-i"). GP8-i was issued in August 2003. All Islamic banks in Malaysia must follow the guidelines for their annual report commencing year 2004. GP8-i sets out the minimum requirements for the presentation and disclosure of reports and financial statements of Islamic banks. The objective of the GP8-i is to provide the basis for presentation and disclosure of reports and financial statements of the Islamic banks. GP8-i is also aimed at ensuring consistency and comparability of the reports and financial statements amongst the Islamic banks in complying with the provisions of the Islamic Banking Act 1983, Companies Act 1965, *Shari'ah* requirements and other Bank Negara Malaysia guidelines. As a comprehensive guideline, GP8-i also incorporated the new requirements of MASB standards, specifically the MASB *i*-1: Presentation of Financial Statements of Islamic Financial Institutions.

Meanwhile, the accounting standard set out by AAOIFI is used as a voluntary guideline by any Islamic bank in Malaysia. Since it is voluntary, no enforcement is made on Islamic banks to strictly follow the AAOIFI standard and no penalty will be imposed for non-compliance. Under the AAOIFI standard (AAOIFI, 2008), the *Qardhul Hasan* fund are presented under a separate statement called as "Statement of Sources and Uses of Funds in *Qardh* Fund". The statement is separated from the other statements such as the Statement of Comprehensive Income, Statement of Cash Flows, Statement of Changes in Owner's Equity, Statement of Sources and Uses of Funds in *Zakat* and Charity Fund.

The basic elements in the Statement of Sources and Uses of Funds in *Qardh* Fund are the sources of fund in the *Qardh* fund, the uses of fund in the *Qardh* fund and fund balance in the *Qardh* fund. With regard to disclosure, the Islamic banks need to disclose; the period covered by the statement, the

balances of *Qardh* outstanding and funds available at the beginning of the period (disclosed by type), the amounts and sources of fund contributed to the fund (disclosed by source), the amounts and uses of funds (disclosed by type) and the balances of *Qardh* outstanding and funds available in the fund (at the end of period).

In general, the structure of the annual report set out by AAOIFI requires the statement of financial position, the statement of income, the statement of changes in owners' equity, the statement of retained earnings, the statement of cash flows, the statement of changes in restricted investment, the statement of sources and uses of funds on the *Zakat* and the charity fund and statement of sources and uses of funds in the *Qardh* fund. Meanwhile, for the purpose of comparison, the basic elements of financial statement set out by Bank Negara Malaysia in the GP8-i requires the statement of financial position which is the balance sheet, the statement of income, the statement of changes in owners' equity and the statement of cash flows.

In relation to CALF practice, it follows GP8-i as a minimal guideline. Hence, there is no separate statement for the *Qardh* fund presented in its annual report like the annual report suggested by AAOIFI. In its annual report, CALF reported the *Qardhul Hasan* financing together with the other financing in the Current Asset section in the Balance Sheet. In the disclosure part, the amount is disclosed under the staff financing type and *Qardh* contract financing. However, no movement of *Qardh* financing is disclosed in the annual report. It only shows the *Qardh* amount for the current year and the previous year.

5. CONCLUSION AND RECOMMENDATIONS

According to Rosly (2005), the *Qardhul Hasan* facility is only accessible to the bank's staff and workers. This agrees with the practice of CALF, which only offers the *Qardhul Hasan* facility to its staff. In addition, the facility is only limited to certain purposes. There are only four reasons for the *Qardh* facility – marriage, birth of child, study and inopportune. Situations regarded as inopportune are the death of immediate family members and catastrophes due to natural disasters. Since the repayment mode is via salary deduction, there is very little possibility that the *Qardh* becomes NPL.

At the moment, CALF only offers the facility to its staff, and there is no plan to extend it to the community as a whole. Perhaps by catering for this small community (the staff), it can also be considered as a means of achieving the social objectives. This practice seems to be considered as not achieving the real objective of *Qardhul Hasan*, which is to fulfil the needs of society (*Maqasid al-Shari'ah*). However, the other two banks in

Malaysia that implement *Qardhul Hasan* as a financing mode also only offer the facility to their staff. In addition, the banks only offer it to the staff as an advance facility for festivals. There is no other situation that allows the staff to apply for *Qardhul Hasan* financing. Hence, this shows that CALF is the best example in implementing *Qardhul Hasan* as a mode of financing among the Islamic banks in Malaysia.

However, it is still recommended that CALF could extend the facility, if it is not to the community as a whole; perhaps CALF could offer it to its existing customers, specifically, loyal customers. Oliver (1997), as mentioned in Singh (2006), said that customer loyalty refers to "a deeply held customer to re-buy or re-patronize a preferred product or service consistently in the future despite situational influences and marketing efforts having the potential to cause switching behavior". It is believed that offering the facility to its loyal customers could mitigate the risk of customers not paying back the *Qardh*. In addition, it is believed that CALF would be able to meet the customer needs and achieve customer satisfaction. As mentioned by Hoyer and MacInnis (2001), as cited in Singh (2006), the satisfied customer will have a positive impact on the organization's profitability. They further added that satisfied customers form the foundation of any successful business.

This study has shown that a proper and valid contract of *Qardhul Hasan* is applied in CALF. There is no *Shari'ah* issue or concern with the whole process of *Qardhul Hasan* financing, from the application, disbursement until the repayment process. Concerning the benefits of this study, any Islamic bank which intends to implement or introduce *Qardhul Hasan* as a mode of financing, whether to its customer or employees, may use the process flow described as a guideline or basis. In addition, in implementing any product related to the *Qardhul Hasan* contract, the issue that concerns the *Shari'ah* Department is to ensure that the repayment amount is equivalent to the amount reimbursed to the recipient. Thus, no administration charges or any other extra charges should be imposed.

