

**LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA
MALAYSIAN ACCOUNTING STANDARDS BOARD**

Technical Release *i-3*

**Presentation of Financial Statements
of Islamic Financial Institutions**

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A	Explanations of terms used

MASB Technical Release *i-3 Presentation of Financial Statements of Islamic Financial Institutions* (TR *i-3*) is set out in paragraphs 1-51 and Appendix A. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms explained in Appendix A are in *italics* the first time they appear in TR *i-3*. TR *i-3* should be read in the context of its objective, the *Foreword to MASB Standards and Other Technical Pronouncements*, and the *Framework for the Preparation and Presentation of Financial Statements*. FRS 101 *Presentation of Financial Statements*, and FRS 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provide bases for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

The need for Islamic accounting pronouncements

- IN1 Islamic banking operations in Malaysia have been in existence for over two decades and have experienced rapid growth due to wider understanding and public acceptance, as well as the introduction by the government of a structural framework and a set of facilitative measures to nurture a healthy development of the industry. Hitherto, Islamic banking financial reporting practices have been under the purview of the Central Bank of Malaysia (Bank Negara Malaysia) as well as the *Companies Act 1965* and applicable Financial Reporting Standards. In the absence of specific accounting guidance, Islamic banks and other Islamic financial institutions, as well as conventional banks that provide Islamic banking services, have relied heavily on the prevailing guidelines issued by the Bank Negara Malaysia and on *Shariah* rulings issued by Shariah advisors appointed by the respective banks. This practice had raised a number of serious concerns. The absence of authoritative additional guidance for the recognition, measurement, and disclosure of Islamic-based transactions may complicate or hinder attempts to compare financial performance among banks or between periods for individual banks. It has become increasingly evident that in the long run the lack of additional guidance may also hamper the development of Islamic investment vehicles as well as a robust Islamic capital market.
- IN2 The existing Financial Reporting Standards, which have been developed with a view to convergence with the International Financial Reporting Standards (IFRSs), does not provide specific accounting guidance for Islamic banking operations. Fundamental differences in underlying principles, along with the distinctive nature of Islamic financial practices, may not have been adequately addressed by conventional accounting standards. Hence, while the existing Financial Reporting Standards are useful in providing a structural framework for reporting, they may not have accommodated Shariah precepts, which form the basis of all Islamic transactions.
- IN3 In formulating its pronouncements on accounting for Islamic financial transactions, the MASB has given careful consideration to the Shariah principles underlying the transactions, and their

implications for financial reporting. This Technical Release is developed specifically to meet the needs of Islamic financial practices, and the regulatory as well as economic structure in Malaysia.

- IN4 In the process of developing Islamic accounting pronouncements, the MASB has engaged in an elaborate and rigorous ‘due process’ to elicit the views of practitioners, accountants, auditors, regulators, and users of financial statements of Islamic financial institutions. The MASB takes cognisance of the fact that all its Standards are legally binding and has to ensure that the accounting standards it issues are enforceable without hindering the healthy development of Islamic financial practices. The MASB believes that the issuance of Islamic accounting pronouncements will guide Islamic banking operations, promote disclosure-based principles, enhance transparency, and help nurture the development of the Islamic capital market.

Reason for withdrawing FRS *i*-1₂₀₀₄ and issuing TR *i*-3

- IN5 The Board has adopted a principle of accounting for Shariah compliant transactions and events in accordance with MASB approved accounting standards in the absence of any Shariah prohibition to do so.
- IN6 In the event that there are issues relating to accounting for Shariah compliant transactions that require additional guidance not provided for in the approved accounting standards, such guidance would be provided in the form of other technical pronouncements.
- IN7 Since much of the material in FRS *i*-1₂₀₀₄ are already dealt with by FRS 101, the Board decided to eliminate duplication by retaining only guidance not found in FRS 101. The additional guidance would be issued as a Technical Release, and FRS *i*-1₂₀₀₄ would be withdrawn.

