6 October 2022

Issues Bulletin 4
Application of Malaysian Financial Reporting Standards (MFRS) to Islamic Social Finance Transactions

Issues Bulletin 4 is issued by the Malaysian Accounting Standards Board (MASB) as part of its Islamic Financial Reporting research. This Issues Bulletin complements the MASB approved accounting standards and nothing in this Issues Bulletin overrides any specific MASB approved accounting standards.

1. Introduction

Purpose of the Issues Bulletin

1.1 The Issues Bulletin (IB) aims to provide accounting, reporting and disclosure guidance to Islamic Financial Institutions (IFIs) extending Islamic Social Finance (ISF) to targeted customer segments in accordance with the Malaysian Financial Reporting Standards (MFRS). In particular, the IB seeks to: -

a) explain the current ISF programmes, activities and products offered by IFIs, the accounting, reporting and disclosure practices as well as Shariah contracts adopted in executing the ISF transactions;

b) identify potential accounting, reporting and disclosure gaps in IFIs' general-purpose financial statements (if any); and

c) recommend accounting considerations and best practices on disclosure of relevant key ISF information in the general-purpose financial statements to facilitate financial statements users' understanding and informed decision making, particularly in respect of utilisation of source of ISF funds and blended Islamic financial services offered under ISF programmes.

1.2 The IB is developed and guided by the main objective of MFRS i.e., accounting standards that provide a basis for preparing useful and consistent information about the financial position, financial performance, changes in equity and cash flows of a reporting entity. Therefore, the IB would serve as guidance and reference to IFIs in ensuring ISF transactions are accounted for and consistent with relevant MFRS requirements as well as ensuring sufficient and appropriate disclosures are made in the general-purpose financial statements.

1.3 While the ISF programmes, activities and products offered by IFIs may be viewed as part of IFIs' agenda in achieving United Nation's Sustainability Development Goals (UN SDGs) objective, and hence, some may argue that the IB is more relevant to facilitate sustainability reporting rather than financial reporting, the IB clearly demarcates between sustainability and financial reporting purposes. The assessment, observation and recommendations outlined under the IB are specifically confined to relevant MFRS application and appropriate disclosure of ISF transactions in the context of the general-purpose financial statements as prepared by IFIs.

Research methodology

1.4 In developing the IB, the following approaches have been considered: -

a) literature review in respect of publicly available materials and information to gain an appreciation of the ISF concept, the mechanics of relevant programmes, the activities and products offered by IFIs as well as the reported information on ISF programmes, including information disclosed under the general-purpose financial statements, sustainability reports, Shariah Committee reports or integrated annual reports;

b) engagement with key stakeholders specifically selected IFIs, regulators, auditors and an industry association to collate views and inputs on current and future ISF programmes, Shariah contracts adopted as well as accounting, reporting and disclosure practices. For example, the discussions held with selected IFIs provided a platform for MASB to confirm the desktop research findings, obtain clarification on areas that required further information and seek feedback on potential areas in the IB that may need enhancement; and

c) technical references to relevant accounting standards including MFRS 7 *Financial Instruments: Disclosures*, MFRS 9 *Financial Instruments*, MFRS 15 *Revenue from Contracts with Customers*, MFRS 132 *Financial Instruments: Presentation* and MFRS 120 *Accounting for Government Grants and Disclosure of Government Assistance* as well as Shariah standards and relevant regulatory policies as issued by Bank Negara Malaysia (BNM).

2. Definition, Scope of Application and Ultimate Outcome of ISF

Definition

2.1 Generally, 'social finance' refers to financial services designed to provide avenues for customer segments that are in the most need of assistance to achieve their economic and social goals. Social finance might seek to raise the economic standing of those who might otherwise not be catered for by financial institutions. Those customer segments might include individuals and micro-enterprises who do not necessarily have an access to conventional mainstream financial services.

2.2 While social finance is not based purely on achieving economic returns, it may or may not include so-called 'charitable' components.

2.3 In some jurisdictions[1], including Malaysia, social finance uses Islamic financial instruments to achieve social finance outcomes. Social finance offered based on Islamic financial instruments will be the key focus in this IB. This also aligns with BNM's Financial Sector Blueprint 2022 – 2026 that aims to elevate social finance as an integral part of Islamic finance ecosystem in Malaysia. Nevertheless, as a matter of comparison, the IB occasionally refers to conventional financial instruments, where relevant.

2.4 For the purpose of consistency, social finance can be specifically defined as financial structures and business models that aim to generate sustainable financial returns while delivering tangible social outcomes by mobilising philanthropic capital – this includes

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[1] Mainly from Muslim majority countries from the region of South East Asia such as Indonesia and the Middle East and African countries such as United Arab Emirates and Nigeria.

Islamic financial instruments such as *sadaqah* (voluntary donation), *wakaf* (endowment) and *zakat* (alms/compulsory donation)[2].

Scope of Application

2.5 Generally, the source of funding for ISF programmes can be in the following forms: -

i. Islamic traditional instruments based on philanthropic capital – *zakat* (alms/compulsory donation), *sadaqah* (voluntary donation) and *wakaf* (special kind of philanthropic deed in perpetuity);

ii. mutual/cooperative-based foundations – *qard* (interest-free loan); and

iii. modern forms of Islamic financial services – investment accounts placement, micro-financing, sukuk and takaful.

For example, under an ISF programme, a micro-financing facility without profit (or *qard* financing) is offered by the IFIs which helps to create businesses and employment opportunities resulting in lower unemployment rates and/or ensuring their business or survival[3].

2.6 The scope of the IB is confined to the current ISF programmes offered under the BNM's iTEKAD pilot initiatives, featuring a blended social finance programme by Islamic banks in collaboration with implementation partners, which offers seed capital, micro-financing and structured training to micro-entrepreneurs. The blended finance feature of the programme enables low-income micro-entrepreneurs to gain access to funding whilst enhancing their business skills in growing and sustaining their businesses.

2.7 From an Islamic finance perspective, any provision of financial services under an ISF programme to the targeted customer segments e.g. the Bottom 40 (B40)[4] in achieving socio-economic welfare can be made through investment in the community via affordable micro-financing and programme-related investments.

