

AAOIFI'S NEW AND REVISED ACCOUNTING STANDARDS ON SUKUK – AND THEIR EXPECTED IMPACT ON MARKET

COMCEC WORKING GROUP MEETING

29 MARCH 2018

OMAR MUSTAFA ANSARI – ACTING SECRETARY GENERAL AAOIFI

AGENDA

INTRODUCTION

FAS 29 – SUKUK IN THE BOOKS OF ISSUER

FAS 34 – FINANCIAL REPORTING FOR SUKUK HOLDERS

FAS 25 - INVESTMENTS IN SUKUK, SHARES AND SIMILAR INSTRUMENTS

AGENDA

INTRODUCTION

FAS 29 – SUKUK IN THE BOOKS OF ISSUER

FAS 34 – FINANCIAL REPORTING FOR SUKUK HOLDERS

FAS 25 - INVESTMENTS IN SUKUK, SHARES AND SIMILAR INSTRUMENTS

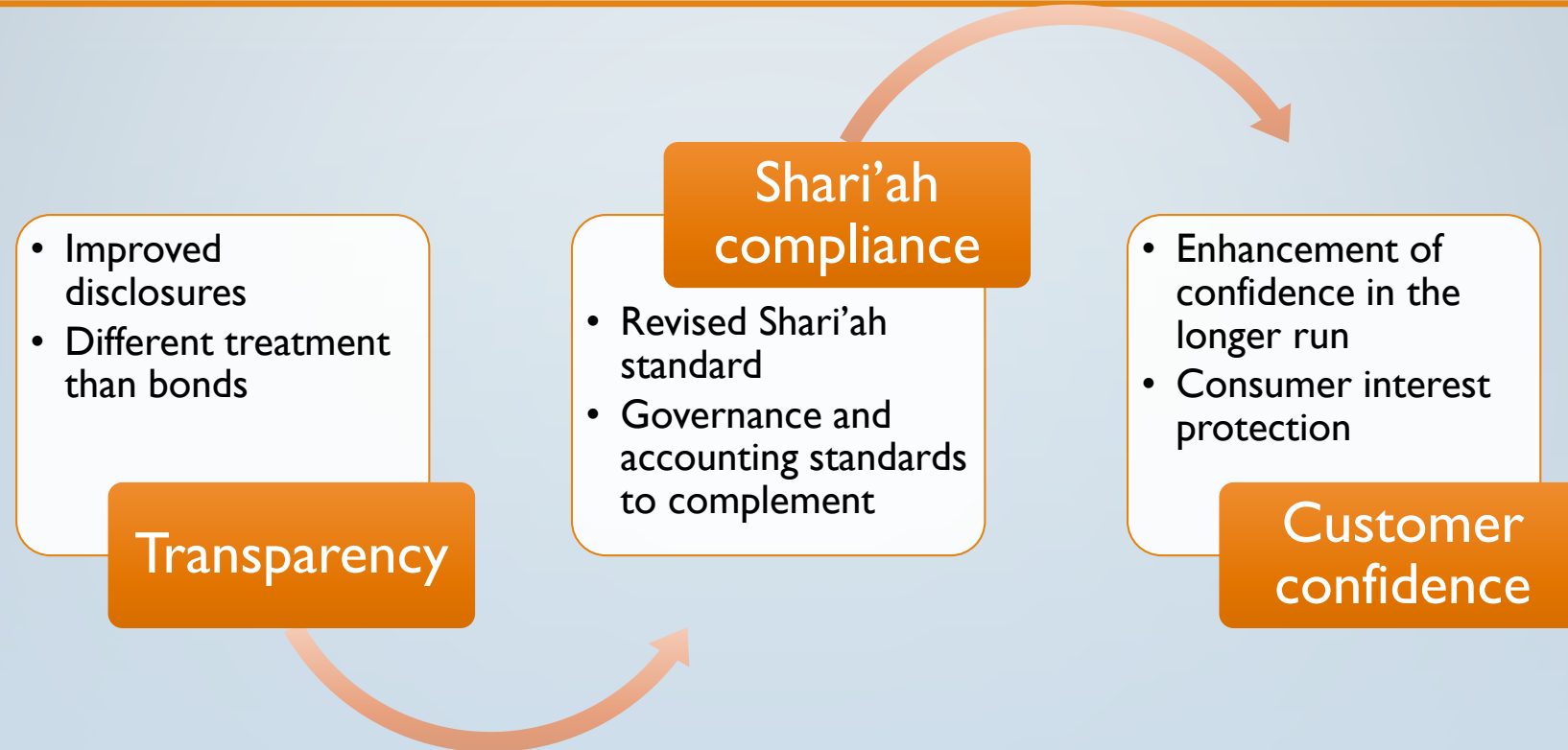
INTRODUCTION

- Development standard FAS 29 and 34 (EDs issued, being finalized) along with revision of FAS 25 (FAS 33, to be shortly issued as ED) is a part of a comprehensive project on Sukuk by AAOIFI commenced with an objective to improve the existing Shari'ah and financial accounting standards of AAOIFI and to fill in the gaps identified by the experts and industry, particularly for the avenues not covered by the existing standards.

INTRODUCTION

- One of the most crucial observations was absence of an existing standard providing guidance to the Sukuk issuers. FAS 29, aims to address this need in particular, while FAS 34 sets out financial reporting guidelines for the Sukuk- holders. Introduction of these standards along with the overall changes in the generally accepted accounting principles required amendments and improvements to the accounting and reporting by the investors in Sukuk.

EXPECTED IMPACT ON SUKUK MARKET



REVISION OF SHARI'AH STANDARD

- The existing standard is a bit old, and there have been significant changes in the market practices since it was issued.
- There are new structures and products being used for issuance, which need to be captured.
- Numerous Shari'ah non-compliances were identified during the last several years, which need to be handled through standard.
- The market input is needed for the standard.
- The project started in beginning of 2015 and now the standard is being drafted.
- Multiple WG meetings and workshops conducted by now.

NEED FOR GOVERNANCE STANDARD FOR SUKUK

- Discussion during the workshops initiated the need for the governance for Sukuk.
- Shari'ah standard discussions also required numerous governance requirements.
- Preliminary study completed and the areas which need consideration are identified. These include, Shari'ah board and its responsibilities, Shari'ah / financial / contractual compliance audit, transparency and disclosure related to the offering documents, relationship between parties, etc.

