

AOSSG ISLAMIC FINANCE WORKING GROUP

Financial Reporting by Islamic Financial Institutions

*An update to the 2014 study of financial
statements of Islamic financial institutions*

A decorative graphic at the bottom of the page consists of overlapping, semi-transparent geometric shapes in shades of blue and grey, creating a modern, architectural feel.

JANUARY 2017

AOSSG Islamic Finance Working Group

Financial Reporting by Islamic Financial Institutions: An Update to the 2014 study of financial statements of Islamic financial institutions

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Introduction

1. At the 2014 annual meeting of the Asian-Oceanian Standard Setters Group (AOSSG), the Islamic Finance Working Group (IF WG) presented a study of 132 financial statements of Islamic financial institutions (IFIs) in 31 countries (“2014 study”). The study was published in 2015¹.
2. The 132 samples were selected from the list of ‘Top Islamic Financial Institutions by Country’ that appeared in the November 2013 issue of *The Banker*. The objective of the 2014 study was to determine the financial reporting standards that IFIs were legally required to comply with and the extent of compliance, and to note the accounting treatment of selected Islamic financial transactions.
3. This paper is an update on the financial reporting practices of the 132 IFIs; specifically, on the four items identified in the 2014 study:
 - a. Financial reporting framework
 - b. Accounting for *ijarah* contracts that transfer ownership
 - c. Classification of customer investment accounts
 - d. Measurement of finance income

This paper focuses only on significant developments since the 2014 study.

4. The findings in this paper were based on the most recent annual financial statements publicly available in English as of 1 October 2016. For 3 of the 132 samples, the financial statements used in the 2014 study were the most recent.
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Findings

Financial reporting framework: Two additional IFIs asserted compliance with IFRS

5. As with the original study, this update classified a set of financial statements as complying with one of four types of standards based on the following criteria:
 - a. International Financial Reporting Standards (IFRS) – if the financial statements included a statement of compliance with IFRS as issued by the IASB.
 - b. IFRS as adopted by specific jurisdiction – if the financial statements included a statement of compliance with IFRS as adopted by specific jurisdiction.

¹ The 2014 study was presented at the AOSSG 2014 Annual Meeting and the report “A Study of Financial Statements of Islamic Financial Institutions”, was published in 2015. It is available from the AOSSG website at www.aossg.org.

- c. Local Generally Accepted Accounting Principles (GAAP) – if the financial statements included a statement of compliance with local GAAP; or if it included a statement of compliance with IFRS but with a departure(s) to comply with local law.
 - d. Financial Accounting Standards (FAS) issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) – if the financial statements included a statement of compliance with AAOIFI FAS.
6. Table 1 below summarises the financial reporting framework used by the 132 financial statements, in comparison to the 2014 findings.

Table 1: Financial reporting framework used by IFIs

Financial reporting framework	2016		2014	
	No.	%	No.	%
IFRS	63	48%	61	46%
AAOIFI FAS	23	17%	24	18%
Local GAAP	44	33%	45	34%
Others*	2	2%	2	2%
	132	100%	132	100%

*The same two IFIs did not specify the accounting standards or law complied in their financial statements. These IFIs reported that their financial statements were prepared based on historical cost and market value, where appropriate.

7. Two additional IFIs asserted compliance with IFRS. The two IFIs had previously complied with local GAAP and AAOIFI, respectively:
 - a. A sample from Brunei – The IFI from Brunei previously used local GAAP. It applied IFRS to its financial statements for the year ended 31 December 2015. This was consistent with an announcement by the Brunei Darussalam Accounting Standards Council (BDASC) that all publicly accountable entities shall apply IFRS with effect from 1 January 2014².
 - b. A sample from Qatar - A *takaful* entity stated compliance with IFRS in its financial statements for the year ended 31 December 2015. In the preceding financial year ended 31 December 2014, the financial statements asserted compliance with FAS issued by AAOIFI, and IFRS for matters which were not covered by AAOIFI.

However, the study noted that the auditors' report accompanying the financial statements stated compliance with AAOIFI FAS. Nevertheless, based on the methodology of this report, we categorised this IFI based on the statement of compliance, i.e. IFRS.