2.8 Financial services offered under an ISF programme can be designed for greater flexibility, thereby increasing the level of resilience to risk in contrast to traditional debt-based finance. It could allow more flexible repayment terms that accommodate irregular income streams. For instance, micro-financing based on a *qard* contract may be designed at a longer repayment period to suit business income streams; alternatively direct financial assistance sourced from *zakat*, *sadaqah* or *wakaf* funds can be extended for the purpose of starting a new business or business expansion, and carries no repayment obligation from eligible recipients.

2.9 IFIs, with agreement from ISF fund providers e.g., State Islamic Religious Councils (SIRCs), investment accounts holders as well as public donors, generally supplement the funding with structured training programmes that upskill beneficiaries/targeted segment in financial management and business acumen through compulsory training provided by approved training partners or conducted by the IFIs. These training programmes enhance their financial literacy, foster entrepreneurial behaviour and empower the beneficiaries to generate a more sustainable income.

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2 Social finance as an enabler of social development in Malaysia, BNM's Financial Sector Blueprint 2022 – 2026.

3 An Analysis on Islamic Social Finance for Protection and Preservation of Maqaṣid al-Shariah, IIUM, 2017.

4 Bottom 40% of the Malaysian household income who earn less than RM4,850 per month.

2.10 An ISF programme is often supported by impact monitoring and "pay-it-forward" mechanisms. The "pay-it-forward" mechanism works when the successful ISF programme's participants contribute back to the society/*ummah* by creating employment opportunities, paying *zakat*, *sadaqah* and *qard* and empowering other micro entrepreneurs through performance indicators such as number of employment opportunities created and growth of business assets. Effective implementation of these mechanisms can build trust among the ISF fund providers, IFIs and target customer segments, as well as foster a virtuous cycle that encourages past beneficiaries to be part of efforts to support future ones[5].

2.11 The COVID-19 pandemic creates further opportunities in elevating and expanding ISF programmes to minimise the economic impact of the pandemic on individual employment and micro enterprises. The blended financial solutions offered under ISF programmes such as *qard* financing, micro-financing at affordable rate and financial assistance aims to help impacted individuals and businesses rebuild their livelihoods after experiencing distressing economic changes.

Ultimate Outcome

2.12 In Malaysia, the B40 and micro-entrepreneurs'[6] segments face difficulties in accessing formal financial services due to lack of business and financial track records, inadequate business and financial management skills, as well as the fact that they engage in business activities that tend to be of higher risk.

2.13 Through ISF programmes as an alternative financial solution, B40 and micro-entrepreneurs can avail themselves of more funding options beyond the traditional debt-based financing to sustain or expand their businesses. Therefore, ISF serves as an alternative, as long as the relevant parties i.e., the IFIs and individuals and micro-entrepreneurs can match their credit risk and funding needs. In short, it is about nurturing the unbanked to become bankable.

3. Current ISF Programmes, Observations on Accounting and Disclosure Practices

Current ISF Programmes

3.1 Launched by BNM in May 2020, the iTEKAD programme, a social finance pilot programme that blends financial and non-financial services, has been used as a platform to accelerate the mobilisation of Islamic financial instruments such as *zakat, sadaqah, wakaf* and social investment funds in offering seed capital with an affordable micro-financing arrangement to targeted customer segments.

3.2 Under the iTEKAD programme, the participating IFIs, in collaboration with implementation partners e.g., SIRCs, investors, public donors and approved training providers, will be providing a wider range of blended financial solutions i.e., seed capital, micro-financing and structured training to targeted customer segments i.e., B40 and micro-entrepreneurs.

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[5] Social finance as an enabler of social development in Malaysia, BNM's Financial Sector Blueprint 2022 – 2026.

[6] Micro-entrepreneurs with less than 5 employees or less than RM250,000 of the sales turnover for all sectors, namely agriculture, mining & quarrying, construction, services and manufacturing.

3.3 As of 31 May 2022, the following ISF programmes are offered by participating IFIs in Malaysia under the iTEKAD programme using various sources of funds:

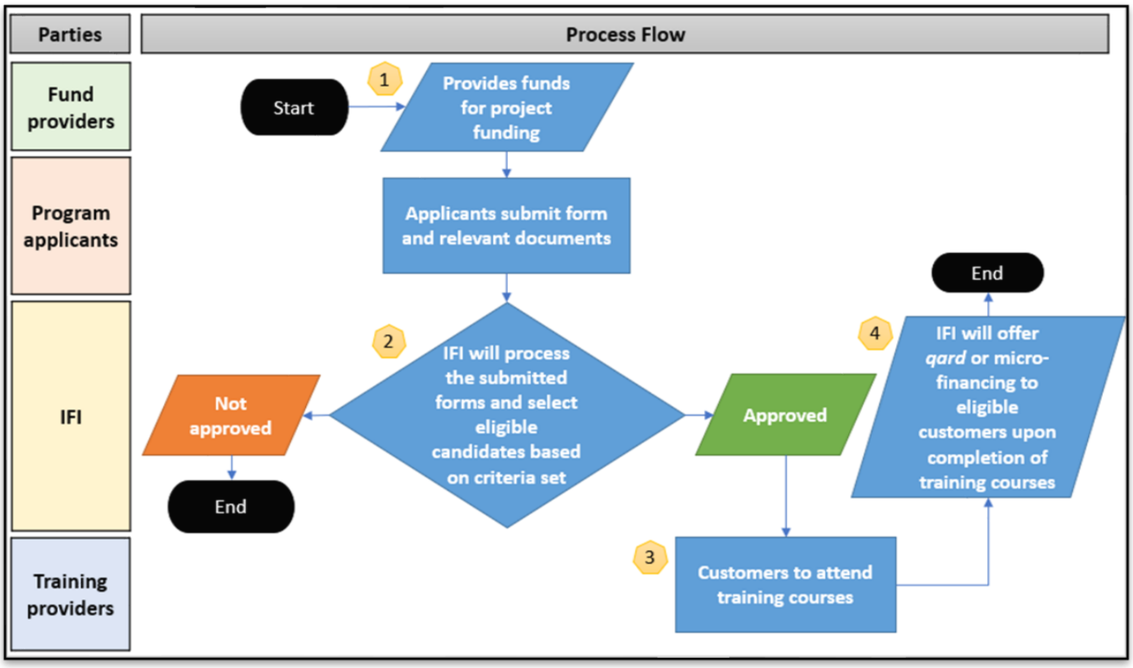
i. Bank Islam Malaysia Berhad's (Bank Islam) iTEKAD micro-financing – ISF funded by philanthropic capital (*zakat*) and BNM's MEF fund;

ii. Bank Muamalat Malaysia Berhad's (Bank Muamalat) iTEKAD Mawaddah – ISF funded by Restricted Investment Accounts;

iii. CIMB Islamic Bank Berhad's (CIMB Islamic) iTEKAD Rider Entrepreneur – ISF funded by bank's own CSR fund; and

iv. Bank Islam's iTEKAD BangKIT micro-financing – ISF funded by donation from public donors via a dedicated crowd funding platform.