Technical Release i-3

Presentation of Financial Statements of Islamic Financial Institutions

Objective

- 1 The objective of this Technical Release is to lay down the basis for the presentation and disclosure of financial statements of Islamic financial institutions that conduct Islamic banking activities. This Technical Release sets out the overall considerations for the presentation and disclosure of the financial statements specific to these institutions in order to ensure comparability of these statements with those in previous periods and with those of other Islamic financial institutions. In addition, this Technical Release provides guidelines for the structure, and basis of the content of financial statements to ensure conformity with *Shariah requirements*. It also prescribes minimum disclosure requirements. The recognition, measurement, and disclosure of specific Islamic-based transactions and events will be dealt with in other MASB Islamic accounting pronouncements.

Scope

- 2 **This Technical Release shall be applied to the presentation of financial statements of *Islamic financial institutions* (hereinafter referred to as IFIs) that conduct Islamic banking.**
- 3 **For conventional banks and other financial institutions that participate in an Islamic Banking Scheme (hereinafter referred to as IBS) or that establish any other schemes of similar nature, such institutions are required to disclose separately a complete set of financial statements in the notes the results of operations under the IBS. The presentation and disclosure of financial statements of the scheme shall comply fully with this Technical Release.**
- 4 This Technical Release is specific to IFIs that conduct Islamic banking business. Specific-purpose financial statements are those intended to meet the particular information needs of users of financial statements of IFIs. Such needs include making economic decisions in accordance with the Shariah principles. Regulatory

authorities may prescribe specific requirements for IFIs in addition to the ones that appear in this Technical Release.

- 5 *Institutions other than IFIs* are encouraged to comply with this Technical Release.
- 6 This Technical Release complements FRS 101 *Presentation of Financial Statements* and shall be read in the context of other Financial Reporting Standards (FRSs) as long as it does not contradict Shariah requirements.

Other reports in addition to the financial statements

- 7 An IFI is encouraged to present, outside its financial statements, any other statements useful to users, for example, *Zakat* Fund and *Qard* Fund.

General features

Materiality

- 8 **The nature of immaterial information shall be disclosed if it is for purposes of compliance with Shariah rulings.**

Offsetting

- 9 Offsetting of balances may be made in respect of unearned profit for *Murabahah*, *Bai' Bithaman Ajil* and *Ijarah* financing against *Murabahah*, *Bai' Bithaman Ajil* and rental receivables when it is required or permitted by an FRS.

Form and classification of financial statements

- 10 **The form and classification used in the financial statements shall ensure a fair presentation of their content. Assets and liabilities need not be classified between current and non-current in the balance sheet but may be broadly presented in the order of liquidity.**
- 11 The most useful approach to classification of the assets and liabilities of an IFI is to group them by their nature and their respective contracts and to list them in the approximate order of

their liquidity, or their maturity. Current and non-current items are not presented separately because most assets and liabilities of an IFI can be realised or settled in the near future.

Structure and content

Identification of financial statements

- 12 In presenting the end of its reporting period, an IFI is encouraged to include the Muslim calendar date.

Statement of financial position

- 13 **The statement of financial position of an IFI shall include the IFI's assets, liabilities and equity. These elements shall be presented separately such that they present fairly the IFI's financial position.**
- 14 The descriptions and the ordering of items presented shall assist preparers in providing information that is necessary for the overall understanding of an IFI's financial position. Such descriptions and ordering may be made in order to apply more specific requirements of regulatory authorities.
- 15 The assets of an IFI include cash balances and short-term funds, placements with other financial institutions, dealing and investment securities, and financing of customers. The cash balances usually comprise deposits made based on the Shariah principle of *Wadiah*. The placement usually comprises money market placement made on the basis of *Mudharabah* principle. Dealing securities usually comprises equity and other capital market instruments acquired for trading purposes and investment securities are acquired for long-term investment purposes. The financing of customers usually comprises financing extended to customers based on various Shariah principles. Other items include receivables, statutory deposits with BNM, and property, plant and equipment.
- 16 The liabilities of an IFI usually comprise deposits from customers, deposits and placements of other financial institutions, bills payable, and other liabilities. Deposits from customers comprise Mudharabah and non-Mudharabah deposits. Non-Mudharabah

deposits include savings, current and Negotiable Islamic Debt Certificates and other similar instruments. Mudharabah deposits consist of deposits accepted by an IFI in the form of investment and other profit-sharing deposit accounts. The non-Mudharabah deposits include money deposited based on Wadiah contracts or any other non-profit-sharing contracts. Other liabilities include provision for taxation and Zakat.

