

# Causes for Near Default Sukuk Cases in the 21<sup>st</sup> Century and Their Rescue Mechanisms

*Penyebab Kasus Sukuk yang Nyaris Gagal Bayar di Abad ke-21 dan Mekanisme Penyelamatannya*

Randi Swandaru, Aishath Muneeza

## ABSTRACT

This study aims to examine the reasons that triggered sukuk to nearly default in the 21st century and the rescue mechanisms they used under the circumstance. This research is constructed as a case study examining selected near default sukuk cases from across jurisdictions. It is found that the main issues that triggered sukuk to nearly default are the lack of development of shariah governance, the backwardness in harmonizing shariah standards, and poor risk management through the business cycle of the underlying project. It is also found that two main rescue mechanisms are used in handling the sukuk that nearly defaulted. The first way is using commodity *murabaha* to pay out ijarah sukuk holders, as in the case of Ingress sukuk. The second way is by altering the terms of *mudharabah* sukuk to accommodate the aspiration of the sukuk holders, as in the case of Dana Gas sukuk. An anomaly in this regard is observed in Nakheel's case, where no restructuring effort was conducted as the Emirate of Dubai covered some of the debts.

**Keywords:** default, governance, sukuk, risk, *shar'ah*

## ABSTRAK

Penelitian ini bertujuan untuk menelaah penyebab yang memicu terjadinya sukuk yang hampir gagal bayar di abad ke-21 dan mekanisme penyelamatannya. Penelitian ini disusun sebagai studi kasus yang mengkaji kasus-kasus sukuk yang hampir gagal bayar tertentu dari berbagai yurisdiksi. Hasil riset ini menunjukkan bahwa isu utama yang memicu sukuk yang hampir gagal bayar adalah kurangnya pengembangan tata kelola syariah, keterbelakangan dalam harmonisasi standar syariah, dan manajemen risiko yang buruk pada siklus bisnis proyek yang mendasarinya. Ditemukan juga bahwa terdapat dua mekanisme penyelamatan utama digunakan dalam menangani sukuk yang hampir gagal bayar. Cara pertama adalah menggunakan *murabahah* komoditas untuk membayar pemegang sukuk ijarah, seperti dalam kasus sukuk Ingress. Cara kedua adalah dengan mengubah ketentuan sukuk *mudharabah* untuk mengakomodasi aspirasi pemegang sukuk, seperti pada sukuk Dana Gas. Anomali dalam hal ini diamati dalam kasus Nakheel, di mana tidak ada upaya restrukturisasi yang dilakukan karena Emirat Dubai menutupi sebagian utangnya.

**Kata Kunci:** gagal bayar, tata kelola, sukuk, risiko, syariah



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**Author(s):**

**Randi Swandaru**<sup>1</sup>

Email: randi.swandaru@gmail.com

**Aishath Muneeza**<sup>1</sup>

Email: muneeza@inceif.org

**Affiliation:**

<sup>1</sup> INCEIF University, Kuala Lumpur, Federal  
Territories of Malaysia, Malaysia

**Correspondence:**

randi.swandaru@gmail.com

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# 1. Introduction

Since its first issuance by Malaysia Shell MDS Sdn Bhd in 1990, sukuk has played a significant role in Islamic banking and Islamic capital market. It has also become a versatile instrument in the Islamic money market to fulfill Islamic financial institutions' dire liquidity management needs. It became the key avenue for the government or corporates to raise funds from the public as it is a suitable and popular investment instrument for people with low risk-seeking behavior.

International Islamic Financial Market (2021), in its Global Sukuk Report 2021, states that the total annual global sukuk issuance reached its highest value in 2020. It reached USD 174.641 billion, or a 19.84% increase in 2020. It was dominated by domestic sukuk issuance, which amounted to USD 132,233 billion. Malaysia is the biggest sukuk issuer in the world, but the significant growth of domestic sukuk issuance came from outside Malaysia, such as Indonesia, Saudi Arabia, Turkey, and Bahrain. For instance, Indonesia issued large sukuk amounted to USD 103,755 or 9.51% of sukuk issuance in 2020. They actively utilize sukuk for balancing budgetary requirements, project financing, and liquidity management. The following figure shows the top global sukuk issuers in the first semester of 2021.