²Full adoption of IFRS in Brunei, as published at <http://www.bdasc.org/020712fulladoption.php>

Notably, the IFI's assertion of compliance with IFRS may be a departure from Qatari rules that require a *takaful* entity to apply AAOIFI. In accordance with the Insurance Business Rules (2006) (PINS)³:

“An insurer must adopt 1 of the following as the basis of its accounting:

(a) in the case of a *takaful* entity, the standards of the AAOIFI;

(b) in any other case:

i IFRS;

ii UK GAAP or US GAAP; or

iii any other accounting standards or principles prescribed in Rules made by the Regulatory Authority.”

8. This update did not note any changes to the financial reporting frameworks of the remaining IFIs in the study. [Appendix 1](#) lists the IFIs that complied with IFRS, AAOIFI and local GAAP.

***Ijarah* that transfers ownership: Reclassifications between IAS 39 financial assets and IAS 17 lease receivables**

9. The 2014 study focused on the accounting treatment of *ijarah* that transferred ownership of the *ijarah* asset to the customer because of the significant differences in IFRS and AAOIFI FAS requirements for such transactions. (Please see [Appendix 2](#) for these requirements.) In particular, the study looked at the accounting treatment for items described as:

a. *ijarah muntahia bittamleek* (IMB) – *ijarah* that ends with ownership transfer;

b. *al ijarah thumma al bai* (AITAB) – *ijarah* that is followed by a sale; and

c. finance lease receivables.

10. Similar to the 2014 study, the majority of the samples reported *ijarah* as financial assets in accordance with IAS 39 / IFRS 9. The second most common treatment was to recognise *ijarah* as fixed assets in accordance with AAOIFI FAS No. 8, *Ijarah and Ijarah Muntahia Bittamleek*. Table 2 below provides a summary of the findings:

Table 2: Presentation of *ijarah* that transfers ownership

Presentation of <i>ijarah</i>	2016		2014	
	No.	%	No.	%
IAS 39/IFRS 9 Financing and receivables	43	48%	39	45%
IAS 17 Finance lease receivables	12	13%	12	14%
FAS No. 8 Fixed assets	31	35%	32	37%

³ Chapter 8, Insurance Business Rules 2006 issued by the Qatar Financial Centre Regulatory Authority. Available at: http://www.complinet.com/qfcr/display/display.html?rbid=1557&element_id=4735

Others[#]	4	4%	4	4%
Total	90	100%	87	100%

Four IFIs from Bangladesh continued to classify *ijarah* as ‘investments’. One of the IFIs stated that *ijarah* was accounted for using Bangladeshi banking regulations.

11. The additional four IFIs that reported *ijarah* as financing and receivables comprise three IFIs from Sri Lanka and the United Arab Emirates (UAE) that did not previously report *ijarah* in the 2014 study, and one IFI from Kuwait that reclassified *ijarah* from lease receivables to financial assets:
- The IFI from Sri Lanka included *ijarah* under “Financing and Receivables to Other Customers”. This was measured in accordance with SLAS 39 *Financial Instruments: Recognition and Measurement*.
 - Two IFRS-compliant IFIs in the UAE classified *ijarah* within its “Islamic financing and receivables”, measured at amortised cost in accordance with IAS 39.
 - An IFI from Kuwait previously reported *ijarah* as lease receivables, but has subsequently reclassified its *ijarah* amounts as ‘financing receivables’. No further information about the reclassification was noted.
12. Conversely, one IFI from the UK reclassified its *ijarah* from financial assets to finance lease receivables. The IFI explained that the reclassification was made in order to be consistent with the requirements of IAS 17. No further quantitative impact to the financial statements was disclosed.
13. The number of IFIs that reported fixed assets for *Ijarah* decreased by one: an IFI from Egypt no longer reported an *ijarah* or finance lease amount in its recent financial statements. Nevertheless, this IFI stated that an asset leased out would be reported as a fixed asset and the lease revenue would be recognised based on the rate of return in the lease contract.
14. The following matters identified in the 2014 study were still present.
- a. Qualified audit opinion for departure from IFRS - The IFI from Mauritius continued to receive a qualified audit opinion on the basis that it applied AAOIFI FAS No. 8 to finance lease contracts entered into during the year. The IFI’s departure from IFRS was directed by the central bank’s guideline for institutions conducting Islamic banking business⁴. The IFI also had a change in auditor.
 - b. Stated compliance with AAOIFI, but application of IFRS – As in the 2014 study, four samples from Qatar asserted compliance with AAOIFI FAS, yet recognised IMB as financial assets measured at amortised cost. This is a departure from AAOIFI FAS No. 8, which requires IMB to be recognised as leased assets measured at cost less depreciation.