3.4 The mechanics of current ISF programmes under iTEKAD by IFIs in Malaysia are generally illustrated as per diagram below:



Brief explanation on the diagram:

1. Funds received by IFIs in executing the ISF programmes could be sourced from various sources such as SIRCs, IFIs' own funds or allocated corporate social responsibility (CSR) funds, public investors through investment accounts placement, public donors through crowd funding platforms or funds from Micro Enterprises Facility (MEF) established by BNM or the Government for the micro-financing component of iTEKAD. The philanthropic capital provided by SIRCs will normally be utilised for the purpose of supporting ISF programmes such as training costs/expenses as well as direct financial assistance to the eligible recipients for purchase of business equipment. The philanthropic capital is managed by IFIs (acting as *wakeel*) on behalf of the SIRCs.

2. IFIs will then perform background check on the applicants based on specific established criteria e.g., household income, business registration, and will shortlist the eligible applicants to undergo the ISF programmes.

3. Approved applicants are required to undergo compulsory training conducted by the approved training providers.

4. Upon completion from the ISF's training programmes, IFIs normally offer *qard* financing or micro-financing at affordable rate as a blended financial solution (beside direct financial assistance) to eligible customers.

Observations on Current Accounting, Reporting and Disclosure Practices

3.5 The sources of funds, which are not controlled by the IFIs e.g. funds that are provided by the third parties rather than from IFI's own account, are recognised as an off-balance sheet item. This is on the basis that one party, i.e., the fund provider (a principal capital provider) engages another party, and the IFIs (an agent) to act on behalf of, and for the benefit of, the principal[7].

For instance, *wakalah zakat* fund allocated to the IFIs for the ISF programmes are managed and controlled by SIRCs and IFIs are obliged to transfer the *wakalah zakat* fund to the identified beneficiaries of the ISF programmes. Hence, the *wakalah zakat* funds are not a liability of the IFIs and will not be recognised in the IFIs' balance sheet.

As the IFIs are only the custodian of the funds, the above basis will also be applied in recognising the financing products offered by IFIs, which are fully funded by off-balance sheet source of funds.

3.6 Further, the ISF programmes are considered "outside" from IFI's main business model/stream e.g., community or charitable programme, which does not have impact (or little impact) on the IFIs' business risk. Similar treatment is also observed on IFIs' CSR funds which have been allocated upfront (early in the financial year) for the purpose of CSR and community programmes.

3.7 As for funds sourced from BNM's MEF, it is observed that one IFI recognised the SME fund as a liability to the Government financing scheme for SME financing based, measured at the financing amount claimed from BNM. Upon extending SME financing to eligible micro-entrepreneurs under its' ISF programme, the IFI recognised the financing amount as part of its other financing business and assessed the financing according to MFRS 9 requirements i.e. business model and cashflow characteristic tests. The relevant provisioning and expected credit losses impact on the SME financing extended are assessed and recognised accordingly.

3.8 Fund received from SIRCs (e.g., *wakalah* fee for managing *wakalah zakat* fund on behalf of an SIRC) may be used to cover training cost and expenses and hence may be treated as off-balance sheet items. In some cases, IFIs bear the cost of training provided by approved training providers under ISF programme directly. Consequently, it is expected that IFIs reflect such transactions under their general management expenses/administrative cost incurred during the year and recognise the expenses as part of their annual profit and loss.

3.9 Disclosure on key ISF transactions in the general-purpose financial statements may be seen as lacking or insufficient. The following are the summary of gaps on current disclosures as practiced by IFIs:

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[7] Paragraph 4.25 of *The Conceptual Framework for Financial Reporting*.

i. ISF programmes are mainly disclosed in the IFIs' Sustainability Report, Shariah Committee Report or analysis report in their Integrated Annual Reports given the ISF is more relevant to achieve Sustainability Development Goals agenda rather than financial reporting despite the ISF programmes involved with channelling blended financing to targeted customer segments;

ii. although *zakat* is declared and reported annually (such as the distribution of a portion of the *zakat* paid by the IFIs based on their agent for distribution to eligible beneficiaries) in the Shariah Committee Report and financial statements respectively, there is no specific disclosure observed on utilisation of *wakalah zakat* for the purpose of ISF programmes;

iii. no specific disclosures are provided in relation to the income derived and operational expenses in relation to ISF programmes i.e., training costs borne by IFIs and sponsorship commitment costs in the general-purpose financial statements. Instead, this is generally dealt with under the overall IFIs' financing income and expenses line items in the Income Statement;

iv. in relation to fund sourced from BNM's MEF, the amount is disclosed under the Government financing scheme for the purpose of SME financing without specific item or explanation in the notes to the accounts on financing amount extended to micro-entrepreneurs under ISF programmes; and

v. IFIs risks and obligations to the philanthropic capital's fund providers i.e. the SIRC or restricted investment accounts differ than IFIs' other fund providers i.e. Government financing or its own funds, which risk exposures from the latter are disclosed in financial risk management note of the general-purpose financial statements or part of Pillar 3 disclosure.

Please refer to the **Appendix** for further information on the IFIs' ISF programmes' background, current accounting, reporting and disclosure practices.

4. Accounting Considerations for ISF Transactions

4.1 As there is no specific MFRS issued that explicitly addresses ISF transactions in the general-purpose financial statements, IFI may be guided by the following accounting considerations to clearly accord ISF transactions under MFRS:

i. The relationship between the IFI and the providers of the philanthropic capital ("funders") is assessed by applying the requirements of MFRS. Paragraph 4.25 of *The Conceptual Framework for Financial Reporting* contemplates a relationship where "one party (a principal) engages another party (an agent) to act on behalf of, and for the benefit of, the principal". Paragraph 10 of MFRS 15 defines a contract as "an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity's customary business practices".

ii. In assessing its relationship with the funders, the IFI should consider the rights and obligations (explicit or implied) created between the IFI and the funders within the context and constraints of the legal and regulatory environment. The IFI should consider exercising judgement in assessing whether it is:

a. acting as an agent on behalf of the funders, under a strictly defined and curtailed mandate, with the economic risks and rewards of the activities being transferred in whole or very substantial part to the funders, in return for receiving a fee; or

b. acting as a principle, with some mandate or restrictions from funders, bearing economic risk and reward of the activities, in return for receiving both a fee and a share of the returns from the activities.

