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standard-setters group

AOSSG Survey

Accounting and Islamic Finance in the Middle East and North Africa

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AOSSG Survey
Accounting and Islamic Finance in the Middle East and North Africa

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About the survey

In 2011, the Islamic Finance Working Group of the Asian-Oceanian Standard-Setters Group (AOSSG) invited national accounting standard-setters around the world to participate in a survey about Islamic financial transactions and entities. The results showed that Islamic finance was present in 58% of respondents' jurisdictions, and that 78% of respondents did not consider having differential financial reporting standards for Islamic finance to be compatible with International Financial Reporting Standards (IFRS). The AOSSG used the survey findings to impress upon the International Accounting Standards Board (IASB) that it needed to consider Islamic-based transactions and entities in its on-going and future projects.

An incidental finding was that many countries in the Middle East and North Africa (MENA) did not have an identifiable national accounting standard-setter. The 2011 survey report noted that the AOSSG Islamic Finance Working Group may need to undertake further work to understand the accounting framework in MENA, especially given the significant presence of Islamic finance in that region.

This year, the AOSSG Islamic Finance Working Group undertook a second survey. It reached out to accountants and auditors in MENA to understand their views about accounting for Islamic financial transactions. As in 2011, this survey asked respondents about the financial reporting requirements in their jurisdiction and how they thought entities were likely to apply those requirements to some common Islamic financial transactions. Additionally, the survey encouraged respondents to write about concerns that they would like to bring to the AOSSG's attention.

The AOSSG Islamic Finance Working Group distributed the survey to accounting and auditing practitioners in 24 countries in MENA. The survey ran from 1 July to 15 October 2013, and received 25 responses. This report summarizes and discusses the responses collated.

Executive summary

Practitioners' views on the financial reporting environment

60% of respondents consider their jurisdiction to be converged with or have adopted IFRS, yet 64% also wrote that Financial Accounting Standards (FAS) issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) apply in their jurisdiction.

It seems that some financial reporting frameworks in MENA allow both sets of standards to co-exist to a certain degree. From respondents' explanations:

1. In some jurisdictions, certain entities must comply with AAOIFI FAS as the primary set of financial reporting standards, and only apply IFRS requirements where AAOIFI FAS requirements are absent.
2. Some jurisdictions which generally apply IFRS may exempt a reporting entity, at the request of the entity, from complying with IFRS and instead allow the entity to apply AAOIFI FAS.

Additionally, 75% of respondents in jurisdictions which apply AAOIFI FAS thought that their jurisdiction should retain AAOIFI FAS even though there is a global trend towards using IFRS. Some of these respondents wrote that IASB should publicly announce how it plans to address accounting for Islamic financial transactions before their jurisdiction considers any changes to the financial reporting framework.

The results indicate that accountants and auditors in MENA generally view the co-existence of IFRS and AAOIFI FAS in a jurisdiction as being compatible with IFRS convergence. They also appear to accept the preparation and presentation of financial statements that comply with IFRS for some items and with AAOIFI FAS for others.

These views contrast sharply with AOSSG's 2011 survey, in which 78% of national accounting standard-setters did not consider having differential financial reporting standards for Islamic finance to be compatible with IFRS convergence.

Accounting for Islamic financial transactions

The co-existence of IFRS and AAOIFI FAS within a financial reporting jurisdiction – and indeed, within the financial statements of a reporting entity – raise interesting questions about how the sometimes contradictory requirements of the two sets of standards would be applied.

We asked respondents how they thought entities in their jurisdictions were likely to treat certain common Islamic financial transactions. The responses indicate that some transactions may not be treated in accordance with IFRS requirements. For example:

- Only 48% thought that the financing element that arises from a *murabahah* contract in their jurisdiction would be measured in accordance with the effective interest rate method of IAS 39/IFRS 9.
- 56% stated that entities in their jurisdiction may recognise a separate element of the financial statement for financial instruments that have characteristics of both liability and equity. IFRS do not currently have an intermediary element between liability and equity.
- 48% replied that entities may not be allowed to treat *ijarah* as a finance lease under IAS 17, *Leases*, even if it meets the criteria for a finance lease.

Conclusions

These findings suggest that some entities in MENA may apply AAOIFI FAS principles, yet still assert that its financial statements are in compliance with IFRS. The AOSSG Islamic Finance Working Group may need to undertake further research to understand how the application of principles from two different sets of frameworks can still result in an assertion of IFRS compliance.

Some Middle East countries are within the continent of Asia, and may qualify for AOSSG membership. One of the stated objectives of AOSSG is to “promote consistent application of IFRSs by jurisdictions in the region”. Hence, AOSSG may need to take the survey findings into consideration in dealing with potential candidates for membership from this region.

The newly established IASB advisory group on *Shariah*-compliant transactions and instruments may also need to consider Middle Eastern stakeholders’ affinity for AAOIFI FAS in its discussions, while keeping its commitment to IFRS.

SURVEY RESULTS

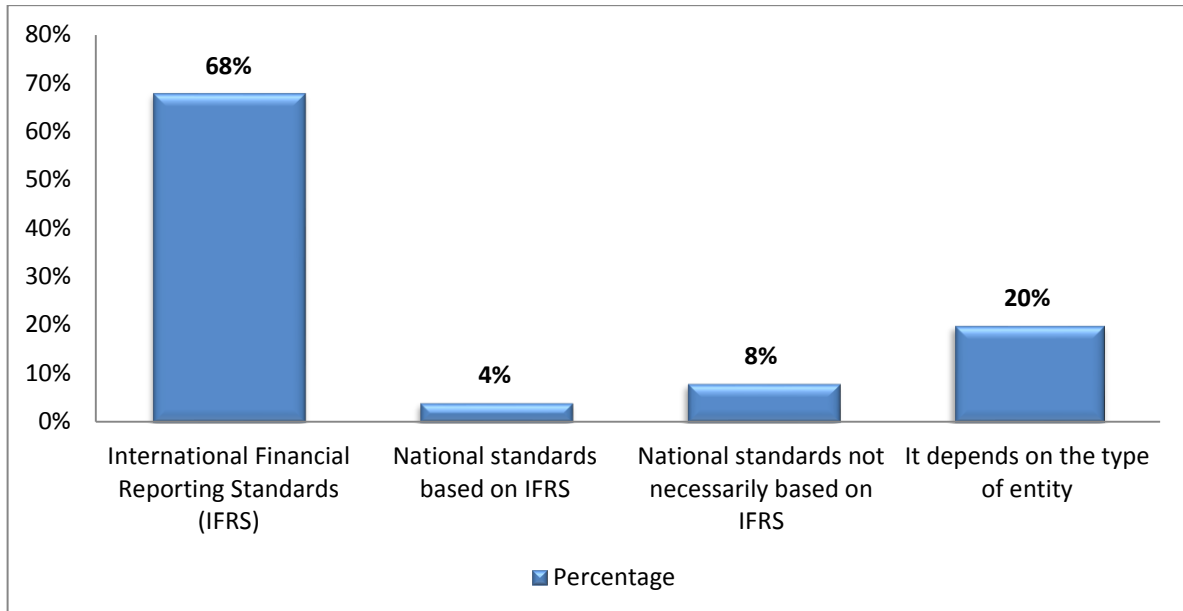
Respondents' views on the financial reporting environment

1. *Please name your financial reporting jurisdiction.*

The AOSSG Islamic Finance Working Group distributed the survey questionnaire to accounting and auditing practitioners in 24 countries in MENA. The table below presents the distribution of responses.

Jurisdiction	No. of Respondents
Algeria	-
Bahrain	3
Djibouti	-
Egypt	1
Iran	-
Iraq	1
Israel	-
Jordan	2
Kuwait	2
Lebanon	3
Libya	1
Mauritania	-
Morocco	-
Oman	3
Qatar	3
Saudi Arabia	2
Sudan	-
Syria	-
Tunisia	-
Turkey	-
United Arab Emirates (UAE)	3
West Bank & Gaza	1
Western Sahara	-
Yemen	-
TOTAL	25

2. *What financial reporting standards generally apply to entities engaged in finance in your jurisdiction?*



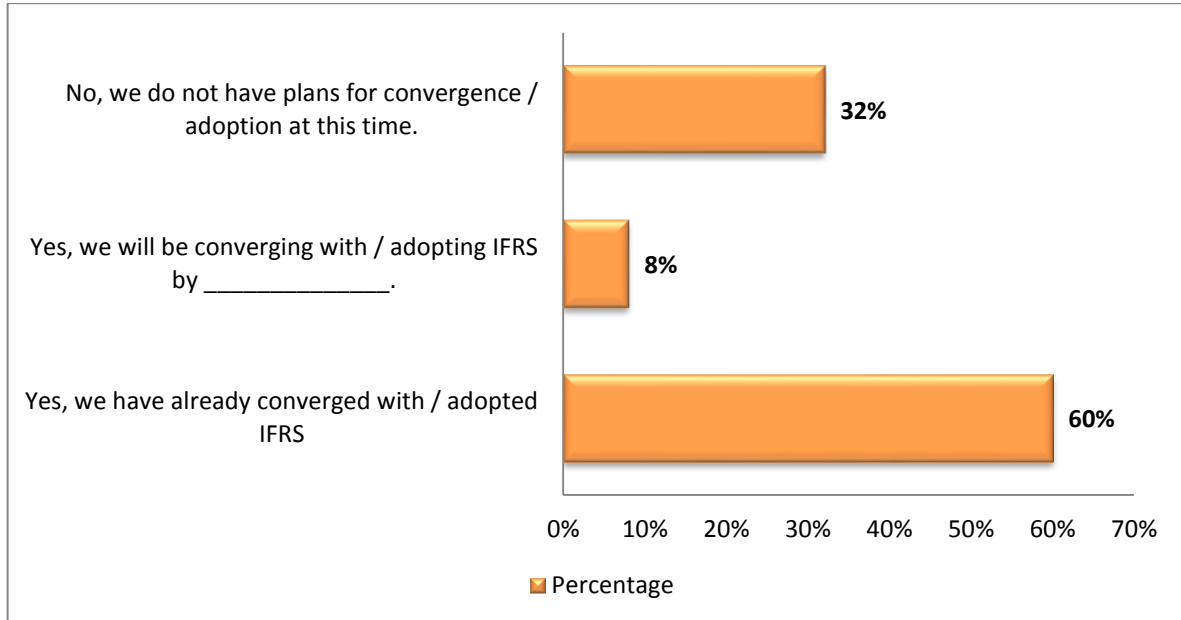
68% replied that International Financial Reporting Standards (IFRS) would generally apply to entities engaged in finance.