Despite its resourceful function as an investment, risk management, and liquidity instrument, the current development of sukuk in the 21<sup>st</sup> century has raised serious concerns about sukuk default. Several studies have been conducted related to the emerging issues of sukuk default. For instance, Nanaeva (2010) argues that in comparison to bonds, sukuk is more prone to default due to the shariah prohibition of debt trading. It makes the markup that emanates from debt rescheduling prohibited. Although some jurisdictions allow debt trading, this divergent opinion makes sukuk less liquid than bonds due to very limited trading opportunities. In contrast, a bond is liquid and easily be traded across jurisdictions.

Kamarudin et al. (2014) in their study found that there were 24 corporate sukuk default cases in Malaysia between 2006 to 2010. It was dominated by sukuk with *murabaha and Bai Bithaman Ajiil* contract. Moreover, more than half of the cases in their observations show the defaulters have a current ratio of less than 1.5, indicating they struggled to meet short-term obligations. In addition, a study by Ab Majid et al. (2011), who scrutinized the sukuk default case in Malaysia, reveals that the long-term debt-based sukuk were more likely to get default than the profit-sharing-based sukuk. Moreover, sukuk default may also happen due to bad economic conditions that make the underlying projects not work well as planned.

One of the earliest sukuk default cases was the East Cameroon Gas Organization (ECGC), which defaulted in the USA in 2008. It was a 13-year *musharaka* sukuk that raised \$165 million for financing the drilling and operating wells in the Gulf of Mexico for a Texas-based oil and gas company. It filed for bankruptcy in judicial court, arguing that its drilling operation did not meet the expected returns because of an unexpected hazardous situation. They stated that the sale of hydrocarbon was for financing purposes only, and thus it should be included in its bankruptcy estate. The burning issue was whether the sukuk holders had legal ownership in the oil and gas royalties. ECGC denied that the contract had involved legal ownership transfer.

Nonetheless, the judge decided that a true sale had happened, and the asset securitization was valid. Then, underlying assets used for the sukuk should not be included in the bankruptcy estate. Hence, the sukuk holders were protected from the originator's bankruptcy (Tasniah et al., 2017) even though the sukuk holders had recourse to the underlying asset. This case has raised

huge concern in the financial market, raised a wider awareness of the potential sukuk default, and straightened the misconception that sukuk is default-free.

However, there are some cases in which the sukuk experienced near default incidence but managed to escape default. Those sukuk were entering some restructuring or bail-out process before finally surviving and avoiding delinquency. One of them was the Nakheel sukuk amounted to AED 15.50 billion that was issued by Dubai World, the constructor of the Dubai Palm Island, in 2009. After the near default incident, the emir of Dubai saved the sukuk by covering some of the debts amounting to \$10 billion (Salah, 2010). Dana Gas Sukuk was another near default sukuk incident that brought huge global attention. It was issued in 2007 and has been declared as non-shariah compliant. This near default sukuk case resulted from insufficient legal framework support and the lag development of shariah governance (Parker, 2017). It put two sukuk tranches for 9% of US\$350 million ordinary certificates and 7% of US\$350 million exchangeable certificates on the brink of collapse. In 2018, Dana Gas survived insolvency after finishing a restructuring process.

Despite its importance, no study yet examines near default sukuk incidences across jurisdictions to seek the loopholes and find solutions for avoiding delinquency. Hence, this writing piece aims to discuss the burning issues in the global near default sukuk cases in the 21<sup>st</sup> century. In doing so, two research questions are developed as the following. Firstly, “What are the main reasons that caused the sukuk to near default in the 21<sup>st</sup> century?”. The answer to this problem statement is important to mitigate potential sukuk default in the future. Secondly, “What were the rescue mechanisms used in those cases so that they could manage the situation and finally survive?”. Finding the answer to this question will be a lesson learned for regulators, corporations, and financial consumers to overcome any potential near default incidence.

This paper is divided into six sections. Followed by this introduction, section two presents the literature review, while section three explains the methodology. Section four presents the case studies, while section five focuses on the paper's main findings, followed by a conclusion.

## 2. Literature Review

### 2.1 Asset-Backed vs. Asset-Based Sukuk

Sukuk is a versatile instrument that can be utilized for liquidity management by providing an alternative solution for bank's mismatch maturity between assets and liabilities. They are also considered risk management instruments, considering the associated projects, coupons, and tenors. Sukuk can be issued either by governments or corporations for project financing purposes of budgetary requirements. They can be traded in the money and bond markets by institutions like banks, insurance companies, pension funds, mutual funds, and central banks. Sukuk are priced using indicative yields benchmarked on reference rates. Furthermore, the earnings of sukuk are bound to the performance of the underlying assets. (Bacha & Mirakhor, 2012).