- 17 In the case of conventional banks and other financial institutions that carry out IBS, funds allocated for the IBS operation is normally disclosed as a separate item after all liabilities of the IBS. The nature of the funds is such that it is deemed to be an advance from the IFIs for purposes of establishing the scheme.
- 18 Equity of an IFI can be defined as the residual interest in the assets of the IFI after deducting all liabilities. It comprises paid up capital, distributable and non-distributable reserves.
- 19 **Separate disclosure of assets, liabilities and equity shall be presented in the notes.**
- 20 Within each classification, distinction is normally made between types, nature and value of the assets in the notes. For example, in dealing securities, type of securities and impairment losses need to be disclosed. In the case of financing of customers, the example of disclosure would include, analysis by product, by concept and by types of customers. Such distinction has reporting consequences in terms of classification of financing accounts.
- 21 This disclosure is useful to users due to the unique features and associated risks of each type of contract. For example, Wadiah contracts guarantee safe custody of deposits. The IFI can decide on a discretionary share of income (*hibah*) to be paid to the depositors. Mudharabah deposits are profit sharing deposits where the profit paid is based on a pre-agreed sharing ratio. Their risk profiles are different. Other forms of liabilities are those that are based on Wadiah contracts.
- 22 The presentation of liabilities is useful to decision makers due to their distinguishing features as described in paragraph 16. Detailed disclosures of contract types and nature of obligations are normally made in the notes.

- 23 Other liabilities include *Istisna'* payables, *Salam* payables, dividend payables, Zakat and tax payables, which are non-profit sharing liability.

Statement of comprehensive income

- 24 The descriptions and the ordering of items presented shall assist preparers in providing information that is necessary for the overall understanding of an IFI's financial performance. Such descriptions and ordering may be made in order to apply more specific requirements of regulatory authorities.
- 25 The income of an IFI includes income derived from investment of depositors' funds, income derived from the investment of shareholders' funds (in the case of conventional banks and other financial institutions that carry out IBS, income derived from the investment of Islamic banking capital funds), income attributable to the shareholders (in the case of conventional banks and other financial institutions that carry out IBS, income attributable to the bank/group), and other income. Income derived from investment of depositors' funds comprise all income from investment of general investment deposits, specific investment deposits, and other depositors' fund. Embedded in this are portions of income attributable to depositors. Income derived from investment of shareholders' funds usually comprises income from financing, trading, and investment activities, which comes from dealing and investment securities in and outside Malaysia.
- 26 The expenses of an IFI usually comprise allowance for loan and financing, expenses directly attributable to the investment of the depositors and shareholders/Islamic banking capital funds, personnel expenses, and other expenditure. Allowance for loan and financing comprise specific and general allowance as well as bad debts recovered and written-off during the financial year. Other expenditure includes Shariah committee members' remuneration, hire of equipment, general administrative expenses and other expenses.
- 27 **An IFI shall present in the notes, an analysis of income according to types of investments and financing of customers.**

Statement of changes in equity

- 28 **An IFI shall present, either in the statement of changes in equity or in the notes, the amount of dividends recognised as distributions to owners during the period, and the related amount per share.**
- 29 Such disclosure of dividends per share may not be applicable to Islamic banking activities carried out by a conventional bank or financial institution.
- 30 The descriptions and the ordering of items presented shall assist preparers in providing information that is necessary for the overall understanding of an IFI's financial performance. Such descriptions and ordering may be made in order to apply more specific requirements of regulatory authorities.

Notes

Capital

- 31 An IFI may manage capital in a number of ways and be subject to a number of different capital requirements. For example, an IFI may undertake *Takaful* activities and may operate in several jurisdictions. When an aggregate disclosure of capital requirements and how capital is managed would not provide useful information or distorts a financial statement user's understanding of an IFI's capital resources, the IFI shall disclose separate information for each capital requirement to which the IFI is subject.