20% replied that it depends on the type of entity. Respondents from Bahrain, Lebanon and Oman wrote that, in their jurisdictions, conventional financial institutions use IFRS, but Islamic financial institutions applied AAOIFI standards. A respondent from Saudi Arabia qualified that, in Saudi Arabia, financial institutions and insurance companies were required to apply IFRS, but other entities applied national standards issued by the Saudi Organization for Certified Public Accountants (SOCPA).

The respondent from Egypt wrote that national standards based on IFRS applied in Egypt.

Two respondents – one from Iraq, the other from Libya - wrote that national standards not necessarily based on IFRS applied in their jurisdictions. The Libyan respondent explained that there are no explicit requirements for financial reporting standards as such under its current banking laws.

3. *Does your jurisdiction have a policy of convergence with, or adopting, IFRS?*

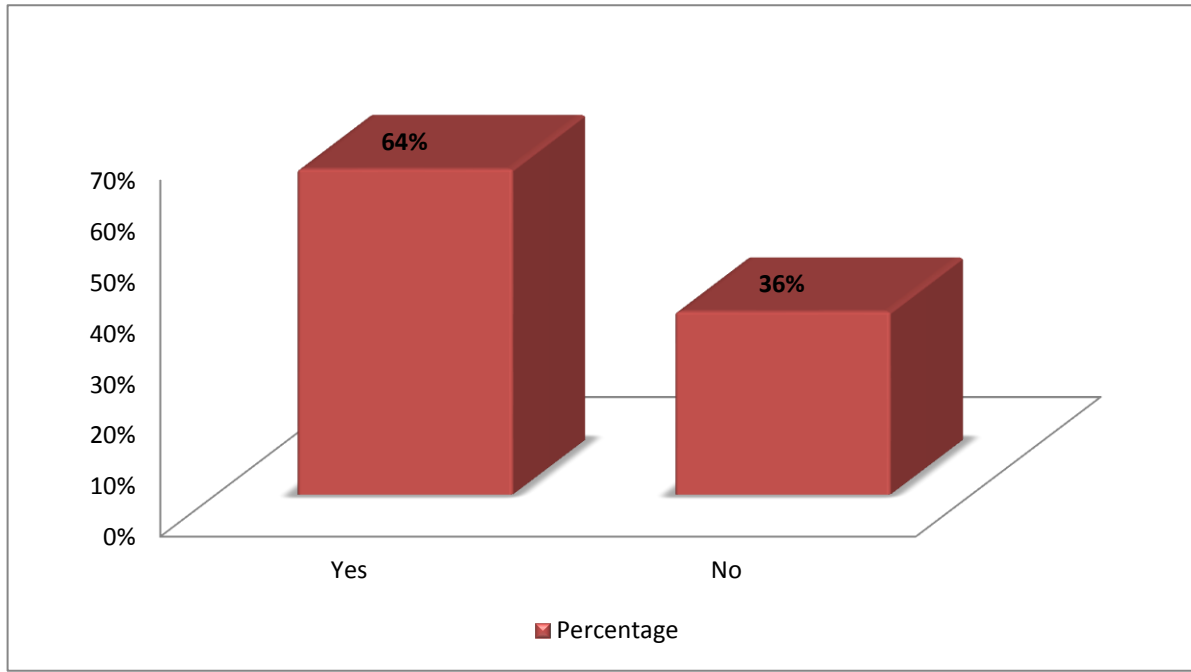


60% responded that they consider their jurisdiction to have already converged with or adopted IFRS.

32% responded that their jurisdictions do not have plans for convergence or adoption at this time.

2 respondents believe their jurisdictions are planning to converge with IFRS but were unable to provide a convergence date.

4. *Do different financial reporting standards (also known as Islamic accounting standards) apply to entities engaged in Islamic finance in your jurisdiction?*



64% believed that entities engaged in Islamic finance in their jurisdiction apply Islamic accounting standards. These respondents came from eight jurisdictions: Bahrain, Iraq, Jordan, Lebanon, Oman, Qatar, UAE and West Bank & Gaza. The respondent from UAE explained that, generally, IFRS is used in its jurisdiction; but an entity can apply to authorities for an exemption from using IFRS and apply AAOIFI FAS instead.

36% did not think that entities engaged in Islamic finance in their jurisdiction apply Islamic accounting standards.

It is significant that although 64% of respondents to Question 4 believed entities engaged in Islamic finance in their jurisdiction applied separate Islamic accounting standards, 60% answered to Question 3 that they consider their jurisdiction to have already converged with or adopted IFRS. This indicates that a large number of respondents do not believe there is a contradiction in applying separate Islamic accounting standards and asserting IFRS compliance.

In contrast, the standard-setters which responded to AOSSG's 2011 survey largely viewed Islamic accounting standards to be incompatible with IFRS convergence.

In a follow-up telephone conversation, a respondent further explained the co-existence of IFRS and AAOIFI FAS in Bahrain. According to him, the Central Bank of Bahrain requires Islamic bank licensees to comply with FAS issued by AAOIFI, but for products and activities not covered by AAOIFI, IFRS/IAS must be followed. In the past, entities had asserted that financial statements prepared in such a manner complied with both AAOIFI FAS and IFRS. However, he claims this practice has waned in the last three years, as auditors were becoming less comfortable with the 'dual-compliance' assertion.

He further claims that, currently, an Islamic financial institution that presents financial statements only for local purposes, e.g. filing with Bahraini authorities, would assert compliance with AAOIFI FAS. An Islamic financial institution that needs to prepare and present IFRS-compliant financial statements for another purpose, e.g. if it has an issuance in an IFRS-compliant jurisdiction, may resort to either one of the following:

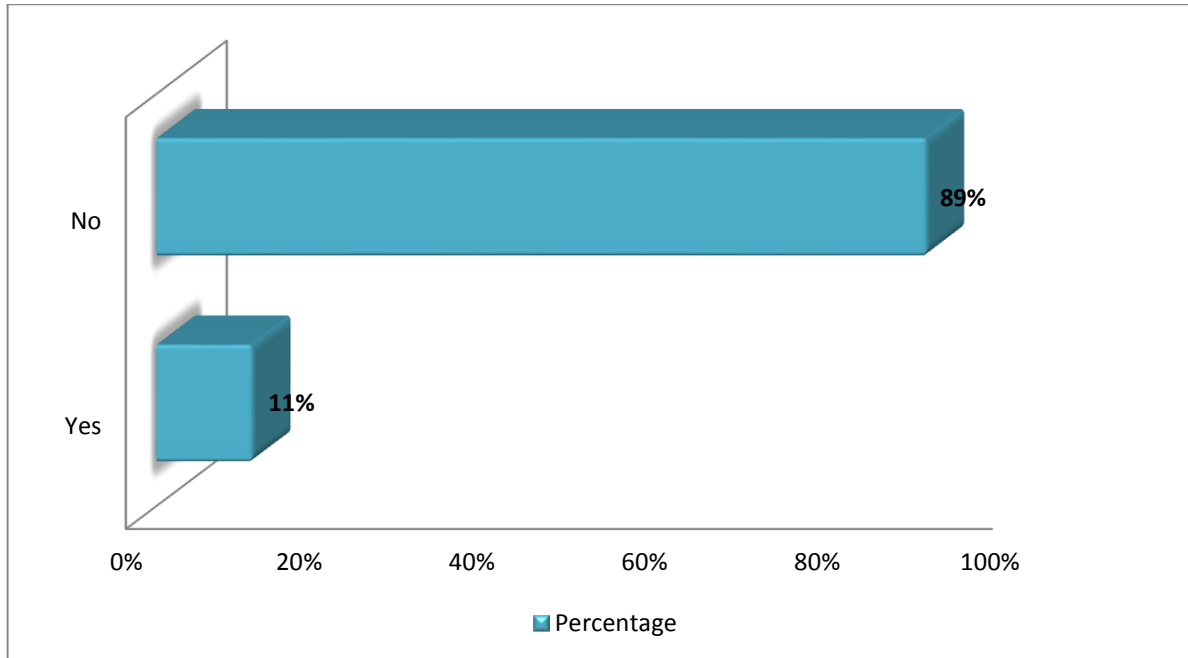
- (a) It prepares a second, separate set of financial statements in accordance with IFRS.

This may require recognising or measuring items differently. For example, unrestricted investment account (URIA) may be recognised as a separate element in the FAS-compliant financial statement, but as a liability in the IFRS-compliant financial statement.

- (b) It avoids all the transactions that result in financial reporting differences between AAOIFI FAS and IFRS.

By avoiding transactions that AAOIFI FAS requires to be treated differently from IFRS – chiefly, *ijarah* - it can assert compliance with AAOIFI for Bahraini filing purposes, and IFRS compliance for its other purpose(s) for, essentially, the same set of financial statements.

5. Does your jurisdiction have plans to issue/apply Islamic accounting standards for entities engaged in Islamic finance?