Furthermore, *Qardhul Hasan* is the most flexible financing contract compared to the other contracts. In addition, the accounting entries are the simplest. In general, it only involves two entries – during the reimbursement of *Qardh* to the staff and during the receipt of the repayment amount from the staff on a monthly basis. It is believed that the accounting entries used by CALF can also be used by the regulatory bodies, namely Bank Negara Malaysia, or the Malaysian Accounting Standards Board or for setting up an accounting guideline or principal on *Qardh*.

Presently, CALF fully complies with the local guidelines on reporting, in accordance with the Guidelines on the Specimen Reports and Financial Statements for Licensed Islamic Banks ("GP8-i"). However, in order for

CALF to provide better information to the stakeholders, it would be good, and recommended, that CALF should upgrade the report and follow the structure of the annual report as set out by AAOIFI, specifically on the "Statement of Sources and Uses of Funds in the *Qardh* Fund".

6. LIMITATIONS AND FURTHER RESEARCH DIRECTIONS

This is an exploratory case study on the implementation of the *Qardhul Hasan* concept as a mode of financing in an Islamic bank. It limits itself to *Qardhul Hasan* as a mode of financing, and does not address the other purposes. Moreover, this study adopts the single case study method. The findings cannot be statistically generalized to the whole population. This study is conducted for a certain period of time in order to finish it on schedule. Hence, only a limited number of people were interviewed for the study. In addition, only limited numbers of observations and reviews have been made. Having in-depth interviews with more respondents will perhaps provide a more comprehensive picture concerning the practice of *Qardhul Hasan* in the organizations.

As the study focuses on the implication of *Qardhul Hasan* as a mode of financing, more research need be conducted in the context of the implementation of *Qardhul Hasan*. This includes the implementation of the *Qardhul Hasan* concept as a deposit product, and the implementation of the *Qardhul Hasan* concept for Islamic credit cards or debit cards. In addition, the same type of case study or multiple case studies can be conducted in other banks that implement *Qardhul Hasan* as a financing product. More interestingly, the study can also take place in organizations (other than the Islamic banks) that provide *Qardhul Hasan* financing as a product or facility to its staff or society. Moreover, a quantitative research can be conducted to study the perceptions of the recipients of *Qardhul Hasan* towards *Qardhul Hasan* facility. As this study indicates that the recipients of the *Qardhul Hasan* financing are only the staff of the banks, it would be easier to collect data using questionnaire to further strengthen the case for *Qardhul Hasan*.

REFERENCES

Abdul Rahman, A.R. "Islamic Microfinance: A Missing Component in Islamic Banking." *Kyoto Bulletin of Islamic Area Studies* 1-2 (2007): 38-53.

Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). *Accouting, Auditing and Governance Standards for Islamic Financial Institutions.* Manama: AAOIFI, 2008.

Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). *Shari'ah Standards*. Manama: AAOIFI, 2008.

Adnan, M. Akhyar. and Puriwardana. Firdaus. "Qardhul Hasan, Kasus BNI 46, Indonesia." *Jurnal Akuntansi dan Auditing Indonesia (JAAI)* 10, No. 2 (2006): 155-171.

Antonio, M. Syafi'i, *Bank Syariah, Suatu Pengenalan Umum.* Jakarta, Indonesia Edisi Khusus, Jakarta: Tazkia Institute, 1999.

Askari, Hossein., Iqbal, Zamir. and Mirakhor, Abas. *New Issues in Islamic Finance and Economics: Progress and Challenges.* John Wiley & Sons (Asia) Pte Ltd., 2008

Harun, S. and B. Shanmugam. *Islamic Banking System, Concepts and Applications.* Selangor: Pelanduk Publications, 1997.

Iqbal, Zamir. and Mirakhor. Abas. *An Introduction to Islamic Finance Theory and Practice.* Singapore: John Wiley & Sons (Asia) Pte Ltd, 2007.

Mohd. Ariffin, Noraini. and Adnan, M. Akhyar. "The perceptions of Islamic Bankers on Qardhul Hasan in Malaysian Islamic Banks." Unpublished Working Paper. (2009).

Rosly, S. Azhar. *Critical Issues on Islamic Banking & Financial Markets.* K. Lumpur: Dinamas Publishing, 2005.

Sadr Kazem. *"Islamic Finance for Micro and Medium Enterprises."* Paper presented at *First International Conference on Inclusive Islamic Financial Sector Development: Enhancing Islamic Financial Services for Micro and Medium Sized Enterprises*, Brunei, 17-19 April 2007.

Saleem, M. Yusuf. and Abdulazeem. Abozaid. "Benefiting from Loan Contracts." Five Pillars. http://www.5pillarsinc.com/finance/wp-content/uploads/2009/12/loan-contract.pdf

Scapens, R.W. Chapter 15: Doing Case Study Research. In *The Real Life Guide to Accounting Research: A Behind-the-Scene View of Using Qualitative Research Methods.* Elsevier Ltd., 2004.

Siddiqi, M. N. *Riba, Bank Interest and the Rationale of Its Prohibition.* Jeddah:Visiting Scholars Research Series, Islamic Development Bank, 2004.

Singh, Harkiranpal. "The Importance of Customer Satisfaction in Relation to Customer Loyalty and Retention." *UCTI Working Paper* WP-06-06 (2006): 1-7.

Yin, Robert K. *Case Study Research: Design and Methods.* (2nd ed.). Thousand Oaks, CA: Sage Publications, 1994.