Disclosure of unusual supervisory restrictions

- 32 An IFI is encouraged to disclose any unusual supervisory restrictions imposed on the IFI by any regulatory or supervisory agency with respect to any regulations regarding such restrictions.
- 33 The situation where the regulatory and supervisory agency may impose the restriction contrary to Shariah principles on IFI is very rare. Such restriction can impair the IFI's ability to make decisions necessary to manage the IFI or it prevents the IFI from carrying out some of the activities it has been authorised to carry out by its charter.

Disclosure of Shariah advisor or Shariah board and Zakat obligations

- 34 **An IFI shall disclose the role and authority of the Shariah advisor or board in monitoring the IFI's activities pertaining to Shariah matters.**
- 35 **An IFI shall also disclose, where applicable, its responsibility towards payment of Zakat on behalf of depositors, shareholders and others.**

Disclosure of earnings or expenditure prohibited by Shariah

- 36 An IFI is encouraged to disclose:
- (a) the amount and nature of earnings realised from sources or means which are not permitted by Shariah;
 - (b) the amount and nature of expenses not permitted by Shariah; and
 - (c) the manner of disposal of prohibited earnings.

Concentrations of asset risks

- 37 **Disclosure shall be made in the financial statements of any significant concentrations of its assets invested or deposited in the following ways:**
- (a) **by geographical areas;**
 - (b) **by customer groups;**
 - (c) **by industry sectors; or**
 - (d) **other concentrations of risk that are appropriate.**

Concentration and distribution of investment accounts

- 38 **Disclosure of concentrations of sources of investment accounts and their equivalent and other accounts shall be made in the financial statements.**
- 39 **Disclosure of the distribution of investment accounts and their equivalent and other accounts in accordance with respective**

periods to maturity shall be made in the financial statements.

Distribution of assets

- 40 Disclosure of the distribution of assets in accordance with respective periods to maturity or expected periods to cash conversion shall be made in the financial statements.

Commitments and contingencies including items not in the statement of financial position

- 41 Disclosure of commitments and contingencies shall be made in the financial statements of the IFIs and include:
- (a) the nature and amount of commitments that are irrevocable; and
 - (b) the nature and amount of contingencies arising from items not in the statement of financial position including direct credit substitutes, transaction related contingencies, sales and repurchase agreements, and other contingencies of similar nature.

Accounting policies, changes in accounting estimates and errors

- 42 The disclosure requirements as per FRS 108 *Accounting Policies, Changes in Accounting Estimates and Errors* shall apply to an IFI. In addition, any accounting effect on investment accounts shall be disclosed.

Profit distribution policy

- 43 An IFI that co-mingles various types of deposits into a single pool of funds shall disclose the method of allocation of income among various categories of deposits.
- 44 An IFI shall disclose the distribution of profit derived from investment of depositors' funds at gross level, after deducting expenditure to the extent that they are directly attributable to the investment of those funds.
- 45 An IFI normally allocates income by using a weighted average method balances and allocates a total income to various categories

of depositors.

- 46 An IFI normally distributes profit derived from investment of depositors' funds based on a pre-determined ratio in the case of Mudharabah deposits, and on a ratio determined at the discretion of the IFIs in the case of Wadiah and other non-Mudharabah deposits.

Related party disclosures

- 47 **An IFI shall comply with FRS 124 *Related Party Disclosures*.**

Specific investment accounts

- 48 Specific investment accounts are restricted as to their co-mingling with other funds. They are to be used for specified financing or investment. Additional disclosures on the nature of fund, profit sharing policy, nature of financing, and investment are encouraged.
- 49 **Profits or losses of a specific investment account shall be separately disclosed. They shall not be offset with profits or losses from other items.**

Transition and effective date

- 50 **An entity shall apply this Technical Release for annual periods beginning on or after 1 January 2010. Earlier application is permitted. If an entity adopts this Technical Release for an earlier period, it shall disclose that fact.**

Withdrawal of FRS i-1₂₀₀₄

- 51 **FRS i-1₂₀₀₄ *Presentation of Financial Statements of Islamic Financial Institutions* shall be withdrawn with effect from 1 January 2010.**

Appendix A

Explanations of terms used

The following explanations are intended to serve as a guide and may not necessarily capture the complexities of the terms. The translations are merely literal renditions that may not necessarily convey the nuances behind the Arabic terms.