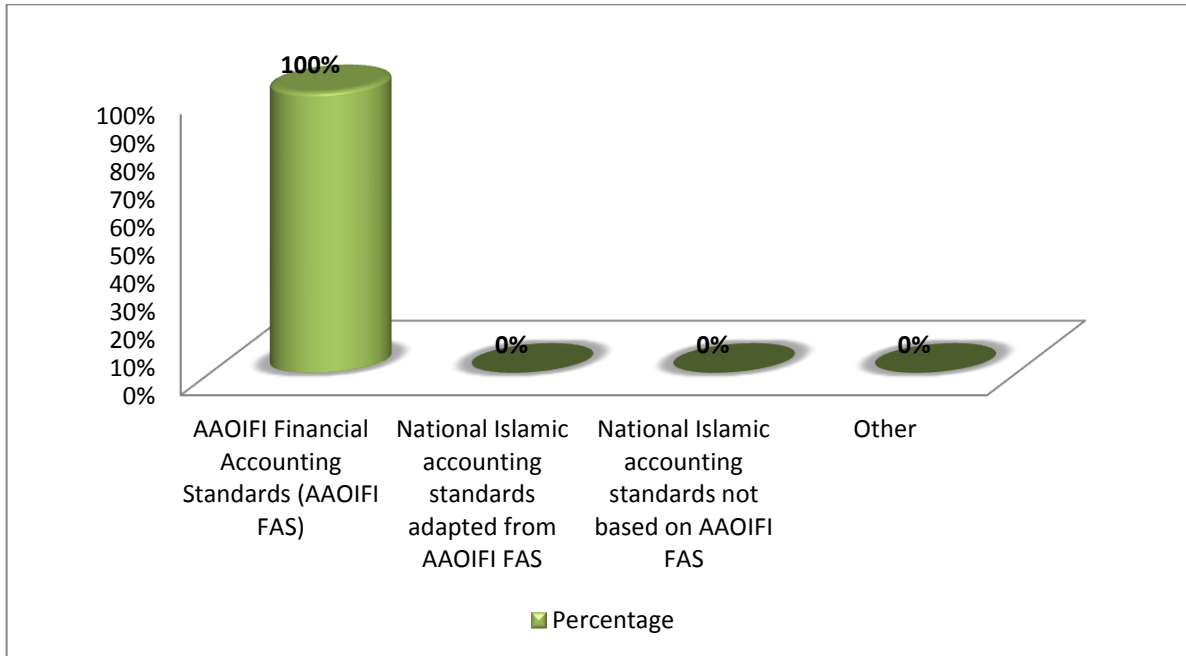


Question 5 applied only to respondents who answered 'No' to Question 4 (i.e. who did not have Islamic accounting standards).

89% believed their jurisdictions have no plans to issue Islamic accounting standards.

Only one respondent - from Libya - stated that its jurisdiction does have plans to issue Islamic accounting standards for entities engaged in Islamic finance.

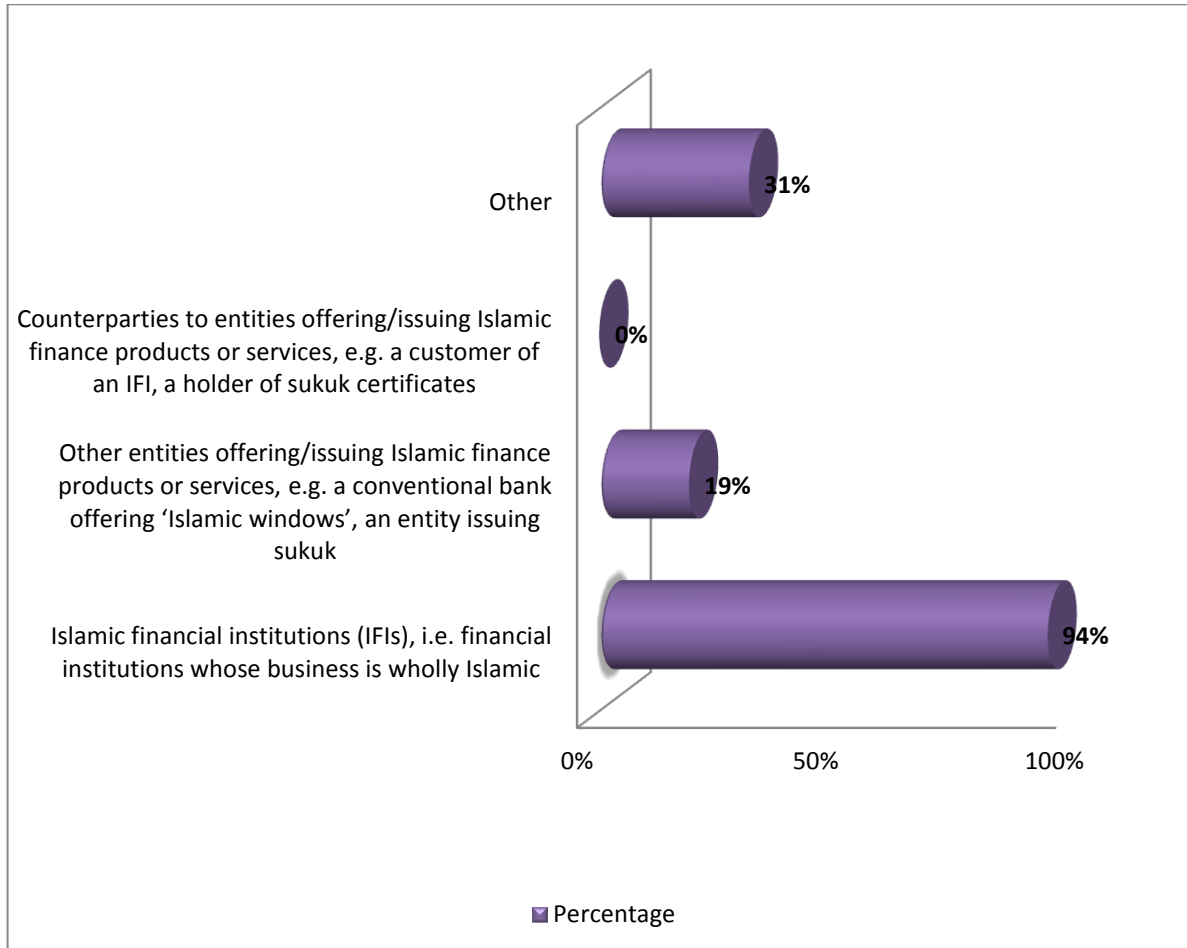
6. *What type of Islamic accounting standards apply in your jurisdiction?*



Respondents who answered ‘Yes’ to Question 4 (i.e. who have Islamic accounting standards in their jurisdiction) were additionally asked to answer Questions 6, 7, 8 and 9.

To Question 6, all the respondents stated that their Islamic accounting standards were AAOIFI FAS.

7. *Which of the following entities in your jurisdiction are required to apply Islamic accounting standards?*

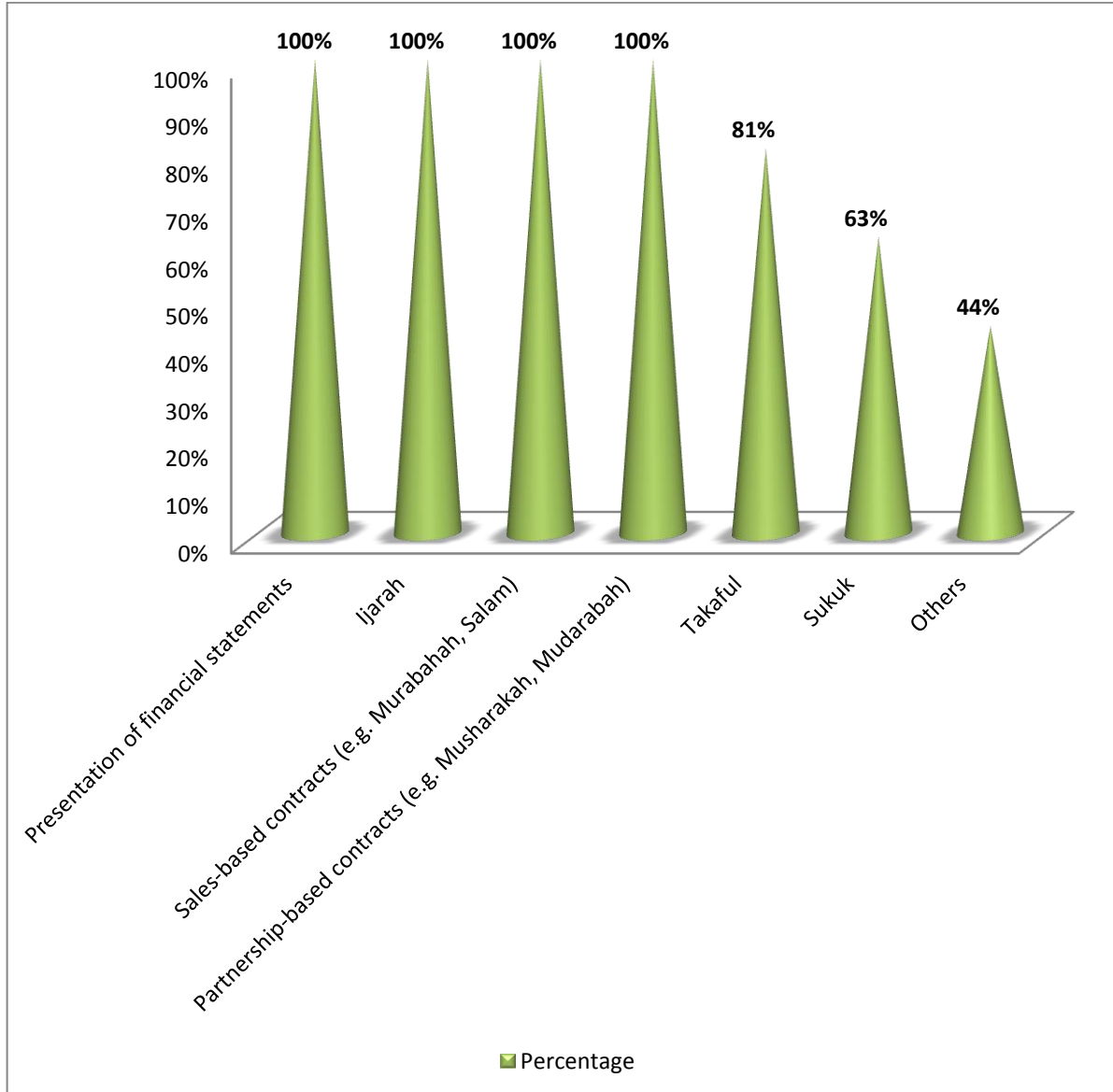


Of the respondents with Islamic accounting standards in their jurisdiction, 94% believed that only full-fledged Islamic financial institutions would apply Islamic accounting standards.