⁴ As disclosed in the financial statements “...in accordance with IFRS except for the treatment of leased assets where Accounting and Auditing Organization for Islamic Financial Institutions (“AAOIFI”) standards have been applied in compliance with the requirement of the Banking regulations.”

Customers' investment accounts: Sudanese IFIs reclassified from liability to quasi-equity

15. The Islamic finance industry generally perceives an investment account to be one of two types:
 - a. An unrestricted investment account (URIA) – where the IFI has the authority to determine how the fund is invested; or
 - b. A restricted investment account (RIA) – where the customer provides parameters for how the IFI may invest the fund.
16. Under IFRS, the amounts that an IFI accepts as an investment account may be recognised as a financial liability if it meets the recognition criteria and the definition of a financial liability under IAS 39 and IAS 32, respectively. Alternatively, an investment account may be reported as an off-balance sheet item, if it does not give rise to assets and liabilities of the IFI.
17. AAOIFI, conversely, requires an investment account to be reported either off-balance sheet or as a separate element of quasi-equity, i.e. an intermediary element between liability and equity. Some local GAAP, notably in Indonesia and Yemen, also required IFIs to report *mudarabah* as an intermediary element between liability and equity.
18. AAOIFI has issued a new accounting standard for investment accounts, FAS No. 27, *Investment Account*, which came into effect on 1 January 2016. This Standard supersedes two earlier accounting standards for investment accounts.⁵ Although FAS No. 27 seems to allow for the concept of substance over form in classifying investment accounts⁶, it still does not allow an investment account to be recognised as liability, but as an independent intermediary element between liabilities and owners' equities in the statement of financial position⁷.
19. Additionally, FAS No. 27 applies only to investment accounts under the principle of *mudarabah*. In contrast, other jurisdictions allow IFIs to structure investment accounts based on other principles. For example, the Central Bank of Malaysia allows Malaysian IFIs to structure investment accounts based on *mudarabah*, *musharakah* and *wakalah bi al-istithmar*.⁸
20. As with the 2014 study, IFIs did not always clearly differentiate between investment accounts and deposits. In accordance with the study methodology, the update noted the classification of 'mudarabah accounts', regardless of whether they were presented as deposits or investment accounts. Tables 3 and 4 below provides a summary of the findings:

⁵ FAS No. 5, *Disclosure of Basis for Profit Allocation Between Owners' Equity and Investment Account Holders*, and FAS No. 6, *Equity of Investment Account Holders and Their Equivalent*.

⁶ The Basis for Conclusion to FAS No. 27 stated: "The acid test under the Conceptual Framework will be the ability of the *mudarib* to exercise authority over decisions with regard to the use of and deployment of funds, thus introducing a substance approach rather than legal form approach to accounting recognition."

⁷ "Equity of on-balance sheet investment account holders shall be presented as an independent category in the statement of financial position of the Islamic Financial Institution between liabilities and owners' equity." (Paragraph 5/1/1, Financial Accounting Standard No. (27) *Investment Accounts*. Fulltext of Accounting, Auditing and Governance Standards for Islamic Financial Institutions as at Safar 1437 A.H. – December 2015 A.D.).

⁸ Paragraph 8.2 of the BNM's policy document on Investment Account dated March 2014.

Table 3: Presentation of *mudarabah* customer accounts

	2016		2014	
	No.	%	No.	%
Presentation of <i>mudarabah</i> customer accounts				
Liabilities at amortised cost	44	59%	50	63%
Intermediary element between liability and equity	18	24%	13	16%
Off-balance sheet	3	4%	1	1%
Combination of intermediary element and off-balance sheet	10	13%	12	15%
Combination of liability and off-balance sheet	-	-	3	4%
Total	75	100%	79	100%

Table 4: *Mudarabah* presented as liabilities and as intermediary element, by country

<i>Mudarabah</i> presented as liabilities, by country			<i>Mudarabah</i> presented as an intermediary element, by country		
	2016	2014		2016	2014
Albania	1	1	Bahrain	4	4
Bangladesh	10	10	Indonesia	7	3
Brunei	1	1	Jordan	1	1
Indonesia	3	3	Oman	1	1
Kuwait	3	3	Qatar	1	3
Malaysia	9	9	Sudan	3	-
Mauritius	1	-	Yemen	1	1
Pakistan	2	6			
Saudi Arabia	1	1			
Sudan	-	3			
South Africa	1	-			
Turkey	4	2			
United Arab Emirates	7	10			
United Kingdom	1	1			
Total	44	50		18	13

21. The number of IFIs that reported *mudarabah* as liabilities fell from 50 to 44 primarily because some IFIs no longer carried *mudarabah* accounts, e.g. some IFIs in Pakistan and UAE.
22. However, it is important to note that three IFIs in Sudan which previously classified URIA as liabilities had reclassified them as ‘equity of investment account holders’ (EIAH), an intermediary element between liabilities and equities. These IFIs applied AAOIFI, which could be the reason for the reclassifications.