Sukuk represents ownership of the underlying assets and their cash flow. The AAOIFI Shariah Standard No 17 characterizes sukuk as “*certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services, assets of particular projects or special investment activity*”. With regard to the assets, shariah requires halal assets as the underlying

of sukuk. Moreover, the asset needs to be tangible, although some can be intangible, according to some jurists. The tangible asset reduces the excessive leverage that is prohibited in Islam. On the contrary, bonds do not need any assets for their issuance. In addition, the purpose of financing and the involved contract in sukuk issuance have to be shariah-compliant, whereas the bond is not bound to any shariah rulings. Sukuk can be structured into various contracts. AAOIFI FAS 17 states four different contracts for sukuk, such as sale-based, lease-based, partnership-based, and agency-based (AAOIFI, 2017). Those various contracts result in different accounting and reporting consequences. It differs from bonds that are quite straightforwardly recognized as debt.

The development in the Islamic capital market has significantly altered the sukuk structure. Originally, sukuk must have a tangible underlying income-generating asset, called asset-backed sukuk. This structure requires true sale and ownership transfer of the underlying assets. In this sense, the sukuk holders have the right to sell it to a third party. In the case of default, the sukuk holders may cover themselves using the underlying asset as collateral to cushion them from the negative financial impact. On the other hand, the sukuk holders have a potential gain from the value incremental of the collateral.

Unlike the counterpart, the asset-based sukuk does not require tangible assets as the compulsory underlying asset but allows intangible assets such as receivables. In asset-based sukuk, the presence of assets is more to fulfill the Shariah requirement than providing a reliable source for income generation. Moreover, there is not any true sale (ownership transfer) involved in this structure but only in the form of beneficial ownership. Unlike the collateral in the asset-backed sukuk that can be sold to a third party, the intangible asset in asset-based sukuk does not have any secondary market. Hence, asset-based sukuk holders do not have any recourse to the underlying asset to cover them from potential downturn impact. In addition, sukuk holders cannot benefit from the potential incremental value arising from the underlying asset in the future.

The similarities between asset-based sukuk and conventional bonds have raised controversy among shariah scholars and academia. El-Gamal (2006) assess this as a replication of conventional product in a less efficient way. It also may inherit the same financial risk feature as Islamic finance and may trigger shariah non-compliance risk that may compromise public trust (Abedifar et al., 2015).

Nonetheless, asset-based sukuk has become popular and has dominated today's global sukuk market since the first sovereign sukuk issuance by the Malaysian government in 2002. It is because asset-based sukuk issuance is simpler due to the absence of complexity arising from asset transfer. Therefore, the nature of asset-based sukuk, which is quite similar to conventional bonds, makes sukuk accounting similar to bonds (Uddin et al., 2015).

## 2.2 Default Under Islamic Perspective

There is a misconception that sukuk is default-free due to its embodiment of shariah requirements. However, that is not true. Sukuk is structured to provide cash flow streams to the issuers. When there is economic turmoil, sukuk may fall into default as the business cycle downturn. The year 2009 was known as the default year for sukuk because of the economic impact of the global financial crisis. The many cases of sukuk default show that sukuk is not default-free (Azmat et al., 2014).

Under the financial definition, default refers to the situation whereby one party cannot meet the financial obligation either from the expected profit pool or from the underlying asset's purchase undertaking (ISRA, 2010). Then, default in Arabic is associated with the term *Takhallafa*, which means lag, delayed, or postponement. It can be inferred as the inability to keep the promises as in the pre-agreed arrangement.

The default incidence violates the notion of *fard* (responsibility) and *amanah* (trust) in Islam. In this sense, one party failed to conduct his duty so that it breaches the agreement or causes a potential loss for the counterparty. The Prophet Muhammad (PBUH) taught Muslims to honor trust and exert serious effort to fulfill their responsibility. One of the famous stories regarding his matter is when the Prophet Muhammad asked Ali to return all of the deposits that were entrusted to the Prophet before he left Makkah for Madina. Many of the deposits were entrusted to him by his enemies.