19% responded that Islamic accounting standards would also apply to other entities offering or issuing Islamic finance products or services. In Bahrain, conventional banks operating Islamic windows are required to comply with AAOIFI FAS disclosure requirements for their Islamic business; however, the accounting framework would continue to be IFRS.

31% wrote that other entities may also prepare financial statements in accordance with Islamic accounting standards. A respondent from Bahrain wrote that a Bahraini entity that complied with AAOIFI's other standards would generally also comply with AAOIFI FAS.

8. Which of the following transactions or events are addressed by your jurisdiction's Islamic accounting standards?



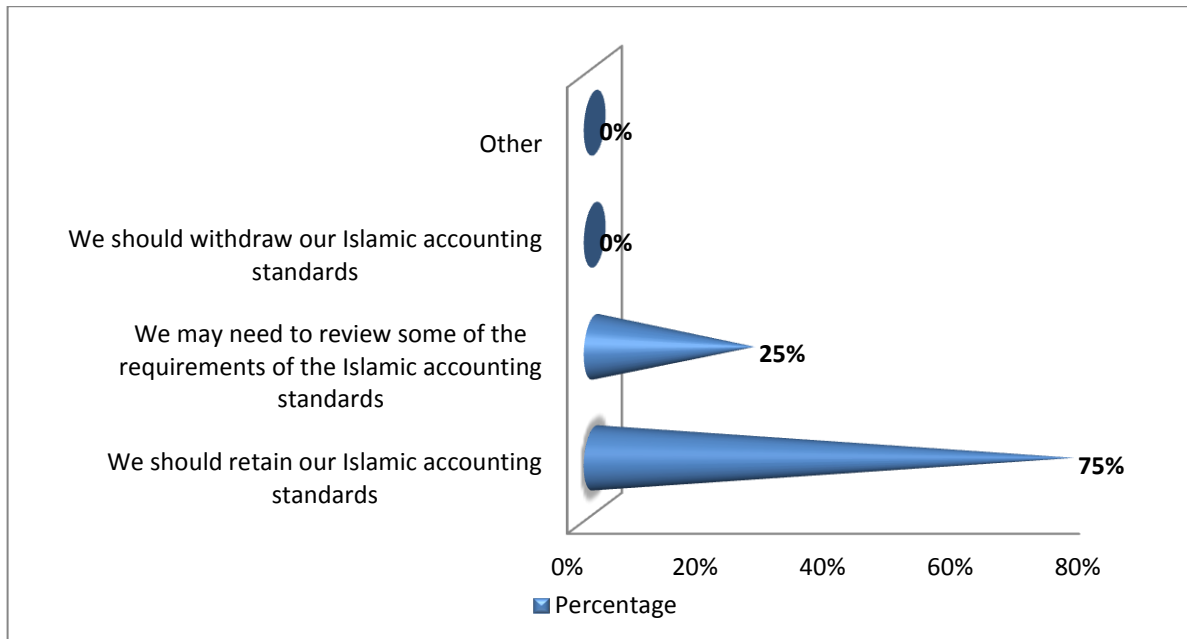
All respondents with Islamic accounting standards wrote that their standards address presentation of financial statements, *ijarah*, sales-based contract and partnership-based contracts.

81% of them stated that their Islamic accounting standards also address *takaful*.

63% have Islamic accounting standards that address *sukuk*. However, a respondent from Bahrain wrote that AAOIFI FAS requirements for *sukuk* only address accounting by a *sukuk* holder (i.e. investor); they do not address accounting by an issuer.

44% stated their Islamic accounting standards address other transactions or events. Respondents from Bahrain, Jordan, Lebanon, Oman and UAE explained that the full set of AAOIFI FAS also included standards on real estate, consolidation, investments in associate and segment reporting, among others.

9. *More and more countries are converging with or adopting IFRS. In light of this, what do you think should be your jurisdiction's policy on Islamic accounting standards?*



75% of respondents in jurisdictions with Islamic accounting standards thought that they should retain their Islamic accounting standards. Five of them were of the general view that their jurisdiction should wait for IASB to publicly announce how it would address Islamic products (e.g. through a white paper) before changing the jurisdiction's financial reporting framework.

25% with Islamic accounting standards stated their jurisdiction may need to review some of the requirements.

A respondent from Bahrain wrote that AAOIFI FAS is the jurisdiction's primary set of standards, with IFRS used where guidance is absent in AAOIFI FAS (e.g. for guidance on property, plant and equipment, taxation, inventory). AAOIFI FAS on its own is not a comprehensive financial reporting framework. It addresses certain specific Islamic products and structures (e.g. *murabahah* and *musharakah*). But it does not have a comprehensive standard for financial instruments in the style of IAS 39/IFRS 9. Additionally, AAOIFI FAS presentation and disclosure requirements are designed to reflect *Shariah* requirements; these may or may not coincide with users' information requirements.

It is significant that none of the respondents thought that their jurisdiction should withdraw their Islamic accounting standards.

In a telephone conversation with a respondent from Bahrain, he explained that his reasons for supporting the retention of AAOIFI FAS were based on local circumstances. In particular:

(a) AAOIFI's extensive disclosure requirements

AAOIFI requires extensive disclosures for certain items, e.g. *takaful*, *zakat*, treatment of non-*halal* items, which are important to local stakeholders. Such disclosure requirements are absent in IFRS.

(b) The general public's understanding of Islamic finance transactions

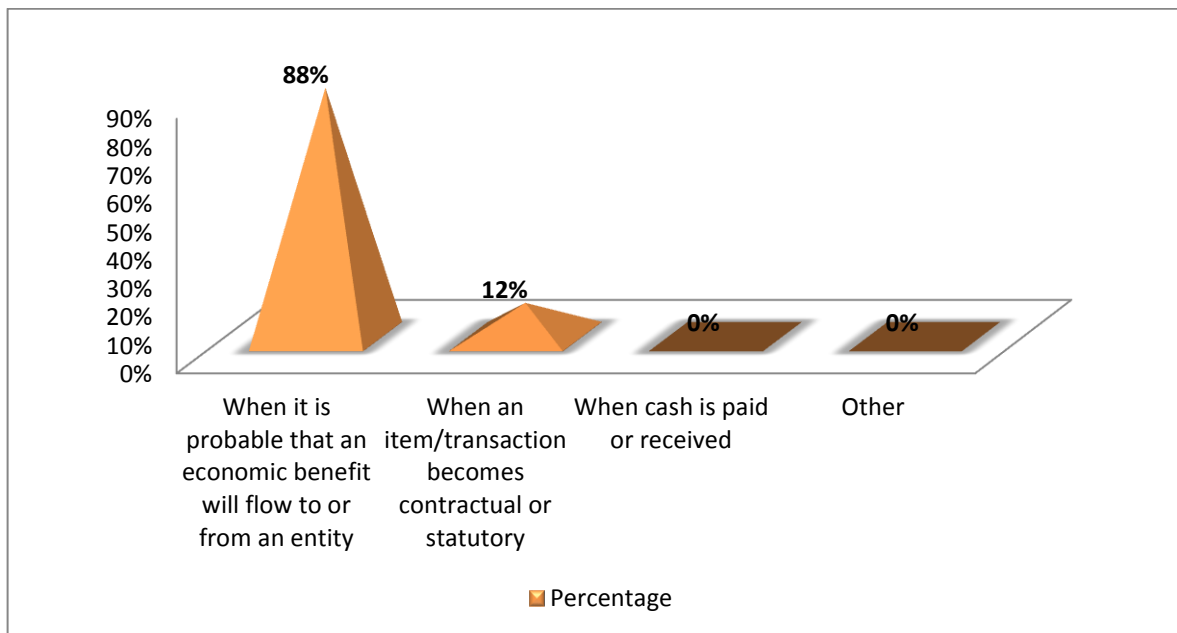
Islamic financial institutions in MENA overtly market the *Shariah*-compliant contract that underlies a transaction. Hence, a consumer – especially a lay retail consumer – may believe he has entered into a trade contract, e.g. a purchase or a lease, with the bank. Such a consumer may not accept the application of IFRS recognition and measurement principles for financial instruments to a transaction that he deems a trade.

(c) The respected position of *Shariah* scholars

In MENA, *Shariah* scholars hold an esteemed position in society. The fact that AAOIFI FAS are developed under the auspices of the AAOIFI Sharia Board is reassuring to many stakeholders in the region.

Accounting for Islamic financial transactions

10. In your jurisdiction, which of the following best describes the general criterion for recognising an element (e.g. asset and liability) of the financial statement?