23. The number of IFIs that classified *mudarabah* as quasi-equity increased from 13 to 18. The primary reasons were as follows:

- The three Sudanese IFIs that reclassified its URIA from liabilities to EIAH; and
- Four additional IFIs from Indonesia reported *mudarabah* as “Temporary syirkah funds” recognised it as an intermediary element, stating that the treatment was in accordance with Indonesian Financial Accounting Standards. However, the update also found three (2014: 3) samples from Indonesia that classified *mudarabah* as deposits.

24. Other notable changes were as follows:

- *Mudarabah* as off-balance sheet increased from 1 to 3. – Two additional IFIs now only report *mudarabah* off-balance sheet: one from Kazakhstan and one from Saudi Arabia. They had previously reported *mudarabah* as both liability and off-balance sheet. The IFI in Kazakhstan stated that *mudarabah* was held under its fiduciary capacity hence it was recognised as an off-balance sheet item. The IFI in Saudi Arabia treated *mudarabah* as off balance sheet as it was a RIA.
- IFIs that reported both *mudarabah* as an intermediary element and as an off-balance sheet item decreased from 12 to 10. – Two IFIs, one each from Indonesia and Qatar, no longer reported RIA off-balance sheet. The update found that these IFIs only reported URIA as an intermediary element in their financial statements.
- No IFIs reported *mudarabah* as both liability and off-balance sheet. The three IFIs that did in 2014 – one each from Kuwait, Kazakhstan and Saudi Arabia – no longer report investment accounts as both liability and off-balance sheet, but as either one or the other. The IFI from Kuwait only reported *mudarabah* deposits, classified as liabilities. An IFI from Kazakhstan and an IFI from Saudi Arabia reported *mudarabah* or investment account only as off-balance sheet items, as explained in paragraph 24 above.

Measurement of finance income: Continued use of ‘proportionate allocation’ and ‘time-apportioned’ bases

25. In its previous work, the IF WG found that AAOIFI FAS and some local GAAP required IFIs to measure finance income on a ‘proportionate allocation’ basis. The IF WG further found that proportionate allocation was interpreted differently by stakeholders: some thought it was similar to the effective interest method, others thought it meant simple straight-line allocation over the number of installments.

26. The IF WG also found measurement bases described as ‘time apportioned’ with similarly conflicting explanations as to whether they were similar to the effective interest method or otherwise.

27. As such, the measurement basis of finance income was identified as one of the four focus areas in the 2014 study. In particular, the study looked at the two main contracts that gave rise to finance income, i.e. *ijarah* and *murabahah*. (Please see [Appendix 3](#) for the relevant requirements under IFRS and AAOIFI with regards to the measurement bases of finance income.)

***Ijarah* income**

28. Table 5 below provides a summary of measurement basis used by the IFIs that reported *ijarah* income.

Table 5: Measurement basis of *ijarah* income

Basis	2016		2014	
	No	%	No	%
Effective profit rate method[‡]	54	60%	53	61%
Proportionate allocation	14	16%	8	9%
Time apportioned	11	12%	12	14%
Others	11	12%	14	16%
Total	90	100%	87	100%

[‡] The ten samples from Pakistan used various terms to describe their measurement basis for *ijarah* income, e.g. accruals, time apportioned and effective yield. However, they further explained that the basis resulted in a constant periodic rate of return. Consistent with the 2014 study, this was understood to be economically similar to the effective interest method.

29. Six additional IFIs applied the “proportionate allocation” method in 2016: three from Indonesia, two from Bahrain and one from Sudan.

- The three IFIs from Indonesia previously applied cash (1) and accrual basis (2) which had been classified as “others” in 2014.
- The two IFIs from Bahrain previously used “time apportioned” method.
- The IFI in Sudan was not included among the 87 IFIs in 2014.