In a hadith narrated by Abdullah bin `Umar: Allah's Messenger (ﷺ) said:

“Surely! Every one of you is a guardian and is responsible for his charges: The Imam (ruler) of the people is a guardian and is responsible for his subjects; a man is the guardian of his family (household) and is responsible for his subjects; a woman is the guardian of her husband's home and of his children and is responsible for them; and the slave of a man is a guardian of his master's property and is responsible for it. Surely, every one of you is a guardian and responsible for his charges.”

It shows how Islam put a huge weight in fulfilling responsibility and keeping trust in society.

When it comes to the current regulation and standard, the AAOIFI (2017) Shariah Standard No. 3 has stipulated regulations regarding the procrastinating debtor. It stipulates that defaulted payment by a debtor who has the capacity to pay his responsibility is haram. Further, it prohibits any financial compensation as a penalty clause. However, the procrastinating debtor is liable for legal and other expenses incurred by the creditor to recover his debt. A different opinion comes from the SAC BNM. The SAC, in its 4th meeting dated 14 February 1998, 95th meeting dated 28 January 2010, and the 101st meeting dated 20 May 2010, has resolved that the late payment charge imposed by an Islamic financial institution encompassing both concepts of *gharamah* (fine or penalty) and *ta'widh* (compensation) are permissible.

## 2.3 Key Reasons for Sukuk Default

There are several factors that lead to sukuk default. The most common factor is non-payment or the inability to conduct timely payments. When the non-payment happens, the enforcement clause will specify the rights. A common clause is that the trustee may declare a dissolution event after about 25 to 30% of sukuk holders have decided to dissolve the trust. To prevent the default, the issuer needs to take immediate action to monitor the generating income project and remediate the situation by refinancing or restructuring (ISRA, 2016).

The second key factor of sukuk default is the poor shariah governance framework and poor supervisory roles from the authority. In this sense, there are insufficient mitigation measures to prevent non-shariah-compliant events. Commonly, the shariah scholars were not adequately involved during the product development process of the sukuk, so the shariah non-compliant risk was not meticulously assessed. In addition, the decentralized shariah governance and lack

of standardization may cause disputes that lead to legal conflicts. Moreover, the poor supervision roles from the authority can trigger the sukuk default and induce reputational risk for the financial industry (Ahmad et al., 2018).

Cross default is another factor that may induce sukuk default. It is a mechanism whereby a sukuk defaults because the issuer has defaulted earlier in another sukuk. BNM defines the cross-default clause as a clause in the borrowing agreement that states that if the borrower defaults on repayment of this borrowing, it will cause other borrowings (normally specified in the agreement) would also be deemed as defaulted and may be called for full settlement. Some scholars may object to it as this is deemed unfair to the customer. The Sukuk-holders have the right to protect their interests as long as they are agreed upon between the parties, and it must be done without any duress. Hence, the cross-default clause may expropriate the rights of the customer. In comparison, some scholars may approve of this term based on *maslahah* (public interest). The primary objective of the cross-default clause is to detect the mismanagement and incapacity of a fund manager, which may trigger an event that protects investors' rights from being violated (Ardiansyah et al., 2013).

### 3. Research Methods

Qualitative research methods, such as content analysis and doctrinal approach, are conducted to scrutinize data and information from academic journals, regulatory guidelines, reports, articles, and textbooks to present issues pertaining to near default sukuk cases (Mayer, 2015). This paper limits its observations to near default cases since 2000 or the beginning of the 21<sup>st</sup> century because since then, the sukuk has become very popular, and the financial market regulatory framework has been way better developed. This paper also focuses only on AAOIFI and IFRS as the two international accounting standards when discussing accounting standards for sukuk and bonds.

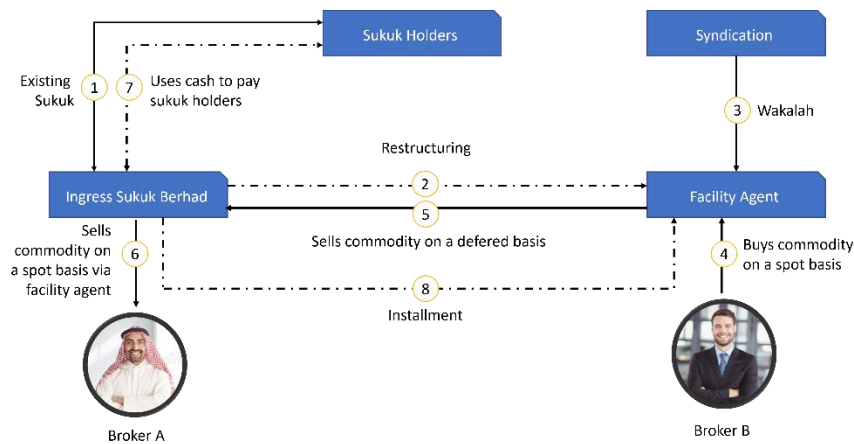
## 4. Findings

### 4.1 Ingress Sukuk

The Ingress Corporation Berhad issued an ijarah sukuk in July 2004 for MYR160 million and was expected to get maturity after seven years in July 2011. The Ingress Sukuk Berhad (ISB) was appointed as the Special Purpose Vehicle (SPV) to govern all the ijarah sukuk issuance. In the beginning, Ingress Corporation Berhad endured a good financial performance. The ISB was rated as an A+<sub>IS</sub> by the MARC. However, the rating was downgraded by the MARC to AIS as time went by. Later in 2009, the ISB could not pay the five-year sukuk that was due in July 2009, and the rating was down significantly to D<sub>IS</sub> (Mohd Noor & Shahimi, 2013).

The ISB explained two reasons for the turmoil. First, they argued that it happened because of a credit management issue. They could not resolve the situation because they did not have enough time to resolve the ijarah sukuk's covenant that restricts the debt-to-equity ratio, which must not exceed 1.75 times. The aggregate of existing securities also must not exceed 20% of the Tangible Assets. Secondly, they argued that the global financial crisis triggered their insolvency as the decline in demand for automobiles made them unable to pay the first tranche, which amounted to MYR 5 million.

Later at the Extraordinary General Meeting in June 2010, the sukuk holders agreed to accept the offer by Maybank Investment to fully redeem the outstanding sukuk via a syndicated commodity *murabaha* arrangement. In this arrangement, the agent benefits from syndicated funding to buy commodities on a spot basis and sell it on a deferred basis to Ingress Sukuk Berhad. The SPV sells the commodity on a spot basis and uses the cash to redeem the existing sukuk holders. The following Figure 1 represents the restructuring process of Ingress sukuk.



**Figure 1 Ingress Restructuring Scheme**

Source: Author's own

## 4.2 Dana Gas Sukuk

Dana Gas, a United Arab Emirates energy producer, issued USD 1 billion convertible *mudharabah* sukuk with a profit rate of 7.5% and was due in October 2012. After the sukuk buyback and conversion amounting to USD 300 million, the total principal amount was USD 700 million, due in October 2017. However, in that year, Dana Gas stopped the payment, arguing that the structure of *mudharabah* sukuk violated certain Sharia elements, such as the prohibition of guarantee to a party to *mudharabah* contract, which is considered unlawful according to the UAE law (Martin et al., 2017)

It induced tension and conflict between Dana Gas as the sukuk issuer and the investor. The company first filed for protection in the federal court in Sharjah to impose its structuring plan on the certificate. It went to the London High Court of Justice to overturn an injunction that prevented them from forcing repayment of the USD700 million of Sukuk. Finally, in 2018, most of the sukuk holders opted for agreement for the modified *mudharabah* agreement, and later the company completed the sukuk buyback program in 2019 (Dana Gas, 2020).

That situation puts a huge concern on the reputational risk. Because if people think that sukuk (Islamic bonds) are not what they are thinking about, it may encourage future sukuk issuers to argue that their product is non-shariah compliant to push the creditors into the debt-restructuring process. It may jeopardize the trust of investors and society in the Islamic finance industry. Investors with minimum shariah knowledge will withdraw their investment, considering that sukuk is uncertain and high risk.

## 4.3 Nakheel Sukuk

Nakheel Sukuk was issued by Nakheel Development Limited and originated by Nakheel Holding LLC. Along with two other Nakheel companies, the three of them act as the co-guarantor of the sukuk. They are fully owned companies by the Government of Dubai. Nakheel sukuk was al-ijarah sukuk that aimed to finance the development of Dubai Palm Island in 2009. The sukuk underlying asset was the leasehold right of certain properties in the Dubai Waterfront and collectively amounted to AED 15.50 billion.