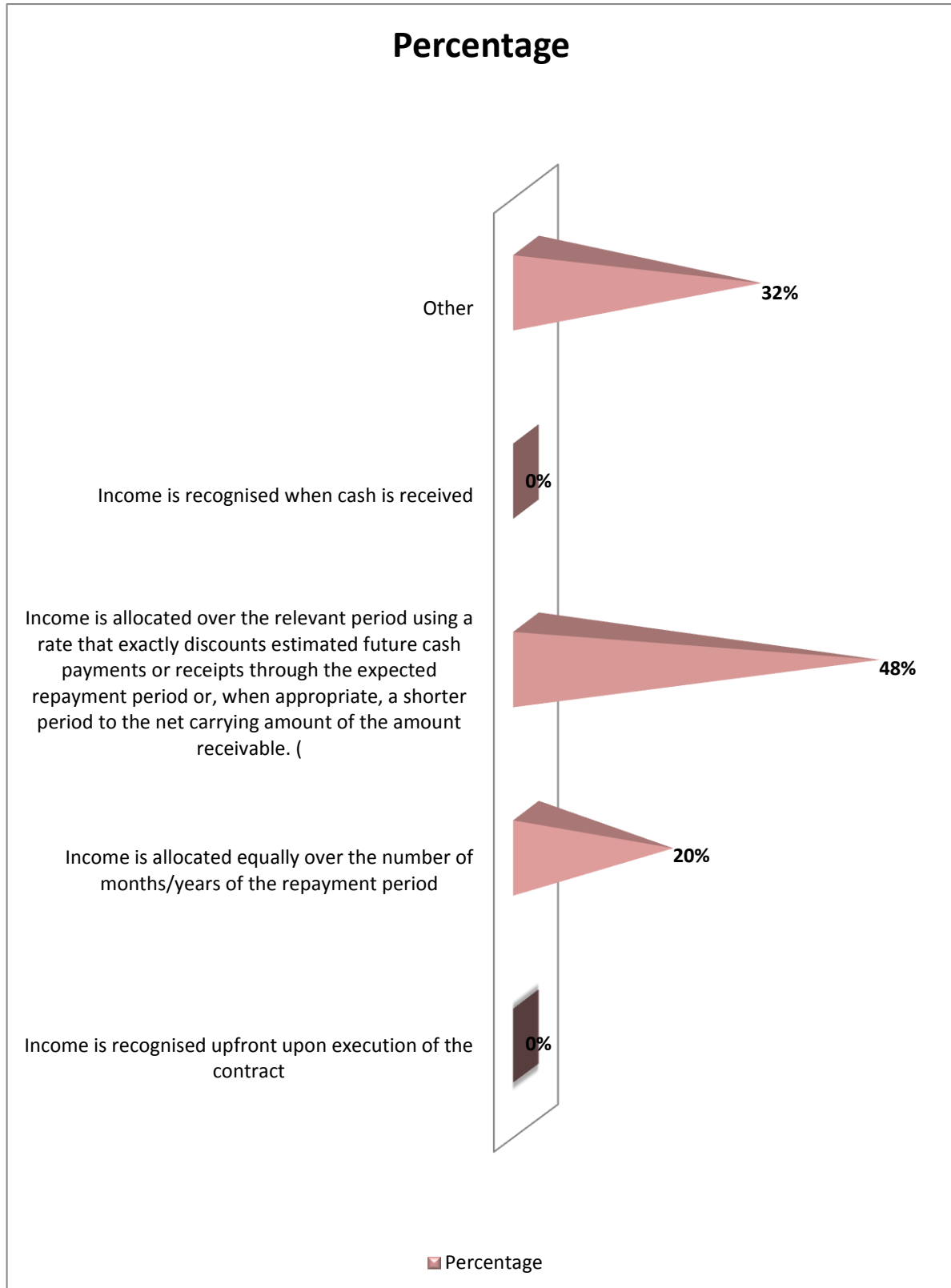


88% expected that entities would recognise an element of the financial statement when it is probable that an economic benefit will flow to or from an entity. This view is consistent with current criteria for the recognition of an asset or a liability in *The Conceptual Framework for Financial Reporting* issued by IASB in 2010.¹

12% expected an entity to recognise an element of financial statement when an item or transaction becomes contractual or statutory. This view is more aligned to AAOIFI's Statement of Financial Accounting No. 1, *Conceptual Framework for Financial Reporting by Islamic Financial Institutions*. AAOIFI's definitions of an asset and a liability emphasise enforceable rights and obligations.

¹ IASB is revising its conceptual framework. Its Discussion Paper DP/2013/1, *A Review of the Conceptual Framework for Financial Reporting*, proposes to omit the need to consider probable flow of economic benefit in recognising an element of the financial statement.

11. In your jurisdiction, how would income on a sale-based transaction (e.g. a murabahah sale) most likely be recognised, where the repayment period exceeds one annual period?



Murabahah is a *Shariah* compliant sale contract where an item is sold at a profit, and the mark-up is made known to the buyer. When payment is deferred, *murabahah* may be, in substance, a financing transaction and the profit may be finance income. Under an IFRS framework, the financing element – if not the entire transaction – would have to be accounted for under IAS 39/IFRS 9.

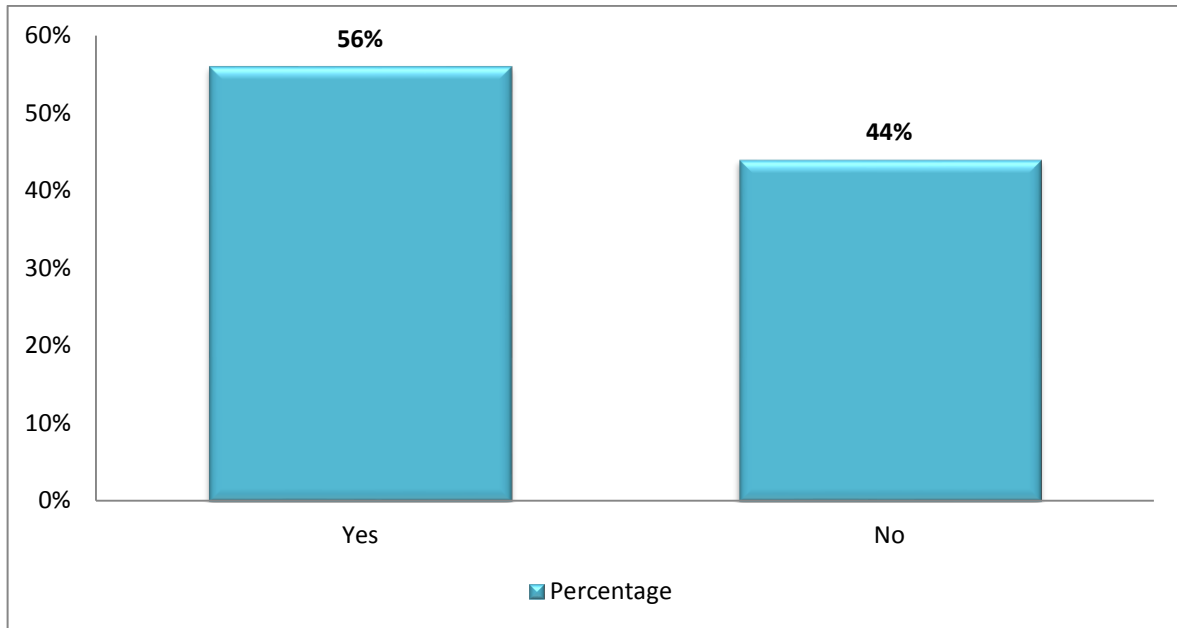
48% of respondents replied that entities in their jurisdiction are likely to allocate income over relevant period using a rate that exactly discounts estimated future cash payments or receipts through the expected repayment period or, when appropriate, a shorter period to the net carrying amount of the amount receivable. This pattern of recognition is similar to the requirement for an effective interest method in IAS 39/IFRS 9.

20% replied that entities in its jurisdiction are likely to recognise income based on the allocation of profit equally over the number of months or years of the repayment period. The respondent from Libya explained that Libya does not yet have financial reporting standards to address *murabahah*; hence an entity may use this method in practice.

24% answered that that they see both of the above methods in practice. This is because the benchmark treatment in AAOIFI FAS No. 2, *Murabaha and Murabaha to the Purchase Orderer*, requires “proportionate allocation of profits over the period of credit”. The words ‘proportionate allocation’ is interpreted by some entities as straight-line allocation, and by others as a pattern similar to the effective interest rate method in IAS 39/IFRS 9. A respondent from Bahrain added that, in practice, the effective profit rate method is used when payment is deferred through instalments, but straight-line allocation is used when payment is done through a single deferred payment.

8% wrote that entities in their jurisdiction may recognise income on *murabahah* using other methods. A respondent from Oman explained that Islamic finance is new in the jurisdiction, and institutions are transitioning to AAOIFI FAS as directed by the Central Bank of Oman. A respondent from Lebanon wrote that some entities recognised ‘deferred profit’ upon receiving a promise from the customer to purchase the *murabahah* item.

12. Do your financial reporting standards allow the recognition of a separate element of the financial statement for items with characteristics of both liability and equity (e.g. some mudarabah items)?



56% replied that the financial reporting framework in their jurisdictions allowed the recognition of a 'sixth' element of the financial statements (i.e. in addition to asset, liability, equity, income and expense) for items with characteristics of both liability and equity.

44% replied that they would not be allowed to do so.