30. Table 6 below provides the descriptions of measurement bases classified under “others” in 2014 and 2016:

Table 6: Other measurement bases for *ijarah* income

Other measurement bases for <i>ijarah</i> income	2016	2014
Straight line basis	1	1
Cash basis	-	3
Accrual basis	5	5
Realisation basis	3	-
Not specified	2	5
Total	11	14

***Murabahah* income**

31. Table 7 below provides a summary of measurement bases used by the IFIs that reported *murabahah* income.

Table 7: Measurement basis of *murabahah* income

Basis	2016		2014	
	No.	%	No.	%
Effective profit rate method ^Δ	62	55%	64	57%
Proportionate allocation	9	8%	11	10%
Time apportioned	16	14%	12	11%
Others	25	23%	24	22%
Total	112	100%	111	100%

Δ The ten samples from Pakistan used various terms to describe their measurement basis for *murabahah* income, e.g. accruals and time apportioned. However, one of the IFIs provided an explanation that in Pakistan “time proportion basis [took] into account the effective yield on the asset”. Consistent with the 2014 study, this was understood to be economically similar to the effective interest method.

32. Table 8 below provides details of “others” in 2016 and 2014:

Table 8: Other measurement bases for *murabahah* income

Other measurement bases of <i>murabahah</i> income	2016	2014
Straight line basis	2	3
Reducing balance method	2	-
Historical cost	2	-
Accrual basis	12	17
Internal rate of return	2	1
Cash basis	1	3
Not specified	4	-
Total	25	24

Conclusion

33. The IFIs in the study continued to apply a variety of financial reporting frameworks. As a result, the differing recognition and measurement bases impede users' ability to meaningfully compare the financial statements.
34. Further efforts must be made to engage with relevant standard-setters and regulators to persuade them of the merits of IFRS compliance. This is all the more important when there may be indications that affected entities in those jurisdictions would prefer IFRS over other frameworks.
35. The instances of IFIs reclassifying *ijarah* from a financial asset under IAS 39 to a finance lease under IAS 17 and vice versa may indicate that further study needs to be undertaken on the salient features of *ijarah* to determine the appropriate standard.

Appendix 1: Compliance with IFRS, AAOIFI and local GAAP

Table 1: 63 IFIs from 18 jurisdictions asserted compliance with IFRS

Jurisdictions	IFRS	IFRS as adopted by the jurisdiction
Albania	1	-
Australia	1	-
Brunei	1	-
Bahrain	2	-
Bosnia [^]	-	1
Kazakhstan	1	-
Kuwait #	2	8
Malaysia	10	-
Mauritius	1	-
Qatar	6	-
Saudi	10	-
South Africa	1	-
Sudan	1	-
Switzerland	1	-
Turkey	2	-
United Arab Emirates	10	-
United Kingdom *	-	4
TOTAL	50	13

[^] The financial statements in Bosnia asserted compliance with International Accounting Standards and International Financial Reporting Standards, which are translated into Bosnian language by the authorised accounting body.

The eight financial statements from Kuwait stated that the financial statements were prepared in accordance with IFRS as adopted in the state of Kuwait.

* The four samples from the United Kingdom asserted compliance with IFRS as adopted by the European Union.

Table 2: 44 IFIs from 11 jurisdictions asserted compliance with local GAAP

Jurisdiction	No of samples	Local GAAP
Bangladesh	7	Bangladesh Accounting Standards (BAS), Bangladesh Financial Reporting Standards (BFRS) and circulars issued by the Bangladesh Bank
	3	Bangladesh Accounting Standards (BAS), Bangladesh Financial Reporting Standards (BFRS), circulars issued by the Bangladesh Bank and AAOIFI.
Egypt	2	Egyptian Accounting Standards
India	1	Indian Accounting Standards
Indonesia	10	Indonesian Financial Accounting Standards (PSAK)
Iran	2	Iranian Accounting Standards
Pakistan	10	Islamic Financial Accounting Standards (IFASs) and IFRS. The financial statements further stated that if local law differed from IFRS, the former prevail.
Philippines	1	Philippines Financial Reporting Standards (PFRS)
Sri Lanka	2	Sri Lanka Accounting Standards (SLAS/SFRS)
Thailand	1	Thailand Accounting Standards
Turkey	2	Turkish Accounting Standards, Turkish Financial Reporting Standards and local guidelines issued by the Public Oversight Accounting and Auditing Standards Authority.
United States of America	2	US GAAP
Yemen	1	Accounting Standards for Islamic Financial Institutions, International Financial Reporting Standards and instructions issued by Central Bank of Yemen.
Total	44	

Table 3: 23 IFIs from 6 jurisdictions asserted compliance with AAOIFI

Jurisdiction	No of samples
Bahrain	8
Jordan	3
Lebanon	1
Oman	1
Qatar	4
Sudan	6
Total	23

Appendix 2: Lessor’s reporting of ijarah that transfers ownership under IFRS and AAOIFI

IFRS requirements

The 2014 study and this subsequent update found that IFIs that asserted compliance with IFRS treated *ijarah* transactions under either IAS 39 / IFRS 9 or IAS 17.

