

An update to the 2018 IFCG Paper: Applying IFRS to Linked Transactions

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Disclaimer:

The slides are prepared by MASB staff for the November 2022 Islamic Finance Consultative Group meeting

Any views are of the staff and not necessarily those of the Malaysian Accounting Standards Board (MASB or the Board).

Agenda

- Recap of the 2018 case studies
- Update & Conclusion

Recap

- A Paper was presented at the 2018 IFCG Meeting on applying IFRS Accounting Standards to three common Islamic finance transactions (drawn from the Malaysian environment):
 - Al Ijarah Thumma Al Bai (AITAB) – “lease” followed by a sale
 - Tawarruq – sale-based financing
 - Musyarakah Mutanaqisah – profit-sharing based financing
- **The Paper was intended** to be useful as benchmarks for considering how IFRS might apply to a range of arrangements involving linked transactions
- **IFRS considered: IFRS 9, IFRS 11, IFRS 15, IFRS 16 & IAS 2**

Recap: For reference

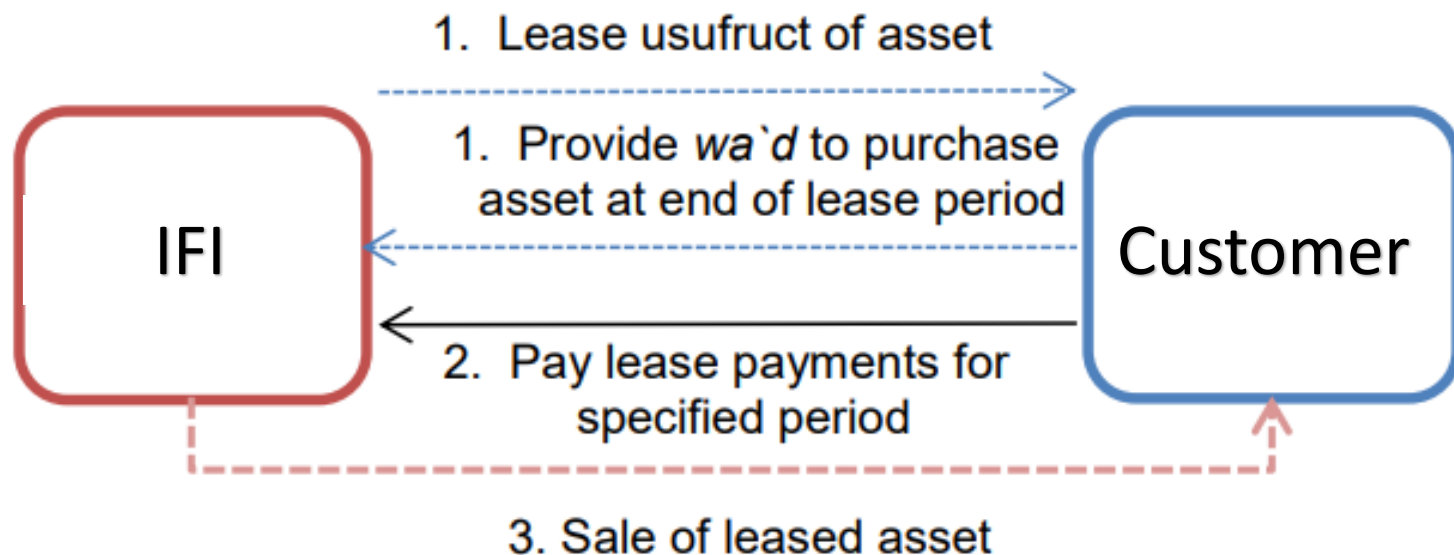
- A prior reading of the Paper is encouraged
- The Paper is available online on the IFRS Foundation website
 - Also included as part of Agenda 3 meeting papers

- To access the Paper online, click:

AP1: Applying IFRS to examples of linked transactions

<https://www.ifrs.org/content/dam/ifrs/meetings/2018/march/ifcg/ap1-applying-ifrs-to-linked-transactions-march-2018.pdf>

Recap: AITAB structure



Note:

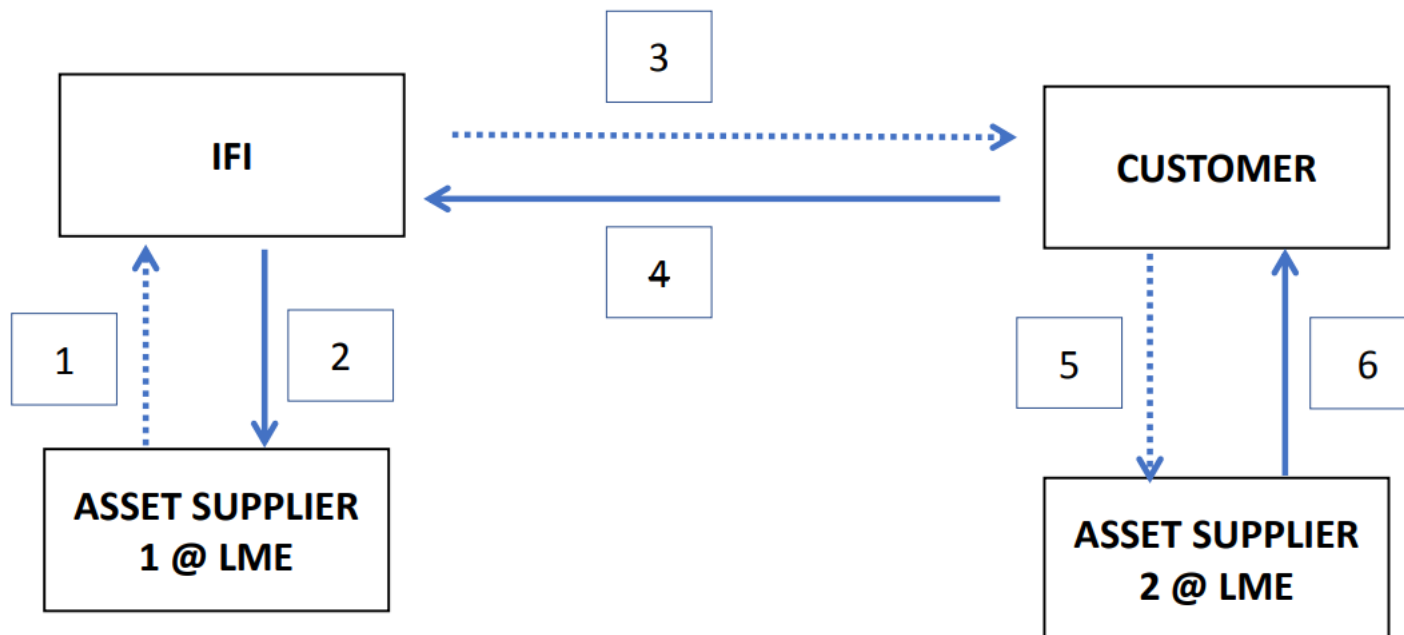
Asset ownership is transferred to the lessee at the end of the *ijarah* financing period.

Recap: Accounting considerations



- [AITAB](#)
- Main question: financing under IFRS 9 or a lease under IFRS 16?
 - A financing from the Islamic financial institution (IFI) to enable customer to buy motor vehicle
 - The financing is accounted for under IFRS 9, at amortised cost
 - Not IFRS 16. Because; the IFI does not control the asset, therefore, cannot convey a right to control
 - ✓ A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

Recap: Tawarruq structure



- IFI buys aluminium via LME
- IFI sells aluminium to customer plus profit margin
- as customer's agent, IFI sells aluminium via LME
- customer to pay IFI monthly instalments for 3 years
- compensation paid to IFI for any overdue payments (based on *ta'widh*)

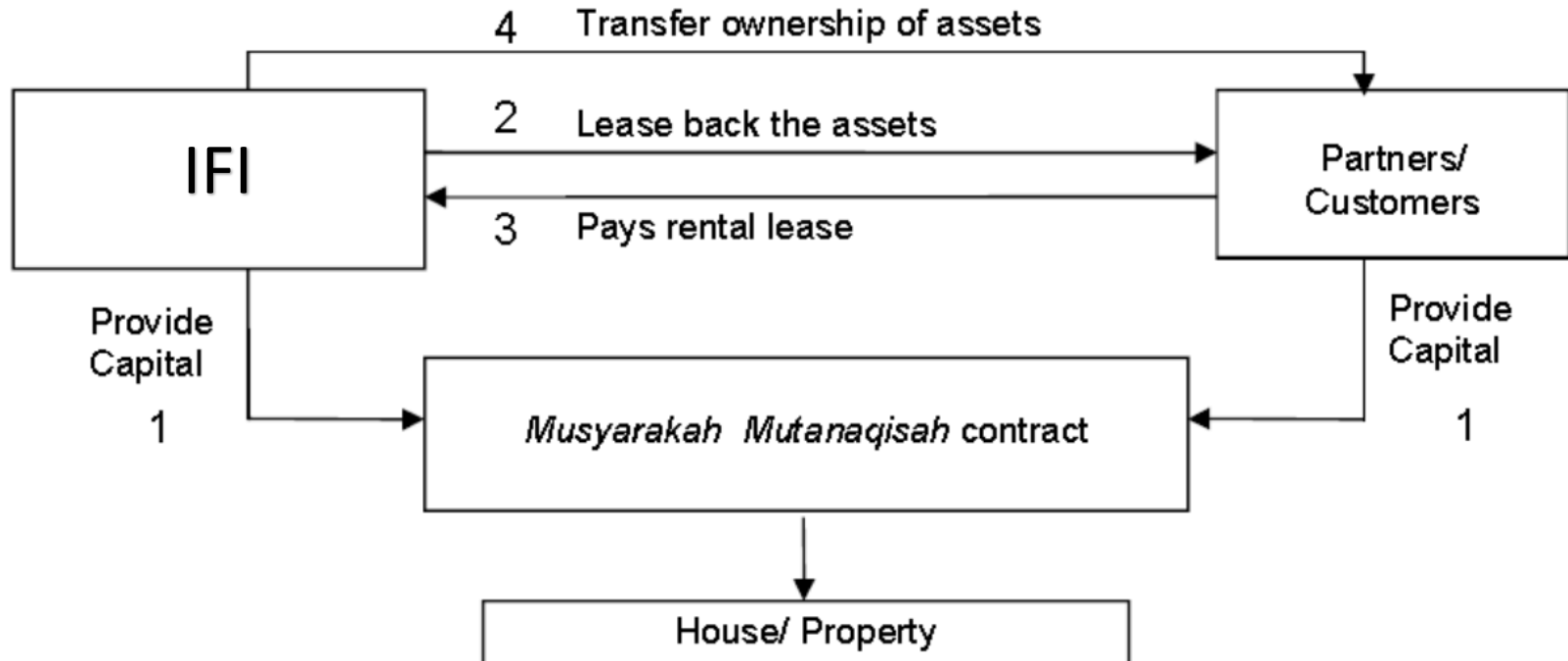
.....> **Asset flow**
——> **Cash flow**

Recap: Accounting considerations



- TAWARRUQ
- Main question: financing under IFRS 9 or a sale under IFRS 15?
 - A financing from the Islamic financial institution (IFI) to fulfill customers' financing needs – in the example – to finance customer's working capital
 - The financing is accounted for under IFRS 9, at amortised cost
 - Not IFRS 15. Because; the contract is not a contract with a “customer” as stipulated in IFRS 15
 - ✓ A customer is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration

Recap: Musyarakah Mutanaqisah



Recap: Accounting considerations



- MUSYARAKAH MUTANAQISAH
- Main question: financing under IFRS 9 or a sale and a lease IFRS 15 / IFRS 16?
 - IFI provides finance to the customer to buy a house the customer will live in
 - The financing is accounted for under IFRS 9, at amortised cost
 - Not IFRS 15. Because; the contract is not a *contract with a “customer”* as stipulated in IFRS 15
 - Not IFRS 16. Because; the IFI does not control the asset and therefore cannot convey a right to control

Update

- How have we determined the update
 - Review
 - ✓ policy documents issued by Bank Negara Malaysia
 - ✓ Malaysian Islamic banks' financial statements (those published as of September 2022)

- Review outcome
 - No change to the fact patterns described in the 2018 Paper
 - The conclusions remain

Overall conclusion

- Assessment of economic effect arising from linked transactions is very important for an Islamic financial transaction
 - analysing each contract on an isolation basis could result in an accounting treatment that does not faithfully represent the overall economic effect.
- Contracts are entered separately and independently but in order for one to understand the economic effect of the transaction, the contracts need to be assessed together.

Malaysian Ijarah: Primary vs Financing

- The Bank Negara Malaysia in its Ijarah Policy Document (June 2018) sets out two main structures of an Ijarah: Primary and Financing
- Their key features are set out below:

Financing Ijarah

- transfer the ownership of the asset to the customer
- Inherent risk: credit risk

- Commonly reported in IFIs' financial statements
- Alternative to conventional financing
- Predominantly: IFRS 9

Primary Ijarah

- ownership of the asset may remain with the IFI
- Inherent risk: operational risk

- Expensive; No take-up (?)
- Economic disparity with conventional financing
- Possibly: IFRS 16

Malaysian Ijarah: Accounting considerations

- Accounting for an Ijarah contract differs depending on the contract terms (both explicit and implied)
- Ijarah, such as in the primary ijarah structure is likely to be a lease under IFRS 16
 - For example: in a primary Ijarah, an IFI may enter into a contract with a customer for leases of a motor vehicle. During the contract term, repairs and maintenance of the motor vehicles will be borne by the IFI. At the end of the contract term or earlier, as may be determined by the customer, the motor vehicle is returned to the IFI.
- Accounting for Islamic finance transactions does not depend on the contract names
 - Ijarah, akin to a lease; but not always a lease contract under IFRS 16
 - Ijarah in Malaysia may not necessarily behave (economically) the same as practiced in other countries

THANK YOU

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