The IASB had previously proposed a project on financial instruments that have characteristics of both liability and equity, but it has deferred work on the project. The project webpage reads:

Any consideration of the distinction between liabilities and equity needs to be undertaken in conjunction with the *Conceptual Framework* work on elements. The research project will focus on identifying financial instruments that are difficult to classify under the current requirements, or for which preparers or users question the classification. These instruments will provide test cases for the staff developing the elements

chapter of the *Conceptual Framework*. This page will be updated once staff has been assigned to this project.²

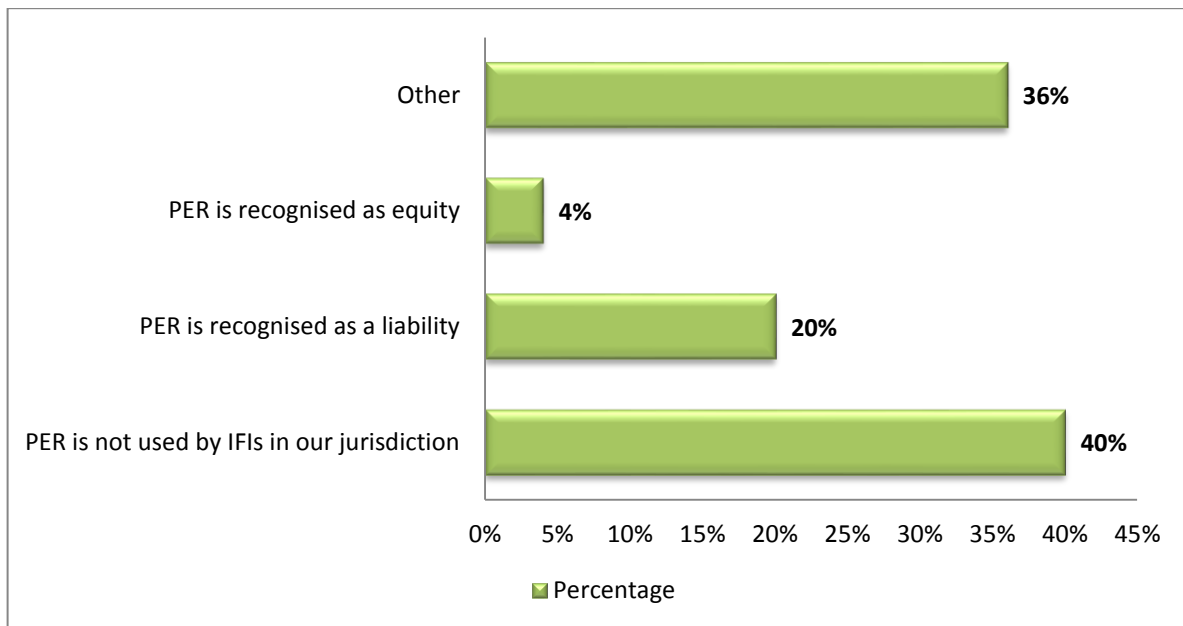
Conversely, AAOIFI's Statement of Financial Accounting No. 1, *Conceptual Framework for Financial Reporting by Islamic Financial Institutions* explicitly recognises 'equity of investment accountholders' as a separate element of the financial statements. It explains:

The IFI is not obliged to return the funds it has received in case of loss unless the loss is due to its negligence and, accordingly, equity of investment accountholders is not considered a liability of the IFI. Likewise, equity of investment accountholders is not considered as owners' equity since the holders of these accounts do not enjoy the powers and ownership rights, for example, voting rights held by owners.

In the example financial statements that accompany AAOIFI Financial Accounting Standard No. 1, *General Presentation and Disclosure in the Financial Statements of Islamic Banks and Financial Institutions*, equity of investment accountholders is presented between liability and equity.

² [IFRS website \(http://www.ifrs.org/Current-Projects/IASB-Projects/Financial-instruments-with-equity/Pages/Fl-with-equity.aspx\)](http://www.ifrs.org/Current-Projects/IASB-Projects/Financial-instruments-with-equity/Pages/Fl-with-equity.aspx) [accessed on 30 October 2013]

13. Some IFIs may employ profit equalization reserves (PER), a smoothing mechanism to provide a consistent rate of return to *mudarabah* accountholders. Under your financial reporting standards, how would an IFI most likely recognise an amount set aside for PER?



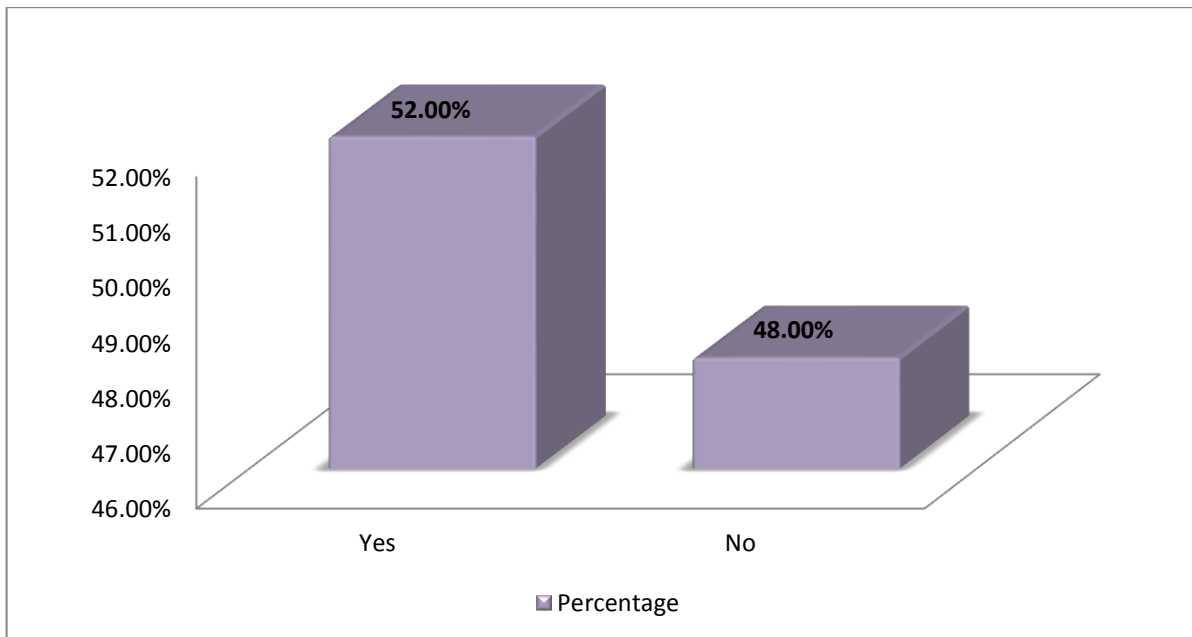
40% replied that Islamic financial institutions in their jurisdictions generally did not use PER.

20% stated that PER would likely be recognized as a liability.

4% stated PER was recognized as equity.

36% responded that PER would be treated in a manner other than those suggested. Some entities in Bahrain, Lebanon, Libya and Oman split the PER on joint pools (i.e. commingled funds that comprise both customers and bank shareholders' monies) between equity of unrestricted investment account holders (URIA) and shareholders' equity. There are also entities in Bahrain that recognise PER in the carrying amount of *mudarabah*, which is presented as an intermediary element, between liability and equity, in the statement of financial position.

14. Do your financial reporting standards allow for *ijarah* to be treated as a finance lease, if the *ijarah* otherwise meets the criteria for finance lease under current IAS 17 Leases?



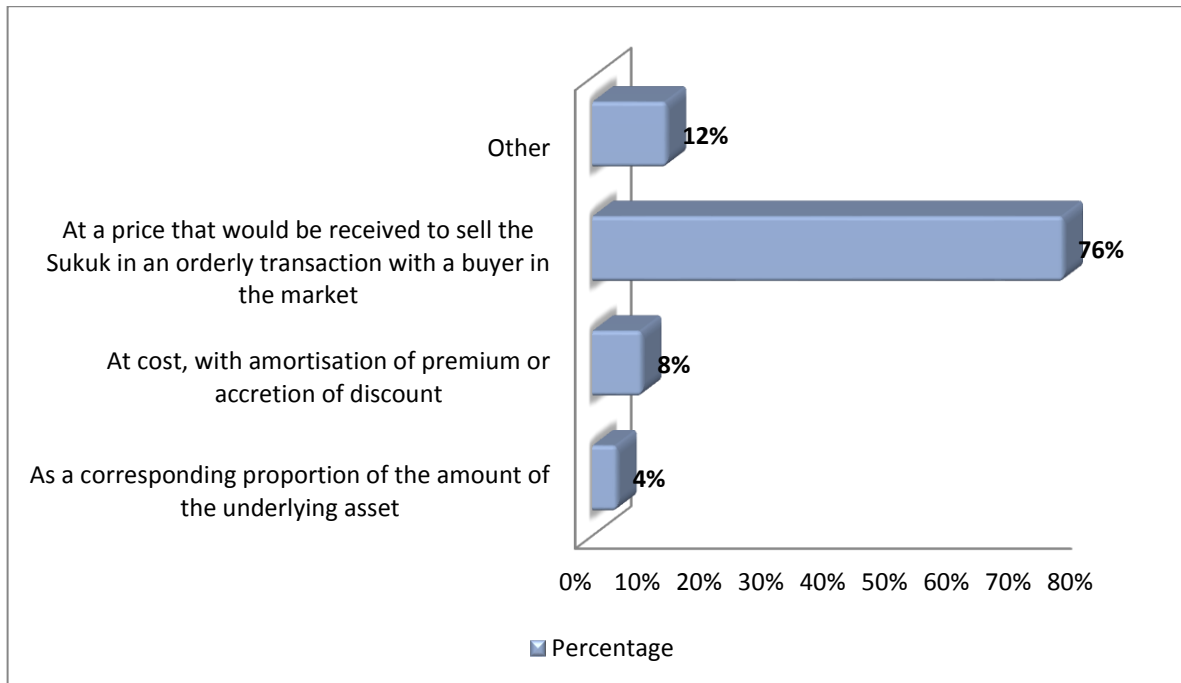
Ijarah is a *Shariah* compliant contract under which a lessor transfers the right-of-use of an asset to a lessee for an agreed period in return for *ijarah* payments. Under AAOIFI FAS No. 8, *Ijarah* and *Ijarah Muntahia Bittamleek*, all *ijarah* are required to be treated similar to operating leases because the standard emphasises a lessor's ownership as an asset, but does not consider that a lessee's rights over the leased asset may itself be an asset.