The main factor in this debacle was the global financial crisis that caused the property market burst in Dubai. It induces several subsequent incidents, such as increasing debt and liquidity mismatch, that added complexity to the table (Ahmad et al., 2018). Another major issue that led to the near default incidence was the debt-based structure of the sukuk that does not involve real asset transfer. This ijarah sukuk scheme only provides leasehold interest on the asset until maturity. However, under UAE law, leasehold rights are not considered legal or property rights, limiting investor claims and law to be enforced. In addition, the investor cannot recourse to the underlying assets as in the Dubai law; the investor cannot claim the government's asset. The investor can sue the government, but they cannot, by any chance, claim the asset. The English law's concept of beneficial interest and trust at the Sukuk was not recognized in Dubai. Finally, this case was resolved after Abu Dhabi covered some of the debts for USD 10 billion. The investors were paid, and their claims were settled.

## 5. Conclusion

From the above cases, we can identify some salient features: the lack of development of shariah governance, the backwardness in shariah standard harmonization, and poor risk management through the business cycle of the underlying project. This section will further illuminate the risks involved in sukuk to understand better how to mitigate them. Then, a debate between substance and form is provided. Lastly, the shariah standard and guideline harmonization across jurisdictions is urgent to solve the potential legal issue in sukuk transactions.

### 5.1 Identifying Risks in Sukuk

The three cases discussed above show a strong presence of default risk. It refers to the possibility of any violation of the committed agreement between parties. The situation becomes complicated when the structure of the sukuk is asset-based, whereby the investors do not have recourse to the real underlying asset. In this sense, in the time of bankruptcy, investors cannot claim the asset to recover their lost (Al-Sayed, 2013). As the asset-based sukuk is quite symmetrical with bonds, the default incidence also raises potential interest risk, like in debt instruments. The interest rate that will be charged is aligned with the probability of default. Portfolio diversification is an immediate solution to make a cushion to the investor's investment. Further, Zakaria et al. (2012) highlight the role of credit rating assessment in mitigating sukuk default incidence.

Shariah non-compliant risk is imminent in sukuk transactions, as what has happened in Dana Gas and Nakheel sukuk. It is because the sukuk structure may have a shariah non-compliant element that does not align with the shariah standard (DeLorenzo, 2007). This risk ultimately happened because, in most cases, the shariah supervisory board was not involved since the beginning of the product development process. They commonly review the product at the very



end before the product's launch. In this regard, Usmani (2007) urges shariah scholars to have a deeper involvement in the product development stage so that any non-shariah event can be mitigated as soon as possible.

Some other risks are involved in sukuk transactions, like operational risk, liquidity risk, foreign exchange risk, and credit risk. The operational risk may emanate from the underlying project's operational activities that involve technical and specific work regarding the project itself. Unexpected incidents like bad weather, hazardous conditions, and even war can contribute to raising operational risk. Liquidity risk refers to the potential loss due to maturity mismatch so that the firm cannot fulfill immediate financial obligations. In this sense, it is essential for sukuk to have a liquid secondary market. Foreign exchange risk occurs due to the variation of foreign exchange rate for sukuk traded in the international market. Meanwhile, the credit risk emanates from the counterparty's inability to fulfill his financial obligation, especially in the debt-based sukuk.

## 5.2 Accounting Preference Between Substance and Form

Accounting and reporting play a paramount role in financial transactions. They comprise several activities, starting from identification, transaction recording, measurement, analysis, and presentation in financial statements or other relevant reporting forms. It is a systematic procedure that will provide information for the executive leader and financial disclosure for the public. However, the robust accounting and reporting process starts with a financial transaction's underlying recording principle. That is the commencement of the tension whether the transaction should be recorded by its economic substance or isolated them according to its legal form. Research by Hanif (2016) finds that several Islamic financial contracts perform their shariah purposes on the surface, but their economic substance shares a lot of similarities in substance with conventional finance. Moreover, Rosly (2010) argues that putting weight on form over substance seems to be aligned with Islamic teaching. However, it creates a leeway on the opposite side that may compromise shariah compliance.

IFRS tends to give more preference to economic substance over form for accounting recognition and measurement. It is reflected in the IASB Conceptual Framework for Financial Reporting, paragraph 4.6, page 12 (IASB, 2010), as quoted below. Nonetheless, IFRS does not ignore the legal form as it is important to provide reliable financial information.