Typically, the entity with execution control bears some fiduciary risk. This risk exists irrespective of whether that entity is an agent or a principal and is therefore typically disregarded in making this assessment.

iii. Key considerations in making the judgment include:

a. which party bears the substantial risks and rewards of the activities; and

b. which party controls the activities (an entity controls an activity if it has the present ability to direct the activity and obtain the economic benefits that may flow from it – execution of a mandate is not control).

iv. If an IFI concludes it is an agent, then:

a. it applies MFRS 15 to the contract, explicit or implied, between itself and the funders;

b. to the extent that it accepts funding, or advances funds in terms of the arrangement, it acts in the capacity of a representative of the principal and is not itself a party to the financial instruments (even if it has signed them); and

c. it recognises any fees received from acting as an agent once the performance obligation is satisfied in accordance with MFRS 15[8].

v. If an IFI concludes it is a principal, then:

a. it applies MFRS 15 to the contract, explicit or implied, between itself and the funders;

b. any financial instruments that arise from the agreement including both funding and advances are accounted for in accordance with MFRS 9; and

c. the initial recognition principle[9] applies in recognising a financial asset or a financial liability in the statement of financial position when, and only when, the entity becomes a party to the contractual provisions of the instrument.

[8] Paragraph B36 of MFRS 15 *Revenue from Contracts with Customers*.

[9] Paragraph 3.1.1 of MFRS 9 *Financial Instruments*.

> **Consideration of derecognition principles under MFRS 9**
>
> MFRS 9 does not consider agent versus principal. However, when discussing whether an entity should derecognise an asset, MFRS 9 does consider the concept of control in the context of financial instruments:
>
> i. When an entity has contractual rights to receive the cash flows from a financial asset, but an obligation to pay those cash flows to others, the entity does not control those assets if:
>
>   a. the obligation is limited to the extent amounts are received;
>
>   b. the entity is prohibited from selling or pledging the asset; and
>
>   c. receipts are to be remitted (or reapplied) without material delay[10].
>
> ii. An entity that has the practical ability to sell an asset to a 3rd party would have the capacity to control it[11]. By deduction, when an entity cannot unilaterally act to sell an asset, it would strongly indicate the entity does not control it.
>
> iii. An entity that has substantially all the risks and rewards of ownership in relation to assets or liabilities would be expected to control them[12].
>
> These are indicators only and are included only for the purposes of considering if control exists. The derecognition requirements of MFRS 9 are not otherwise relevant because they would only ever be triggered in respect of assets and liabilities previously recognised by the IFI.

vi. Types of Shariah contracts adopted in each transaction under ISF programmes such as *mudarabah, wakalah, qard* or *tawarruq* may result to different accounting treatments. The application of relevant MFRSs to accord for different type of Shariah contracts involves judgment which needs to be carefully considered and applied to each Shariah contract.

For example, *tawarruq* that is used as an underlying contract of an ISF transaction may require further considerations whether the contractual terms stipulated under the contracts would fall within the scope of MFRS 15, or alternatively the contracts may be accorded as financial assets within the scope of MFRS 9.

vii. Types of financial services offered to the eligible customers that are commonly either in micro-financing or financial assistance, may be assessed similar to other financial instruments as per MFRS 9 and MFRS 132. The assessment may be guided by the contractual rights from the asset.

For example, when financial assistance provided to eligible recipients using *sadaqah*, *zakat* or *wakaf* funds, the funds are directly received from fund providers and IFIs has an obligation to remit the funds to the eligible recipients. The terms and

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[10] Paragraph 3.2.5 of MFRS 9 *Financial Instruments.*

[11] Paragraph 3.2.9 and B3.2.7 to B3.2.9 of MFRS 9 *Financial Instruments*.

[12] Paragraph 3.2.16 and 3.2.20 of MFRS 9 *Financial Instruments*.

conditions including no repayment obligation by eligible recipients should also be assessed against the recognition principles of MFRS 9.

5. Recommendation on ISF Disclosures in Financial Statements

5.1 MFRS does not explicitly address disclosures related to ISF transactions in the general-purpose financial statements. However, MFRS does not preclude any disclosures so long the disclosures provide relevant information and facilitate understanding of the users of financial statements. For example, paragraph 15 of MFRS 101 *Presentation of Financial Statements* states (in part):

> *Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Conceptual Framework for Financial Reporting (Conceptual Framework). The application of MFRSs, with additional disclosure, when necessary, is presumed to result in financial statements that achieve a fair presentation.*

5.2 Greater transparency on ISF in enhancing socio-economic of the community is imperative. This aligns with IFI's commitment towards achieving the intended outcome of *Maqasid Shariah*[13] through impact focused disclosure under Value-based Intermediation[14]. Therefore, for the purpose of enhancing transparency and facilitating users of financial statements' understanding on ISF transactions and informed decision-making process, the following are recommended disclosures of key ISF information in the general-purpose financial statements:

i. *Wakalah zakat* – disclose *wakalah zakat* funds received from SIRCs that have been utilised for the ISF programmes including the amount of *wakalah* fee received (if any) by IFIs in managing the *wakalah zakat* funds and how *wakalah zakat* funds have been channelled to the eligible recipients. IFIs should also disclose their obligation to beneficiaries by disclosing unutilised *wakalah zakat* funds or disclose returned *wakalah zakat* funds to SIRCs. This would provide transparency and detailed information on the utilisation of *wakalah zakat* funds for ISF programmes;

ii. BNM's MEF fund – disclose SME financing figures extended to eligible micro-entrepreneurs under ISF programmes. This would facilitate clear demarcation between IFIs' exposures in relation to financing extended under the ISF programmes as opposed to other SME financing;

iii. Income (including any fees) derived and operational expenses borne related to ISF programmes – disclose income figures derived from the ISF products and amount of expenses borne by the IFIs and borne by other source of fund in supporting ISF programmes e.g., training cost and crowd funding platform operational expenses incurred using either IFIs' own annual allocation or funds allocated by SIRCs. This disclosure would provide users with a basis for assessing the revenue contributed from ISF programmes and the extent of the IFIs' commitment to ISF programmes

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[13] Generally defined as purposes, meanings and wisdoms set by Shariah Islamiyyah in the sanctioned rulings as well as the secrets behind it with the purpose of protecting the welfare of humans (Mufti of Federal Territory's Office, *Irsyad Usul Al-Fiqh Series 33: Introduction to Maqasid Al-Shariah*, 2019).

[14] An intermediation function that aims to deliver the intended outcomes of Shariah through practices, conduct and offerings that generate positive and sustainable impact to the economy, community and environment, consistent with the shareholders' sustainable returns and long-term interests (BNM, *Value-based Intermediation: Strengthening the Roles and Impact of Islamic Finance*, 2018).

and the extent to which the IFIs are relying on outside sources for operational supports;

iv. Restricted Investment Accounts (RA) – disclose amount of RA placed in relation to ISF programmes. This will provide users with additional information of RA as one of the sources for the ISF programmes;

v. On-balance sheet financing – disclose ISF financial instruments which are accounted for in accordance with MFRS 9 and the types of Shariah contracts adopted;

vi. Off-balance sheet financing – disclose off-balance sheet financing extended using crowd funding platform or extended by separate entity which are managed by IFIs. Although the crowd funding platform is a separate entity from the IFIs and offering financial products separately from the IFIs' book, the platform is still leveraging the IFIs' identity and its corporate governance practice and hence, the additional information would be valuable for the users in assessing IFIs' exposures and commitment; and

vii. Risk exposures and obligations – disclose the risk exposures and obligations from the philanthropic capital's fund providers in the financial statements.

5.3 While the above disclosure recommendations aim to promote and enhance consistency on ISF transactions in the general-purpose financial statements, IFIs may be guided by the materiality concept as explained in paragraph 31 of MFRS 101, which states (in part):

> *An entity need not provide a specific disclosure required by a MFRS if the information resulting from that disclosure is not material. This is the case even if the MFRS contains a list of specific requirements or describes them as minimum requirements. An entity shall also consider whether to provide additional disclosures when compliance with the specific requirements in MFRS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.*

In relation to materiality, paragraph 7 of MFRS 101 also states (in part):

> *Materiality depends on the nature or magnitude of information, or both. An entity assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole.*

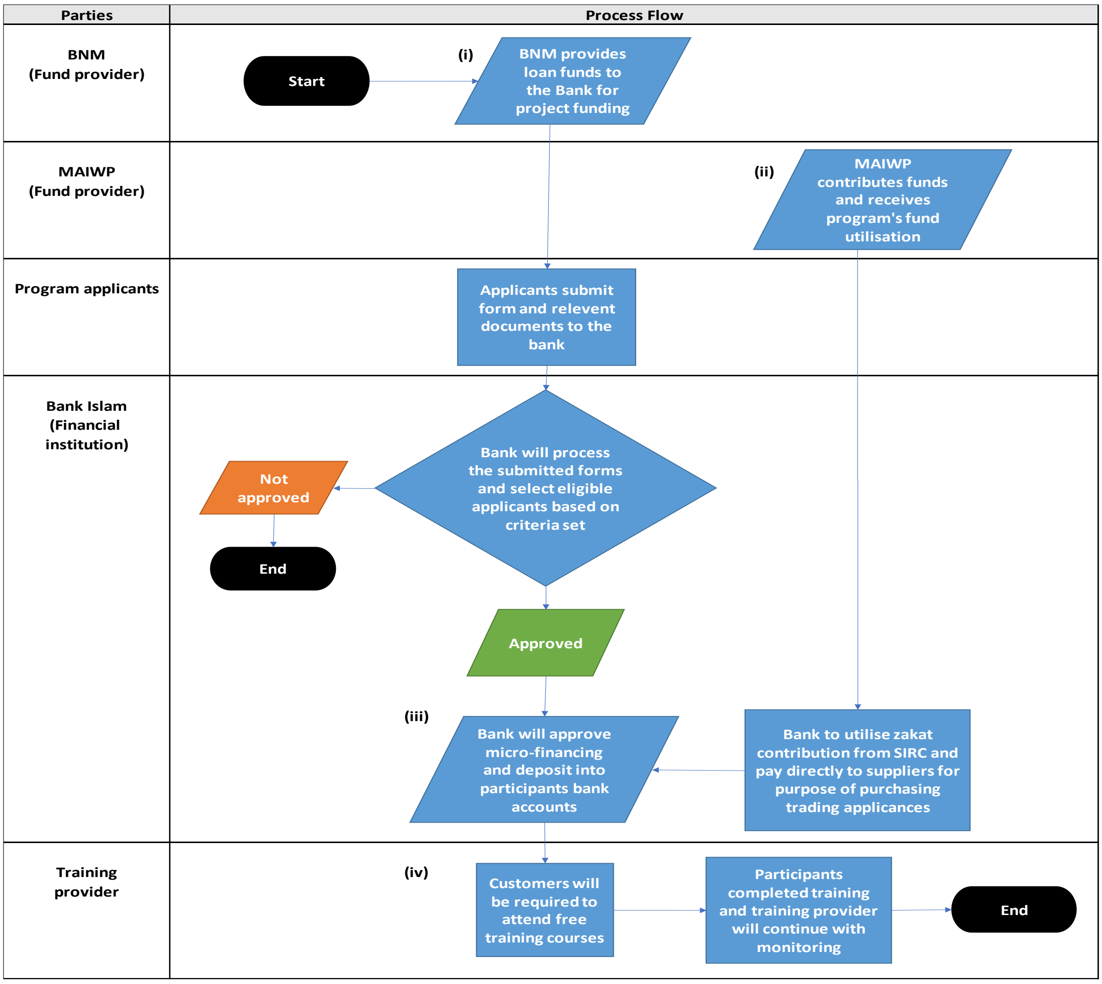
Appendix

A. Bank Islam's iTEKAD micro-financing – ISF funded by philanthropic funds (*zakat*) and BNM's MEF fund

Background

- Bank Islam collaborated with Majlis Agama Islam Wilayah Persekutuan (MAIWP) in providing *Murabahah* micro-financing to SME traders. The financing ranging from RM5,000 to RM50,000 with fixed profit rate of 4% per annum and no guarantee or collateral required.
- The programme is supported by BNM's MEF as an initial capital for the bank to extend the micro-financing and MAIWP's *wakalah zakat* funds as direct financial assistance for purchase of business equipment by the eligible participants.
- The programme is mainly introduced by the bank to help eligible micro-entrepreneurs to grow business to generate sustainable income.
- Eligible participants are required to attend business development training programmes conducted by the implementation partner of the bank i.e., SME Corp Malaysia.
- The Shariah concept used in the programme is *tawarruq* (purchase of a commodity on deferred payment basis and then sold by the purchaser for cash for a party other than the original seller).

Diagram 1: Bank Islam's iTEKAD micro-financing



Accounting practices as per Diagram 1

i. BNM's MEF fund is obtained as a revolving loan under the BNM's MEF initiative for project funding which will be part of bank's financial liabilities and repayment is assessed accordingly as per MFRS 9.

ii. MAIWP's *wakalah zakat* funds are allocated upfront during the selection of the participants. The funds are received separately from the SIRC and the bank will report on the utilisation once successfully distributed to the eligible participants.

iii. The *murabahah* micro-financing product is recognised similar to other financing products as part of bank's financial assets as per MFRS 9.

iv. The bank will bear all training cost in relation to the compulsory training programme as part of its operating expenses during the year.

Disclosure practices

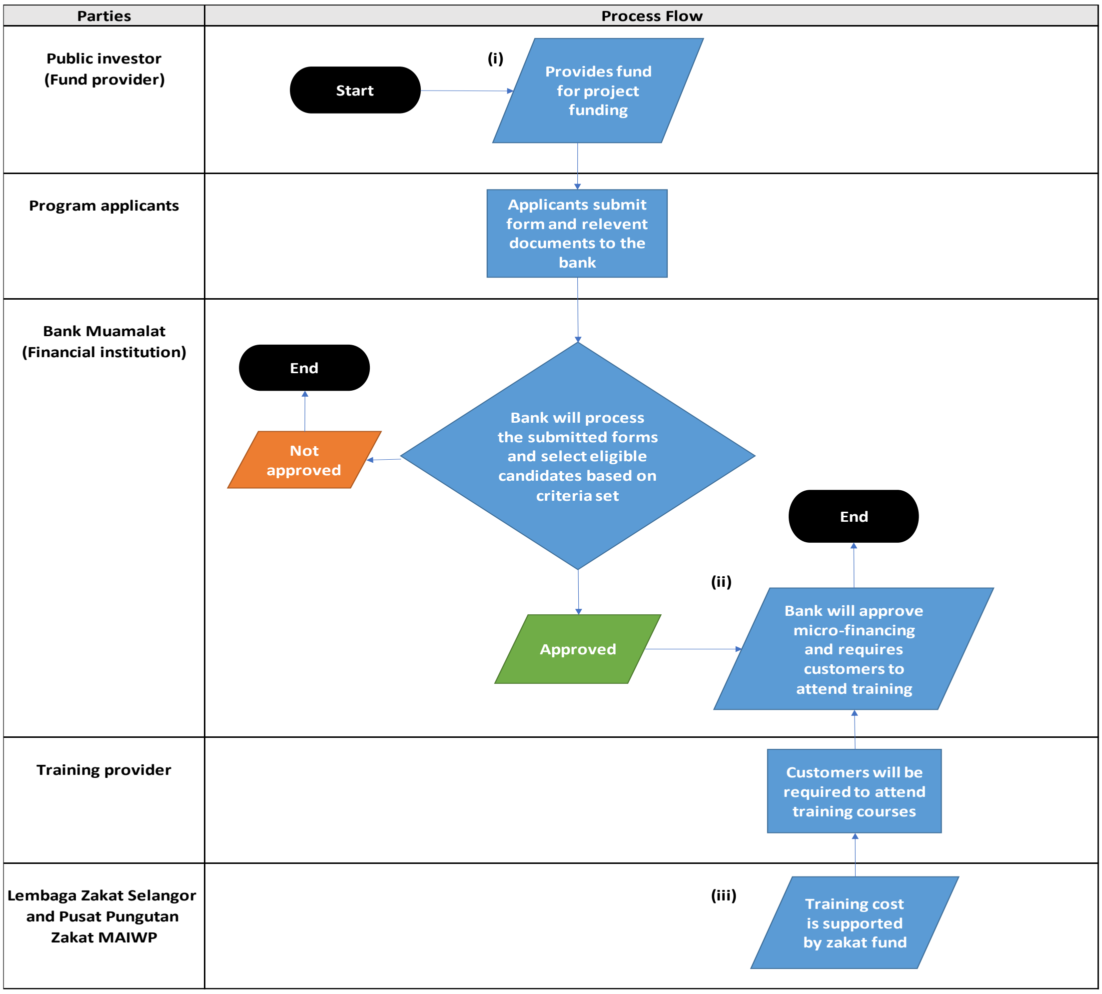
- The ISF programme has been disclosed as part of the bank's annual Sustainability Report, including the programme objectives and the targeted customer's segment.
- Based on Shariah Committee Report, it was mentioned that *zakat* authorities had mandated distribution of a portion of the *zakat* paid by the bank annually (as an agent) for distribution to eligible beneficiaries.
- No specific disclosures in relation to the product and training costs in the financial statements and notes to the accounts, which could be catered in other line items of financing note and overhead expenses note.
- In relation to the BNM's MEF fund for the programme, it was stated in the notes to financial statements that the SME financing at a concessionary rate under Government financing scheme, which could be related to the ISF programme.

B. Bank Muamalat's iTEKAD Mawaddah – ISF funded by Restricted Investment Accounts

Background

- Bank Muamalat has introduced iTEKAD programme to food and beverages entrepreneurs via 2-tier *mudarabah* financing. The programme provides micro-financing for up to RM10,000 per applicant.
- The programme is based on restricted investment account (RA) placement where the bank's own staffs acted as the investors with profit sharing of 95:5 ratio (Tier 1 arrangement) on the profits generated via financing to eligible customers (Tier 2 arrangement).
- All losses incurred will be borne by the investors in accordance to *mudarabah* concept.
- Successful applicants are required to attend business development training programme conducted by the implementation partners, People Systems Consultancy Sdn Bhd dan Serunai COE Sdn Bhd.
- The programme is also supported via *wakalah zakat* funds from Lembaga Zakat Selangor, MAIWP and other state *zakat* agencies where the *wakalah zakat* is distributed as direct financial assistance to eligible recipients as well as to cover training expenses.

Diagram 2: Bank Muamalat's iTEKAD Mawaddah



Accounting practices as per Diagram 2

i. RA is accounted as an off-balance sheet item given the bank has no risk and reward in respect of the financial assets related to the RA except for the fee income generated by the bank in managing the RA e.g. *wakalah* fee. The assessment of RA is guided by the policy document on Investment Account Framework as issued by BNM.

ii. *Mudarabah* micro-financing extended to eligible applicants is recognised as an off-balance sheet item given the risk and exposure will not have impact to the bank i.e., investors will incur any loss from the investment.

iii. The programme's training cost is borne by the contribution of SIRC's *wakalah zakat* funds.

Disclosure practices

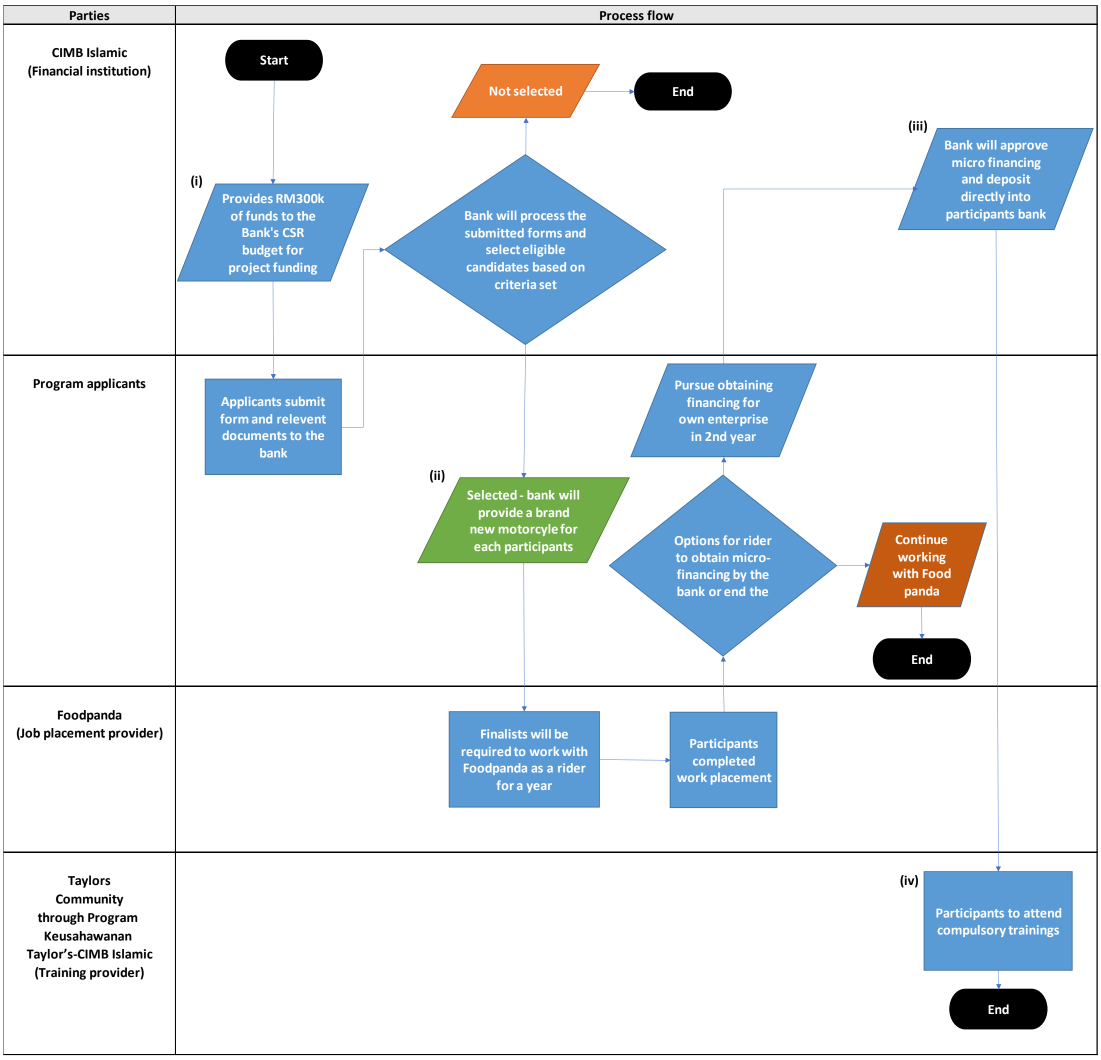
- The ISF programme has been disclosed as part of the bank's annual Sustainability Statement, including the programme objectives, the targeted customer's segment and amounts of working capital and training fees involved for the programme.
- Based on Shariah Committee Chairman's Statement, it was mentioned that the programme has optimised the *wakalah zakat* fund for training and halal certification costs.
- No specific disclosures in relation to the product in the financial statements and notes to the accounts.

C. CIMB Islamic's iTEKAD Rider Entrepreneur – ISF funded by bank's CSR funds

Background

- CIMB Islamic Rider Entrepreneur aims to give back to the community by providing quality training and job opportunities, especially to youth who are impacted by the COVID-19 pandemic.
- The bank pledged to sponsor RM300,000 as part of the bank's CSR funds that supports the B40 communities affected by the pandemic with training and job opportunities as well as micro-financing.
- The programme is coordinated by Yayasan Belia Malaysia with training provided by Taylor's community and Foodpanda as the work placement partner.
- Once the riders successfully completed the one-year work placement with Foodpanda, they are provided the option of either continuing their employment with Foodpanda or setting up their own enterprise in second-year of the programme.
- CIMB's MicroBizReady entrepreneurship training programme, with a special micro-financing facility, as well as the Programme Keusahawanan Taylor's-CIMB Islamic, which offers business grants, are available to support those who opt to start a business after their work placement with Foodpanda.

Diagram 3: CIMB Islamic's iTEKAD Rider Entrepreneur



Accounting practices as per Diagram 3

i. CSR fund of RM300,000 is allocated as part of yearly budget to the programme and will only be recorded in financial statements once incurred during the year.

ii. Through CSR fund, the bank will provide a brand-new motorcycle, complete with helmet and rain coat and Foodpanda registration fees of RM150. The first year's motorcycle registration will be part of bank's overhead expenses during the year.

iii. The micro-financing will be recognised similar to other products as part of the bank's financial assets as per MFRS 9.

iv. The bank will bear all training cost in relation to the compulsory training programme as part of its operating expenses during the year.

Disclosure practices

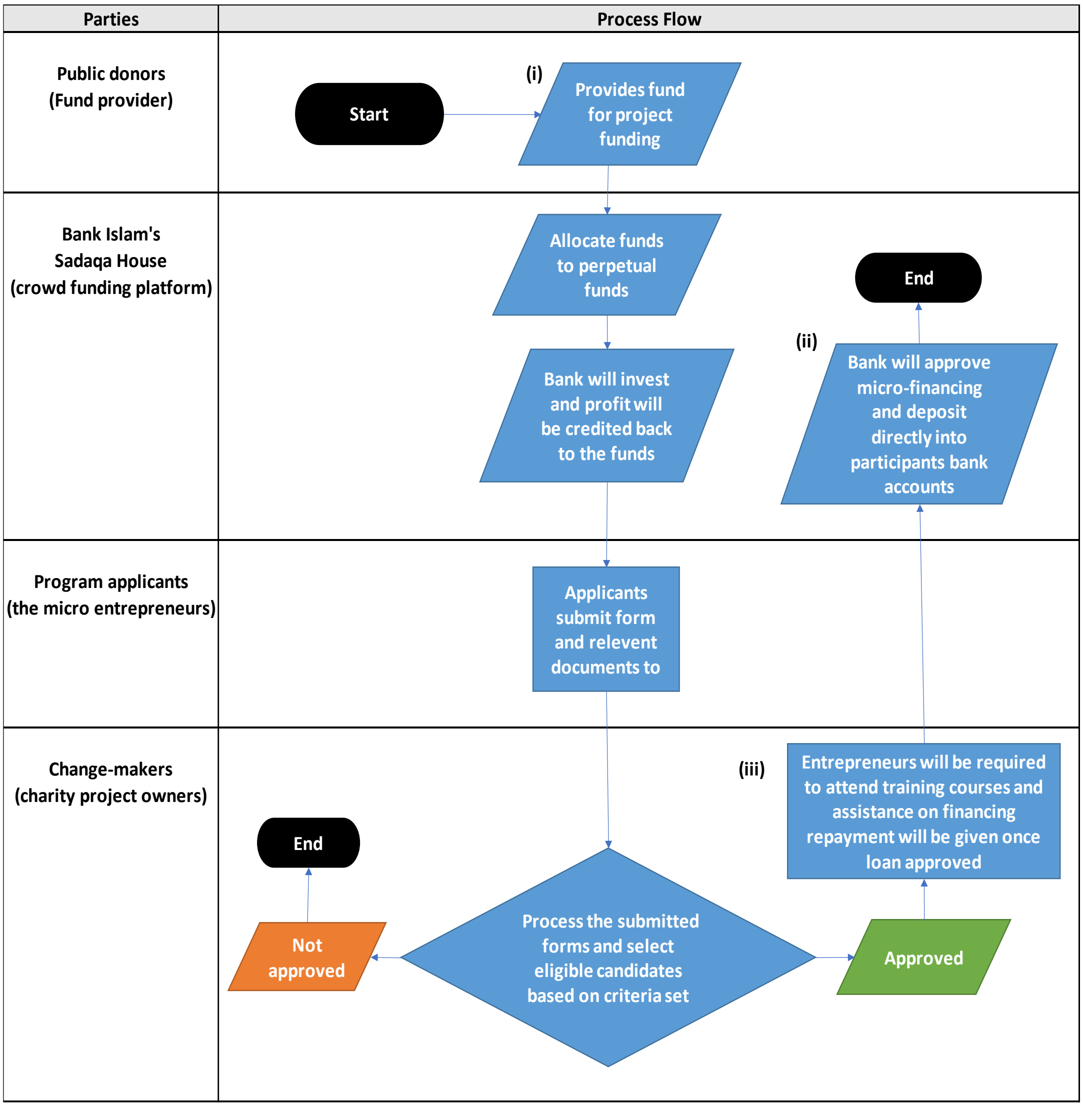
- In the recent Integrated Annual Report, the programme has been disclosed as part of its Management Discussion and Analysis Report and Sustainability Report, which the bank announced the programme objectives, seed fund amounts the bank pledged to sponsor, the targeted customers and update on first stage of the programme during the year it was launched.
- No specific disclosures in relation to sponsorship commitment cost in the financial statements notes, which could be included under overhead expenses note.

D. Bank Islam's iTEKAD BangKIT micro-financing – ISF funded by donation from public donors

Background

- Bank Islam through its charity crowd funding platform, Sadaqa House provides *qard* financing to micro-entrepreneurs of up to RM3,000 per applicant for business start-up and RM20,000 for business expansion.
- Sadaqa House acts as intermediary between public donors, change-makers and beneficiaries. Sadaqa House operates independently from the bank and the bank supported Sadaqa House's operating costs and leverage its corporate governance practice for the platform's operation.
- Sadaqa House will allocate the public donors' funds into investments portfolio and all the returns generated will be distributed to the charitable causes.
- Under this programme, change-makers or the charity project owners will be appointed and will be responsible in selecting eligible candidates.
- Customers are required to attend entrepreneurship training programmes organised by the bank and the relevant change-makers.

Diagram 4: Bank Islam's BangKIT micro-financing



Accounting practices as per Diagram 4

i. Sadaqa House receives public donors' funds, where the funds will be invested and returns generated will be distributed back to the fund.

ii. This product is treated as an off-balance sheet item in the bank's book given Sadaqa House operates independently from Bank Islam and the *qard* financing is extended using public donors' funds instead of the bank's own fund.

iii. The bank will bear all training cost in relation to the compulsory training programme together with other operational costs incurred by Sadaqa House. This is treated as part of annual operating cost and reflected under profit and loss.

Disclosure practices

- In the recent Integrated Annual Report, the Sadaqa House's programme has been disclosed as part of its Sustainability Report, which the bank announced the programme objectives, the targeted customers and fund amount raised during the year.
- In its Shariah Committee Report, the bank confirmed that the fund management and distribution of Sadaqa House are in accordance with Shariah rules and principles.