52% replied that *ijarah* is likely to be treated as a finance lease if the *ijarah* meets the criteria for a finance lease under current IAS 17 Leases.³

48% replied that their accounting standards do not allow for *ijarah* to be treated as a finance lease, even if the *ijarah* otherwise meets the criteria for finance lease under current IAS 17 Leases. A respondent from Bahrain explained that *ijarah muntahia bittamleek*, though operationally similar to a finance lease, would not be treated in accordance with IFRS requirements for a finance lease. The respondent from Egypt added that all *ijarah* leases are accounted for as operating leases with certain adjustments.

³ IASB is revising its standard on leases. Its Exposure Draft ED/2013/6, *Leases*, replaces the operating lease and finance lease models with a right-of-use approach.

15. In your jurisdiction, how is sukuk held for trading most likely to be measured?



Many writings on *sukuk* purport that *sukuk* represent the holder's proportionate ownership in an underlying asset. In practice, however, *sukuk* are often structured to be similar to either conventional bonds or securitisations, with the former structure being much more common. Hence, economically, *sukuk* are financial instruments that represent the holder's right to the cash flows arising from a beneficial interest in an underlying activity or asset.

76% stated that *sukuk* held for trading would most likely be measured at a price that would be received to sell the *sukuk* in an orderly transaction with a buyer in the market. This would be consistent with IAS 39/ IFRS 9, under which a financial instrument held for trading would most likely be measured at fair value after initial recognition. Similarly, *sukuk* held for trading is generally measured at fair value under both the previous guidance AAOIFI FAS No. 17, *Investments*, and the new guidance in AAOIFI FAS No. 25, *Investments in Sukuk, Shares and Similar Instruments*.

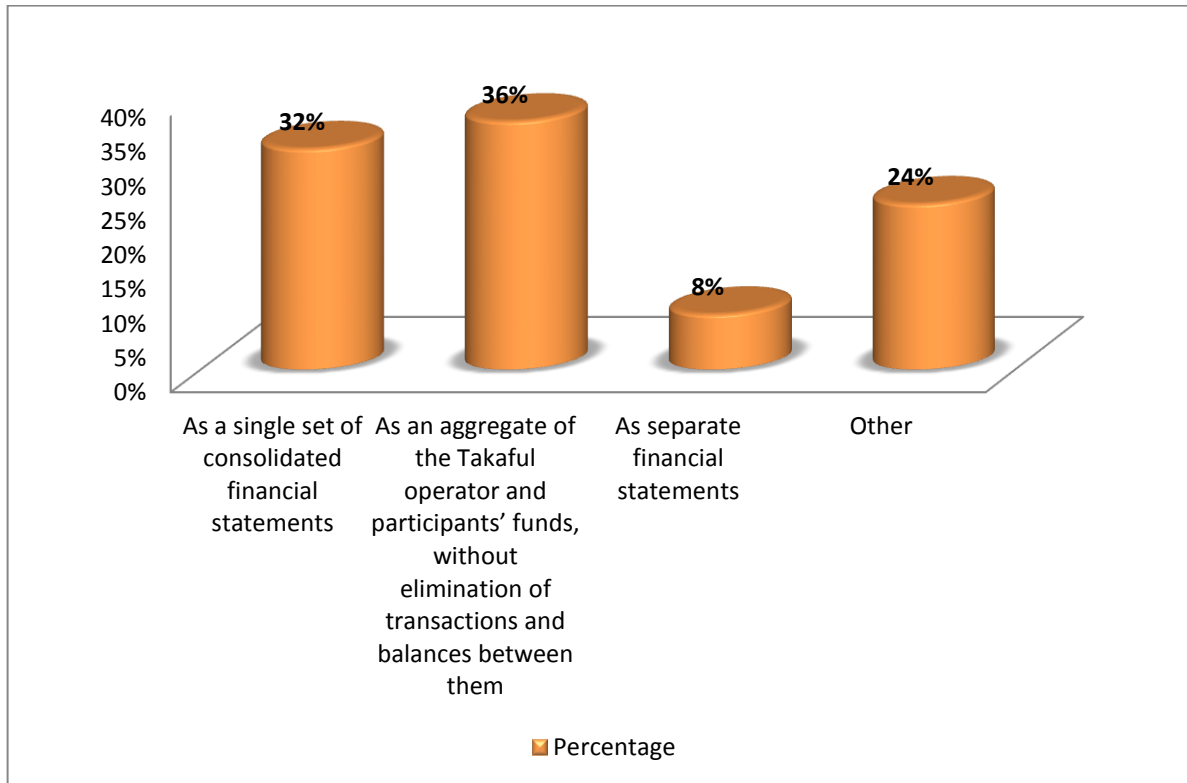
8% responded that *sukuk* held for trading may be measured at cost. Under an AAOIFI framework, it is possible that an entity may construe a disclosure requirement in AAOIFI FAS No. 17, *Investments*, as implicitly allowing measurement at cost:

Disclosure shall be made of the fair value of investments held for trading purposes in cases where the fair value is not used to measure the carrying amount of investments. Disclosure shall be made of the reasons for not using fair value as the measurement basis.

12% stated that *sukuk* held for trading may be measured using some other method. A respondent from Bahrain explained that *sukuk* held for trading are likely to be measured at market price if that market price represents fair value; if market price is not available (e.g. for unquoted instruments) alternative methods of fair valuation would be performed with the method depending on whether the *sukuk* are 'debt-type' or 'equity-type'. The respondent from Libya attributed the possibility of varying methods in its jurisdiction to the lack of accounting standards. The respondent from West Bank & Gaza wrote that there are no *sukuk* in its jurisdiction.

Only one respondent – from Egypt – thought that *sukuk* held for trading may be measured as a corresponding proportion of the amount of the underlying asset.

16. *In your jurisdiction, how would a takaful operator most likely present its financial statements, and those of the participants' funds it manages?*



Takaful is a *Shariah* compliant alternative to insurance. A *takaful* operator would initiate a fund and solicit participants to contribute to it. The *takaful* operator would manage the participants' fund in return for a fixed fee and/or share of profit. Participants agree that if a member suffers loss from an agreed adverse event, they would compensate the aggrieved member from the fund. Strictly following *Shariah* rules, the *takaful* operator is merely a fund manager and assumes no direct insurance liability. However, for consumer protection, many regulators require a *takaful* operator to provide financial assistance in case the participants' fund suffers a deficiency or loss. The financial assistance is often in the form of an interest-free loan, *qard*, which is repaid to the *takaful* operator when there is sufficient surplus in the participants' fund.

A requirement to provide financial assistance may indirectly expose a *takaful* operator to insurance risk, hence rendering it economically similar to an insurer. Consequently, questions have arisen as to how items relating to the *takaful* operator and participants' funds should be presented for financial reporting purposes.

36% replied that a *takaful* operator would most likely present aggregated financial statements. An aggregated financial statement combines amounts for the *takaful* operator and participants' funds into a single financial statement, without eliminating inter-entity transactions. This view considers that there is a relationship between the *takaful* operator and participants' fund that would be better represented by showing the total amounts for the entities. However, this relationship does not constitute control by one entity over the other. It should be noted that IFRS do not currently include an 'aggregated financial statement' as a presentation option.

A respondent from Bahrain explained that *takaful* presentation is not well-addressed by AAOIFI, hence there were differences in practice. In Bahrain, *takaful* entities generally present an aggregated statement of financial position (which eliminates *qard* balances, but not the *wakala* receivables and payables between the operator and the fund) and two separate income statements, i.e. an income statement each for participants and for shareholders in the operator. However, a Bahraini *takaful* entity that applied IFRS consolidation principles would prepare a single consolidated balance sheet and income statement. He noted there were differing presentations under IFRS as well.

32% thought a *takaful* operator would most likely present a single set of consolidated financial statements for itself and the participants' funds it manages. A consolidated financial statement consolidates the *takaful* operator and participants' funds into a single entity, with elimination of inter-entity transactions.

8% replied that a *takaful* operator would most likely present its financial statements, and those of the participants' funds it manages, as separate financial statements. This view presupposes that a *takaful* operator does not control the participants' funds for financial reporting purposes. As each is treated as a separate entity, inter-entity transactions would not be eliminated.