Paragraph 37 of IAS 17 states:

“Under a finance lease substantially all the risks and rewards incidental to legal ownership are transferred by the lessor, and thus the lease payment receivable is treated by the lessor as repayment of principal and finance income to reimburse and reward the lessor for its investment and services.”

With regards to the lease asset, paragraph 36 of IAS 17 states the following:

“Lessors shall recognise assets held under a finance lease in their statements of financial position and present them as a receivable at an amount equal to the net investment in the lease.”

IFIs that judged their *ijarah* to be a “financing” may apply IFRS 9 to its *ijarah*. Under IFRS 9, a financial asset is measured at amortised cost if both of the following conditions are met:

- a. “the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and
- b. the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.” (IFRS 9, paragraph 4.1.2).

Finance income arising from financial assets measured at amortised cost is recognised based on the effective interest method, as stipulated by paragraph 5.4.1 of IFRS 9:

“Interest revenue shall be calculated by using the effective interest method.”

Requirements of AAOIFI FAS No. 8, *Ijarah and Ijarah Muntahia Bittamleek*

AAOIFI FAS No. 8 requires a lessor to record an *ijarah* asset similar to the lessor’s accounting treatment for fixed assets. That means, an *ijarah* asset is carried at book value, net of accumulated depreciation.

In addition, *ijarah* rental which is due as at end of a financial reporting period is treated as *ijarah* receivables. The *ijarah* asset would be derecognised upon legal transfer.

Income from *ijarah* is recognised ‘proportionately’ over the *ijarah* term.

Appendix 3: Measurement bases of finance income

Measurement basis under IFRS

IAS 39 and IFRS 9 require finance income (interest) to be recognised using an effective profit (interest) method, which is defined as follows:

“The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.”¹

Specific to leases, paragraph 39 of IAS 17 requires a lessor in a finance lease to recognise finance income “on a pattern reflecting a constant periodic rate of return on the lessor’s net investment in the finance lease”.

Paragraph 75 of IFRS 16 *Leases* carried forward the above measurement basis of a lessor’s finance leases.

Measurement bases under AAOIFI

AAOIFI has the following bases of income recognition, specifically to murabahah, deferred sale and ijarah.

AAOIFI FAS No. 2, *Murabaha and Murabaha to the Purchase Orderer*

Paragraph 8 states:

“2/4/1 Profits of Murabaha or Murabaha to the purchase orderer are recognized at the time of contracting if the sale is for cash or on credit not exceeding the current financial period.

2/4/2 Profits of a credit sale which will be paid for either by means of one payment due after the current financial period or by instalments over several future financial periods shall be recognized by using one of the following two methods:

- (a) Proportionate allocation of profits over the period of the credit whereby each financial period shall carry its portion of profits irrespective of whether or not cash is received. This is the preferred method.
- (b) As and when the instalments are received. This method shall be used based on a decision by the Shari’a supervisory board of the Islamic bank or, if it is required, by the Supervisory authorities.

¹ Paragraph 9, IAS 39 Financial Instruments: *Recognition and Measurement*. Appendix A of IFRS 9 *Financial Instruments* defined effective interest rate as “The rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortised cost of a financial liability”

In both 2/4/1 and 2/4/2 above, revenues and costs of goods sold shall be recognized at the time of concluding the sale contract, subject to the deferral of profits in 2/4/2.”

AAOIFI FAS No. 8, *Ijarah and Ijarah Muntahia Bittamleek*

Paragraph 9 states: “Ijarah revenue shall be allocated proportionately to the financial periods in the lease term.”

AAOIFI FAS No. 20, *Deferred Payment Sale*

Paragraphs 9 and 10 state:

“Revenue from deferred payment sale transaction shall be recognised at the point of contracting.”

“Profits from deferred payment sale shall be recognised on an accrual basis and proportionally allocated over the period of the contract, whereby each financial period shall carry its portion of the profits. Profits related to future financial periods shall be recorded in “Deferred profit account”.