Bai' Bithaman Ajil <i>(lit., deferred payment sale)</i>	A sale where payment of the consideration is deferred, either in instalments over a specified period or in full on a specified date.
Hibah <i>(lit., gift)</i>	A unilateral benevolent contract in which a party voluntarily transfers the ownership of an item to another party without any consideration.
Ijarah	<ol style="list-style-type: none"> <li data-bbox="501 711 963 804">1. A contract to employ the services of a party, with wages given as consideration for the hired services. <li data-bbox="501 820 963 916">2. A contract to transfer the usufruct of an item to another party, for a specified period, in exchange for rent.
Institutions other than IFIs	Non-bank financial institutions that comprise provident and pension funds, insurance companies including Takaful operators, savings institutions, and development finance institutions. Other non-bank financial institutions include unit trusts, Tabung Haji, Cagamas, housing credit institutions, the Credit Guarantee Corporation, leasing and factoring companies, and venture capital companies.
Islamic financial institution (IFI)	An Islamic bank, commercial bank, finance company, merchant bank, or discount house that carries out Islamic banking business or Islamic financial business. "Islamic banking business" and

“Islamic financial business” have the same meaning as the definition provided in the *Islamic Banking Act 1983*, and the *Banking and Financial Institutions Act 1989* respectively.

Istisna’
(*lit., order sale*)

A sale in which the subject is an item that has yet to be fabricated, manufactured, or constructed. Delivery of the item takes place at a future pre-determined date. The consideration may be paid before, at or after delivery, or based on the stage of completion.

Mudharabah
(*lit., profit sharing*)

A form of partnership between a party which contributes capital (*rabb al-mal*, i.e. capital provider) and another which contributes efforts, managerial and/or entrepreneurial skills (*mudarib*, i.e. manager / entrepreneur). Profit from the outcome of the venture is shared between the capital provider and manager / entrepreneur according to a mutually agreed profit sharing ratio, while losses are borne solely by the capital provider, provided such loss is not due to the manager’s/entrepreneur’s negligence or violation of specified conditions.

Murabahah
(*lit., cost plus*)

A sale based on trust, in which the seller must disclose to the purchaser the mark up on the item sold. The consideration in a Murabahah sale may be paid either in cash or deferred.

Qardh
(*lit., loan*)

A loan. In Shariah, a borrower is formally obligated to repay only the principal amount of the loan and the lender is not entitled to demand any return over and above the principal. However, an additional payment may be made at the borrower’s discretion, provided that no such stipulation is made in the contract.

Salam <i>(lit., future delivery)</i>	A sale in which the consideration is paid at the time of contracting, while delivery of the subject item takes place at a future pre-determined date.
Shariah	Islamic laws derived from Al-Quran and As-Sunnah .
Shariah requirements	Shariah principles, rules and regulations adopted by the Shariah Advisory Councils of Bank Negara Malaysia (BNM) and the Securities Commission, as well as Shariah rulings promulgated by the Shariah Supervisory Board of IFIs.
As-Sunnah	The acts, sayings and tacit approvals of Prophet Muhammad (peace be upon him).
Takaful <i>(lit., insurance)</i>	A fraternal arrangement based on solidarity and mutual assistance under which participants agree to contribute to a common fund for the purpose of mutual financial benefits payable to the participants or their beneficiaries on the occurrence of pre-agreed events.
Wadiah <i>(lit., savings)</i>	A contract by which the owner of an item would deposit the item with another party on the basis of trusteeship (<i>amanah</i>) for safekeeping purposes. If the asset deposited is in the form of money or currencies, the custodian is allowed to use it.
Zakat	Obligatory contribution assessed based on certain assets owned by a Muslim that satisfy certain conditions and is to be distributed to specified categories of beneficiaries.