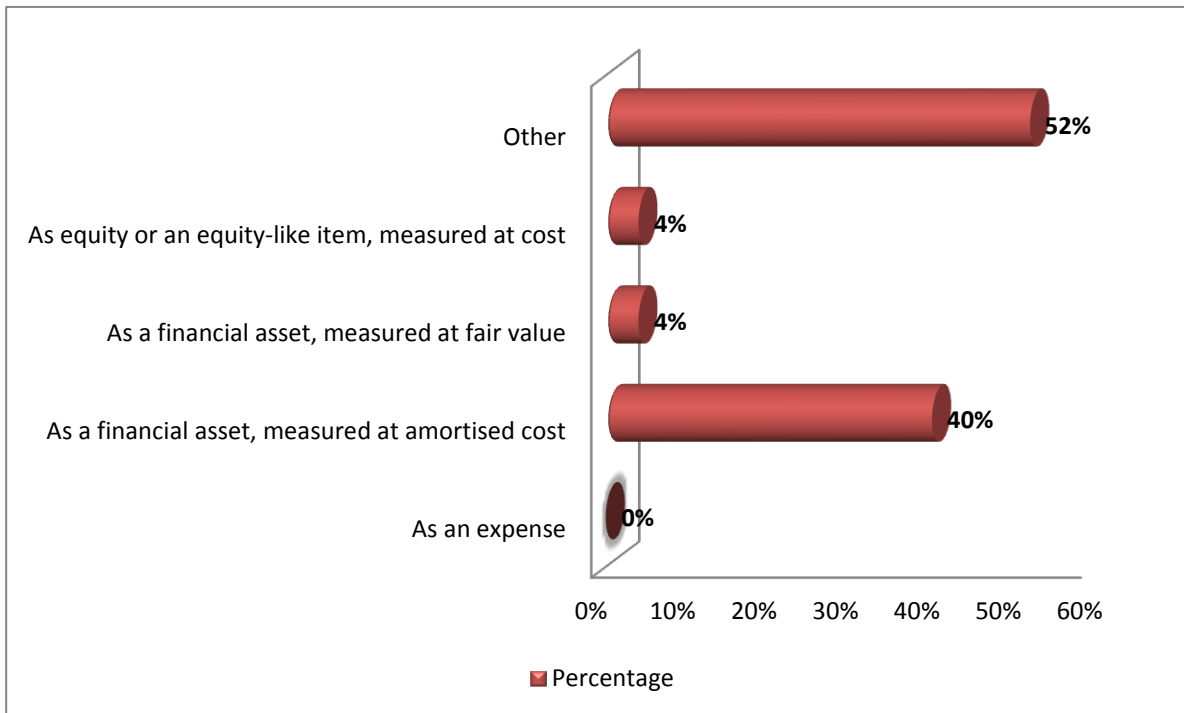
The 24% of respondents who selected 'Other' provided the following explanations:

- In Kuwait, the view taken by accounting and auditing practitioners is that a participants' fund is an off balance sheet item. The financial statements only show the separate balance sheet and income

statement of the shareholders, but the activities of any participants' funds are disclosed in the notes.

- Three respondents – one from Saudi Arabia, two from Lebanon – stated that *takaful* is not available in their jurisdictions
- Two respondents – from Libya and Oman – believe that there may be differing practices due to, respectively, a lack of or a fledgling financial reporting framework.

17. In your jurisdiction, how would a takaful operator most likely recognise *qard* extended to a participants' fund?



As explained in the narrative to Question 16, a *takaful* operator is usually required by regulators to provide financial assistance in the form of an interest-free loan, or *qard*, to cover any deficiencies in a participants' fund. *Qard* would be repaid when the participants' fund had sufficient surplus. For consumer protection, *qard* is usually subordinated to all other liabilities of the participants' fund. There are differing opinions on how *qard* should be treated in the separate financial statements of a *takaful* operator: although it takes the contractual form of a loan, it does not meet the IAS 39/IFRS 9 definition of a loan and receivable.

40% replied that a *takaful* operator would most likely recognise *qard* extended to a participants' fund as a financial asset, measured at amortised cost. This treatment likely presumes that *qard* meets the criteria for a loan and receivable under IAS 39/IFRS 9.

4% stated that a *takaful* operator would most likely recognize *qard* extended to a participants' fund as financial asset, measured at fair value. This is the default measurement for financial instruments under IAS 39/IFRS 9 that do not qualify for measurement at amortised cost.

4% stated that a *takaful* operator would most likely recognize *qard* extended to a participants' fund as an equity-like item, measured at cost. The rationale behind this view is that *qard* is akin to an investment in a subsidiary. A respondent from Bahrain noted that measurement at cost did not require consideration of time value of money; thus avoiding controversies related to the concept.

52% replied 'Other'. The explanations provided by respondents for selecting this category are as follows:

- Four respondents – two from Saudi Arabia, two from Lebanon – stated there is no *takaful* in their jurisdiction.
- Three respondents – from Libya, Qatar and Oman – cited an absence of, or less developed, standards on *takaful*.
- Two respondents from Jordan and West Bank & Gaza wrote that *qard* would be recognised at a nominal value.
- A respondent from UAE wrote that there is no *qard* in the consolidated financial statement; it is an inter-entity transaction that is eliminated on consolidation.
- A respondent from Oman wrote that *takaful* operators in its jurisdiction did not have *qard*.
- Two - from Egypt and Iraq - offered no explanation.

Additional comments

This section presents additional comments that respondents wanted to bring to the AOSSG's attention.

Bahrain

A respondent from Bahrain wanted the AOSSG to know that AAOIFI is currently working on a wider *takaful* project and a new standard is expected to be issued in 2014. The *takaful* standard will focus on:

- Presentation of primary statements
- Accounting for *qard*
- Insurance liabilities
- Disclosures

Other standards in AAOIFI's agenda are as follows:

- Amendment of *ijarah* standard
- New standard on *sukuk* from issuers' perspective
- Interim financial statements
- *Takaful*
- Amendment to *murabaha* standards

Iraq

The respondent from Iraq stated that its business environment is not developed and the actual accounting policies adopted by entities may differ from the standards.

Kuwait

A respondent from Kuwait stated that there are divergent presentations by *takaful* entities within the Gulf Cooperation Council (GCC), and that it looked forward to consistent presentation and disclosure of *takaful* funds.

Oman

A respondent from Oman explained that its answers were based on established banking law in Oman which required all Islamic banks and Islamic windows of conventional banks to comply with AAOIFI FAS. However, the regulations for *sukuk* and *takaful* were still in draft form and likely to become law in the near future, pending approval from the Capital Market Authority of Oman.

Another Omani respondent added that Islamic financing services in Oman have only recently commenced and the Islamic windows of some banks provided only very basic services, which are required by the Central Bank of Oman to comply with standards set by AAOIFI.

Next steps

The survey showed stark differences in opinion between practitioners in MENA and accounting standard-setters around the world.

Practitioners in MENA appear at ease with entities preparing and presenting financial statements based on a mix of requirements from IFRS and AAOIFI. A majority of them believe they should retain AAOIFI FAS, even as more and more jurisdictions are converging with AAOIFI.

Conversely, the majority of national accounting standard-setters who responded to the 2011 survey did not consider having differential financial reporting standards for Islamic finance to be compatible with IFRS convergence.

The AOSSG Islamic Finance Working Group may need to undertake further research to understand how the application of principles from two different sets of frameworks can still result in an assertion of IFRS compliance.

Some Middle Eastern jurisdictions are deemed to be part of Asia and appropriate representatives may qualify for AOSSG membership⁴. The AOSSG is committed to “promoting consistent application of IFRSs” by jurisdictions in Asia-Oceania. Therefore, AOSSG needs to be aware that “consistent application of IFRSs” may be interpreted differently by some jurisdictions, and will need to take this into consideration in dealing with potential candidates for membership from this region.

The findings may also impact on IASB’s newly established advisory group on *Shariah*-compliant transactions and instruments. Some respondents wrote that the IASB should publicly issue its agenda for addressing Islamic financial transactions before their jurisdictions consider changing their financial reporting framework. Hence, the group’s dialogue with stakeholders in MENA must be sensitive to stakeholders’ affinity for AAOIFI FAS, and address the reasons for AAOIFI FAS departures from IFRS. However, the advisory group should not lose sight of its commitment to IFRS in finding solutions to minimise the differences between the two sets of standards.

⁴ A recognised standard-setter from a jurisdiction listed under Asia-Oceania by the United Nations Statistics Division may be eligible for AOSSG membership.

Glossary

This glossary is included to explain some of the terms used in this report. The explanations are intended to serve as a guide and may not necessarily capture the complexities and nuances behind the Arabic terms.

Halal	Permissible under <i>Shariah</i> .
Ijarah	A contract whereby the lessor transfers to the lessee in return for a payment or series of payments the usufruct of an Ijarah item for an agreed Ijarah period, with terms mutually agreed by the contracting parties.
Mudarabah (Alternative spellings : <i>Mudaraba,</i> <i>Mudhorabah</i>)	A form of profit-sharing between a party which contributes capital (<i>rabb al-mal</i> , i.e. capital provider) and another which contributes effort, managerial and/or entrepreneurial skills (<i>mudarib</i> , 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.
Mudarib	An entrepreneur in a profit-sharing arrangement who contributes effort and time.
Murabahah (Alternative spellings : <i>Murabaha, Morabaha,</i> <i>Morabahah</i>)	A sale based on trust, in which the seller must disclose to the purchaser the mark-up on the item sold. The consideration may be paid either in cash or deferred.
Musharakah (Alternative spellings : <i>Musharaka,</i> <i>Musarakah</i>)	A form of partnership where partners contribute capital in cash or in kind, and share profits according to an agreed profit-sharing ratio, while losses are shared according to the capital contribution ratio.

<p>Qard (Alternative spelling : Qardh Related term : Qard Hassan – a benevolent loan)</p>	<p>A loan. In Shariah, a borrower is obligated to repay only the principal amount of a 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.</p>
<p>Rabb Al-Mal (Alternative spellings : RAbul Mal, Rabbul Maal)</p>	<p>Capital or fund provider for an investment project or Mudarabah investment account.</p>
<p>Salam</p>	<p>A sale in which payment is made at the time of contracting but the delivery of the goods is deferred to a specified time in future.</p>
<p>Shariah</p>	<p>The body of law derived primarily from the Quran and Sunnah, and from other secondary sources, that governs religious and secular matters.</p>
<p>Sunnah</p>	<p>An act, saying or tacit approval of Prophet Muhammad (peace be upon him).</p>
<p>Sukuk (Plural. Singular : Sakk)</p>	<p>A financial certificate representing ownership in an asset or its usufruct.</p>
<p>Takaful</p>	<p>An arrangement under which participants agree to contribute to a fund, where sums from the fund would be disbursed to participants or their beneficiaries on the occurrence of pre-agreed events.</p>
<p>Usufruct</p>	<p>The right of enjoying the advantages derivable from the use of an item that belongs to another, as far as is compatible with the substance of the item not being destroyed or damaged.</p>