*“In assessing whether an item meets the definition of an asset, liability or equity, attention needs to be given to its underlying substance and economic reality and not merely its legal form.”*

On the contrary, AAOIFI put special attention on Shariah compliance and the form of the contract (Hamour et al., 2019). For instance, in the case of *ijarah muntahiyah bi al-tamlik* or a period of leasing with a transfer of ownership at the end, AAOIFI (2010) demands a distinct contract for the ownership transfer on top of the operating lease contract at the beginning. It shows how AAOIFI put more concern on the form over substance. In contrast, if the concept of substance over form is conducted, the financial statement will only record the final sale, and both contracts are blended into a single contract.

Another example regarding the tension between substance and form is relevant to the case of *bay inah*. The transaction requires immediate purchase after a sale transaction. If the concept

of substance over form is conducted, the accounting procedures will only recognize the customer's financing cost payable. However, if the form over-substance principle is used, the accounting procedures will record two transactions. They are a sale from the bank to a consumer and another sale of the same asset back to the bank.

The burning accounting issues on sukuk also lie in the debate between substance and form, whereby the asset-backed sukuk is considered a better shariah compliance representation than asset-based sukuk (Tasnia et al., 2017). As elaborated, the structure of asset-based sukuk somehow diverges Islamic tenets such as true sale, transfer of ownership, and excessive leverage. The nature of assets in asset-based sukuk is merely to circumvent shariah prohibition to make it aligned with Islamic law. Hence, it makes asset-based sukuk essentially the copycat of conventional bonds. Yet, the emergence of Malaysian Global Sukuk received international recognition and was listed as the first asset-based sukuk listed in Luxembourg Stock Exchange. The following section will further discuss the accounting issues on sukuk

### 5.3 Harmonization of Shariah Standards

The discussion above shows that the different shariah opinions and diverse legal jurisdictions trigger the sukuk accounting and financial reporting differences among countries. On top of that, the market or public demands synchronized procedures to treat sukuk like conventional bonds. Hence, it is urgent to have guideline standardization to solve this issue. The harmonization initiative is important because it is maybe quite difficult in the short run to have a single Shariah standard, recognizing different Shariah schools and opinions that exist in various jurisdictions. However, it may be possible to develop a unified, standardized, and comprehensive Shariah guideline that accommodates specific requirements for each region or jurisdiction. It can be a reference for various Islamic financial institutions to conduct their accounting and financial reporting procedures.

There are at least two ways to realize this initiative. First, it requires regular meetings between shariah scholars and financial experts to discuss and create harmonized shariah and accounting guidelines. The meeting may take a few years to complete all the expected issues, but it can deliver some desired progress along the way. Secondly, it demands political leader's support from Muslim-populated countries. They have a significant role in accommodating this initiative in their regulatory regimes. The communication between political leaders may also enable cross-country shared experience. In this sense, countries like Malaysia, Pakistan, and Indonesia may extend their help to other OIC countries to develop Shariah governance and the Islamic financial ecosystem in their respective country.

## 6. Conclusion

This paper aims to shed the most salient feature that caused near default sukuk incidence and the solution that avoided them from default. This research uses the desk research method to examine three global near default sukuk incidents, namely Ingress sukuk, Dana Gas sukuk, and Nakheel sukuk. The most salient feature of near default sukuk incidence is the lack of development of shariah governance, the backwardness in shariah standard harmonization, and poor risk management through the business cycle of the underlying project.

Then, there are two main ways out of restructuring the global near default sukuk. First, using commodity *murabaha* to pay out ijarah sukuk holders as in the case of Ingress sukuk. Second, altering the terms of *mudharabah* sukuk to accommodate the aspiration of the sukuk holders, as in the case of Dana Gas sukuk. In the case of Nakheel, there was not any restructuring effort conducted as the emirate of Dubai covered some of the debts.

Further, it is important to meticulously identify and manage the risks involved in sukuk transactions, such as default risk, shariah non-compliant risk, credit risk, liquidity risk, foreign exchange risk, and operational risk. On a global scale, the Islamic financial industry needs to exert serious effort in harmonizing shariah standards and guidelines to impede future non-shariah compliant incidence that is detrimental to the trust in the Islamic finance industry. Harmonization is also important to bring efficiency and value to the stakeholders.

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