

AOSSG ISLAMIC FINANCE WORKING GROUP

This Memo sets out the following:

1. Details of Working Group Members
2. Objective of the Working Group
3. Work done
4. Proposed agenda of the Working Group

Action from Members:

Please provide any comments or feedback on the proposed current and future agenda of the Working Group.

1. Working Group Members

No	Organisation	Representatives
1	Malaysian Accounting Standards Board (Leader)	Mr. Mohamed Raslan Abdul Rahman Mr. Mohammad Faiz Azmi Ms. Tan Bee Leng
2	Association of Syrian Certified Accountants	Mr. Abdulkader Husrieh
3	Institute of Chartered Accountants of Pakistan	Mr. Muhammad Maqbool
4	Saudi Organization for Certified Public Accountants	Dr. Ahmad Almeghames Dr. Abdulrahman Alrazeen Gihad Alamri
5	The Indonesian Institute of Accountants	Mr. Djohan Pinnarwan Ms. Rosmianingrum Nainggolan

2. Objective of the Working Group

The objective of the Islamic Finance Working Group (WG) is to facilitate AOSSG in providing input and feedback to the IASB on the adequacy and appropriateness of proposed and existing IFRS Standards to Islamic financial transactions.

The WG will take into cognizance that there may be variation in interpretations and practices of Islamic finance in different jurisdictions. Thus to achieve the objective, the WG will undertake research on the conduct of the Islamic financial transactions and financial reporting practices in those jurisdictions.

In the short term, the WG plans to seek input from the Members to understand their challenges in applying IFRS to Islamic financial transactions. This feedback will be used as a basis for the WG to set its future agenda.

Financial reporting framework

The WG acknowledges that some jurisdictions report Islamic financial transactions in accordance with standards other than those of the IFRS Standards. The WG may refer and/or make references to these other standards as necessary. However, the WG will undertake to make recommendations within the framework of IFRS Standards.

Shariah authority

Islamic financial transactions in many jurisdictions are subjected to approval by Shariah advisors or advisory bodies. The WG may make references to such Shariah advisors or advisory bodies when necessary. However, such references, whether in oral or written, shall not be construed as a Shariah opinion of either the WG or of the Shariah advisors or advisory bodies.

Roles of the Lead Country

The lead country is expected to formulate draft comments and other proposals relevant to the topic, and in doing so, the Lead Country will communicate and consult with Members of the WG.

3. Work done from 2010 – 2017

3.1 Completed work

Comments on the following IASB's documents	Publications
1. ED/2015/11 <i>Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts</i>	1. <i>An Update to the 2014 Study of Financial Statements of Islamic Financial Institutions</i> , 2017
2. ED/2015/3 <i>Conceptual Framework for Financial Reporting</i>	2. <i>A Study of Financial Statements of Islamic Financial Institutions</i> , 2015
3. ED/2011/6 <i>Revenue from Contracts with Customer</i>	3. <i>AOSSG Survey – Accounting and Islamic Finance in the Middle East and North America</i> , 2013
4. Request for Views: <i>Agenda Consultation 2011</i>	4. <i>AOSSG Survey – Accounting for Islamic Financial Transactions and Entities</i> , 2011
5. ED/2011/1 <i>Offsetting Financial Asset and Financial Liabilities</i>	5. <i>Financial Reporting Issues relating to Islamic Finance</i> , 2010
6. ED/2009/12 <i>Financial Instruments: Impairment</i>	
7. ED/2010/13 <i>Hedge Accounting</i>	
8. ED/2010/8 <i>Insurance Contracts</i>	
9. ED/2010/6 <i>Revenue from Contracts with Customers</i>	

3.2 Work-in Progress

Draft responses have been submitted to the Working Group Leader on *Presentation and Disclosure* on 8 September 2017 in formulating views to the IASB. According to the timeline, draft comment letter will be circulated to AOSSG Members by 15 September 2017.