AGENDA

INTRODUCTION

FAS 29 – SUKUK IN THE BOOKS OF ISSUER

FAS 34 – FINANCIAL REPORTING FOR SUKUK HOLDERS

FAS 25 - INVESTMENTS IN SUKUK, SHARES AND SIMILAR INSTRUMENTS

FAS 29 – SUKUK IN THE BOOKS OF ISSUER

- This standard aims at setting out accounting and classification guidelines for Sukuk in the books of the issuer.
- For accounting of issuance of Sukuk, the standard refers to already issued FAS based on the underlying product and provides presentation and classification guidelines on the liability side based on structure and characteristics of Sukuk.
- The standard for the first time introduces the definitions of business, control and quasi equity and on the basis of determination the extent of control of the issuer, the Sukuk are accounted as on-balance sheet and off-balance sheet Sukuk.

ON-BALANCE SHEET SUKUK

- On-balance sheet Sukuk are classified in accordance with structure, entailing contract / product governing the relationship of the Sukuk-holders, the SPV and the institution, as well as, the nature of underlying assets / business, as either equity, quasi equity or liability.
- The standard further provides guidance on the characteristics of on balance sheet equity, quasi equity and liability.
- The standard goes on to explain the accounting implications, where the ownership of asset is transferred to Sukuk holders. The carrying value adjustment due to change in ownership of underlying asset and recognition of resulting gain / loss is provided (as well as any amortization on gain).

OFF-BALANCE SHEET SUKUK

- When issuance of Sukuk does not result in control of the issuer, such Sukuk are classified as off-balance sheet Sukuk. Where the Sukuk are classified as off-balance sheet the involvement of issuer is primarily that of the manager or agent or user i.e. in a fiduciary capacity only, and whereby the control entailing risks and rewards incidental to ownership with regard to the underlying assets is with the Sukuk-holders.
- The gain / loss on de-recognition of asset is recognized in the period the sale is consummated.

PRESENTATION AND DISCLOSURE

- The standard provides minimum presentation and disclosure requirements based on each classification of Sukuk. However, along with these requirements in its financial statements in respect of Sukuk issuances as applicable to respective instruments, the issuer shall also follow disclosure requirements of FAS I.

AGENDA

INTRODUCTION

FAS 29 – SUKUK IN THE BOOKS OF ISSUER

FAS 34 – FINANCIAL REPORTING FOR SUKUK HOLDERS

FAS 25 - INVESTMENTS IN SUKUK, SHARES AND SIMILAR INSTRUMENTS

FAS 34 – FINANCIAL REPORTING FOR SUKUK HOLDERS

- This standard introduces the financial reporting for the benefit of the Sukuk-holders and other stakeholders – considering them a real or virtual entity collectively.
- After extensive market interactions and expert discussions it was concluded that for purpose of improved transparency and Shariah compliance, a standard on financial reporting for Sukuk holders be issued.
- FAS 34 is issued for Sukuk through SPVs or similar mechanism. The Sukuk which are kept on-balance sheet in accordance with FAS 29 may opt not to apply this standard.

FAS 34 – FINANCIAL REPORTING FOR SUKUK HOLDERS

- The standard assigns the responsibility to of financial reporting on the originator on at least annual basis to be shared with the stakeholders of the originator.
- The standard bifurcates Sukuk into two classification i.e. Business Sukuk and Asset Sukuk and further provides guidance on financial reporting in accordance to said classification.

BUSINESS SUKUK

- Accounting treatment of all assets and liabilities and related revenue and expenditure in case of business Sukuk shall be in accordance with respective FAS. However, for financial reporting purposes, the Standard further divides business Sukuk into Islamic finance transaction and assets, good and services other than Islamic finance transactions.

BUSINESS SUKUK

- The standard states that the financial reporting and characteristics of financial statements of an institution shall be distinguished by the nature of business carried out by the institution. While Islamic finance transactions shall follow FAS I: “General Presentation and Disclosure in the Financial Statements of Islamic Banks and Financial Institutions”, the institutions other than Islamic finance transactions shall follow financial reporting framework of generally accepted accounting principles.

PRESENTATION AND DISCLOSURE REQUIREMENTS

- In addition to the disclosure requirements of FAS I, the standard provides guidance on further disclosure requirements included but not limited to the nature of business and its main activities, legal ownership of underlying asset and fair valuation.

ASSET SUKUK

- A set of financial statements for managed assets shall comprise of :
 - Statement of net assets (with NAV)
 - Statement of changes in net assets
 - Significant notes to the financial statements

ASSET SUKUK

- FAS 34, requires asset Sukuk (managed assets) to be recognized at cost then subsequently at fair value at reasonable intervals so that the information reported is not obsolete. Where, fair value is cannot be determined the same shall be measured at cost or amortized cost after adjusting impairment (if any).
- Unless contrary to a specific requirement of this standard, the resulting revenues, expenses, gains and losses, arising from the managed assets, shall be measured and accounted for, respectively, according to the nature of the contract(s) in line with the requirements of respective or similar FAS applicable to such transactions in line with the Framework or in absence thereof, in line with the generally accepted accounting principles

PRESENTATION AND DISCLOSURES

- FAS 34 provides minimum disclosure and financial reporting requirements.
- These along with other requirements include disclosure of NAV on the face of statement of net assets, disclosure regarding type of assets, main activity and underlying contract, disclosure of valuation techniques used to determine the fair value along the level of observable inputs used in line with the generally accepted accounting principles.

AGENDA

INTRODUCTION

FAS 29 – SUKUK IN THE BOOKS OF ISSUER

FAS 34 – FINANCIAL REPORTING FOR SUKUK HOLDERS

FAS 25 - INVESTMENTS IN SUKUK, SHARES AND SIMILAR INSTRUMENTS

FAS 25 (NEW FAS 33) - INVESTMENTS IN SUKUK, SHARES AND SIMILAR INSTRUMENTS

- The standard is being revised to accommodate changes brought by FAS 29 and FAS 34, along with other changes in line with the current accounting practices for such investments.
- Additionally, the revision intends to bring accounting closer to the generally accepted accounting principles, particularly, IFRS 9.
- The objective of this standard is to set out principles for recognition, measurement, presentation and disclosure of investment in Sukuk, shares and other investments that exhibit characteristics of expected effective yield instruments and equity instruments made by Islamic financial institutions (IFIs).

Thank you!