4. Proposed agenda

4.1 2017 AOSSG Annual Meeting Update on Financial reporting issues relating to Islamic finance

In 2010, the WG has undertaken a research to identify issues in applying IFRS to Islamic financial transactions. In total, the WG had identified 15 issues including topics on profit-sharing contracts, *sukuk*, *takaful* and *ijarah*. We believe it is timely to revisit the issues to understand Members' current position pertaining to the issues.

Please click on the following link to obtain a copy of the report:

http://www.aossq.org/docs/AOSSG_IF_WG-Research_Paper_11Oct2010.pdf

We have tabulated the 15 issues in **Appendix 1** to this Memo for your reference.

4.2 Future agenda Challenges in applying the IFRS Standards on revenue, leases and insurance

These new IFRS Standards are expected to affect Islamic financial transaction in one way or the other. For instance, the guidance on revenue recognition in IFRS 15 for sale-based contract with significant financing component may be a topic worth exploring as it may have implications to the Islamic sale-based contracts.

In this regard, we propose to undertake research on the above topics to share common issues and challenges in applying those IFRS Standards to Islamic financial transactions.

Issue 1: Recognition of profit in sales

- Would a seller be permitted to recognise the entire 'sale proceeds' upfront?
- Would a buyer be permitted to capitalise the entire 'purchase price' as an asset?

Updates:

Issue 2: Derecognition in sale and buy back agreements (“SBBA”)

- Does the initial sale of securities meet derecognition criteria?
- Would the seller be able to recognise income on the initial sale?
- Would the transaction(s) be treated differently if the subject of sale was not a financial instrument?

Updates:

Issue 3: Transaction fees

- Are these fees to be recognised in full upon execution of the loan, or allocated throughout the financing period?

Updates:

Issue 4: Classification of Shirkah-based placements and accounts

- How would a Shirkah item be classified in the statement of financial position?
- Would a financial asset based on Shirkah meet criteria for measurement at amortised cost?

Updates:

Issue 5: Profit equalisation reserves (“PER”) and Investment risk reserve (“IRR”)

- Is the setting-aside of PER/IRR in compliance with IFRS requirements?
- Does the resultant item in the statement of financial position meet the definition of liability?

Updates:

Issue 6: Accounting treatment of Ijarah

- Why do Islamic accounting standards classify Ijarah as operating leases?
- Is this classification appropriate given that, in classical texts, the usufruct is deemed to be an asset (mal) for the lessee?

Updates:

Issue 7: Assets transferred to a special purpose entity

- Does the initial sale of assets meet derecognition criteria?
- Would the special purpose entity be consolidated with the originator?

Updates:

Issue 8: Sukuk valuation

- Many sukuk are 'tradable', but they are usually not. Do they need to be measured at fair value? If so, how?

Updates:

Issue 9: Applying IFRS 4 to Takaful

- Does the definition of 'insurance contract' include takaful?
- Does the scope of IFRS 4 Insurance Contracts include takaful operators?

Updates:

Issue 10: Classification and measurement of Qard

- How should Qard from a takaful operator to a takaful fund be classified in the financial statement?
- How should qard be measured?

Updates:

Issue 11: Presentation of financial statements of Takaful entities

- Is it appropriate to present the assets and liabilities of the takaful operator and of the various participants' funds in a single statement of financial position?
- The presentation of Qard as a receivable in a combined statement of financial position may be inappropriate

Updates:

Issue 12: Embedded derivatives

- In some Islamic financing transactions with variable rates, a profit rate cap is used. Would this give rise to an embedded derivative?
- Would that embedded derivative need to be separated from the host contract?

Updates:

Issue 13: Additional Shariah related disclosures

- Are additional disclosures required to inform / explain to users about Shariah compliance?

Updates:

Issue 14: Terminology

- Would different word choices alleviate the resistance to (and misunderstanding of) some IFRS requirements?

Updates:

Issue 15: Departures and exemptions from IFRS requirements

- How would exempting an Islamic financial transaction from a requirement of an IFRS affect convergence?

Updates: