

**MINUTES OF ADVISORY GROUP MEETING**

## Shariah-Compliant Instruments and Transactions

Date : Tuesday, 2 July 2013 / 23 Sya'ban 1434  
 Time : 9.00 a.m. – 12.30 p.m.  
 Location : Penang Room,  
 Shangri-La Hotel,  
 Kuala Lumpur, Malaysia

## Present :

Mr. Ian Mackintosh	Chair	IASB
Mr. Wayne Upton	Participant	IASB
Mr. Mohammad Faiz Azmi	Participant	MASB
Mr. Matt Gamble	Participant	DFSA
Dr. Obaid Saif Al-Zaabi	Participant	GCCAAO
Mr. Jaseem Ahmad	Participant	IFSB
Mr. Abdelilah Belatik	Participant	IFSB
Mr. Jusuf Wibisana	Participant	IAI
Mr. Rashid Rahman Mir	Participant	ICAP
Dr. Mohammed F. Bahjatt	Participant	SOCPA
Dr. Abdurrahman Al-Razeen	Participant	SOCPA

## Observers:

Mr. Ng Kean Kok	ACCA
Mr. Wan Mohd Nazri Wan Osman	Bank Negara Malaysia
Ms. Nurmastuji Ab Malek	Bank Negara Malaysia
Ms. Shahira Zaireen Johan Arief Jothi	Bank Negara Malaysia
Dr. Nordin Mohd Zain	Deloitte
Dr. Marjan Muhammad	ISRA
Ms. Nurazalia Zakaria	ISRA
Ms. Siti Norhayati Bt Mohd Ali	Accountant-General's Department
Ms. Zeti Azlida Binti Zakaria	Accountant-General's Department
Mr. Ahmad Nasri Abdul Wahab	KPMG
Mr. Muhammad Syarizal Rahim	EY
Dr. Nurmazilah Dato' Mahzan	Malaysian Institute of Certified Public Accountants
Mr. Manjit Singh	PwC
Ms. Veena R. Sankaranarayan	Securities Commission Malaysia
Mr. Nor Zahrul Zainal	Audit Oversight Board, Malaysia

## In attendance :

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Ms. Mas Sukmawati Abu Bakar	MASB
Ms. Tan Bee Leng	MASB
Ms. Christine Lau	MASB
Ms. Nor Amirah Nordin	MASB
Ms. Aidura Jamaludin	MASB
Ms. Norsuriani Noridil	MASB

### **Session One (9.00 am – 10.30 am)**

#### **1.0 Introduction and purpose of meeting**

- 1.1 The meeting started with a welcome speech by MASB Chairman, Mr Mohammad Faiz Azmi. He encouraged participants to share their views and listen to others with an open mind with the objective of arriving at solutions to issues identified. This was followed by opening remarks by the Chair of the advisory group and IASB Vice-Chair, Mr Ian Mackintosh, and self-introductions from participants.
- 1.2 Mr Wayne Upton said that he had circulated to participants a meeting outline which included questions related to the topics for discussion. He noted that two participants had responded: SOCPA and MASB.

#### **2.0 Topic 1: Membership**

- 2.1 Mr Wayne Upton observed that the group's current composition mainly comprises standards setters and regulators. He sought suggestions whether the group should also include practitioners and, perhaps, academicians. He, nevertheless, emphasised that the group should be kept to a manageable size, which in his opinion would be 12 to 15 persons.
- 2.2 Mr Matt Gamble thought that the group needed practitioners on-board as they would be able to inform the group of issues on the ground.
- 2.3 Mr Rashid Rahman Mir thought more academicians were needed, pointing out that many of the existing members are practicing accountants and auditors.
- 2.4 Mr Jaseem Ahmad thought the group should include bankers and specifically mentioned Gatehouse Bank PLC, a London-based investment bank. He also asked the IASB to consider including an academic-like research body, the International Shari'ah Research Academy (ISRA).
- 2.5 Dr Mohammed F. Bahjatt suggested representation from supranational bodies such as the Council for Islamic Banks and Financial Institutions (CIBAFI) and the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI). Dr Abdurahman Al-Razeen suggested the Islamic Development Bank (IDB).
- 2.6 Mr Jusuf Wibisana thought that the group should be limited to 12-13 persons, but that others can be invited to attend group meetings as resource persons. He suggested that

Shariah experts from various jurisdictions can be called in as resource persons, given the disparity of views held among Islamic finance jurisdictions.

- 2.7 Mr. Mohammad Faiz Azmi said that that geographical consideration was important because of the variety in product offerings worldwide. He also recommended ISRA, which will be publishing a paper on applying IFRS from a Shariah point of view.

### **3.0 Topic 2: Objectives**

- 3.1 Mr Wayne Upton asked participants whether they agreed with the proposed objectives of the advisory group as drafted in the meeting outline.
- 3.2 Mr Abdurrahman Al-Razeen said that Muslim investors and users are concerned with Shariah compliance not just in Islamic financial institutions (IFIs), but in all entities that they deal with. However, current disclosure requirements may not enable them to make that determination. He conceded that IFRS 8, *Operating Segments*, may indirectly result in an entity disclosing information about compliant and non-compliant operating segments, but there is no requirement to disclose other aspects of Shariah compliance. He specifically cited the general absence of disclosures on compliant and non-compliant investing and financing activities. Mr Matt Gamble and Mr Rashid Rahman Mir expressed general agreement with Mr Abdurrahman Al-Razeen.
- 3.3 Mr Mohammad Faiz Azmi said that the need for additional information is not unique to Muslim stakeholders; ethical investors would also like more granularity to enable them to understand the business they are investing in. He noted that IASB has a project on disclosures, and suggested that disclosures important to Muslim users could be a sub-topic within that main project.
- 3.4 Mr Ian Mackintosh said it may not be feasible for the IASB to require disclosures tailored to a specific user-group's information needs. He noted that, other than Muslim users, there were also other stakeholders which had their own disclosure needs.
- 3.5 Mr Wayne Upton noted that there were no objections from participants on the proposed objectives of the advisory group.

### **4.0 Topic 3: Working Approach**

- 4.1 Mr Wayne Upton said that the meeting outline suggested a research-oriented approach for the advisory group, *i.e.* IASB and the advisory group would recommend or solicit papers from third parties for the IASB's consideration. He asked participants for their views.
- 4.2 Mr Jaseem Ahmad stressed that the quality of the output is important and agreed to the use of third parties. He drew a parallel with IFSB: while IFSB produces prudential standards for the Islamic finance industry, it relegates matters of accounting to its sister organisation, AAOIFI.

- 4.3 Mr Abdul Rahman Al-Razeen suggested engaging more than one institution, given the divergent views in Islamic finance. He also noted there may be a problem in identifying suitable writers, as the output would have to consider the operational side of a transaction as well as the accounting aspect. Mr Rashid Rahman Mir shared that Islamic accounting standards in Pakistan already do this: for example, the standard for *ijarah* provides a description of the transaction followed by an explanation of how to apply the lease standard to it.
- 4.4 Mr Matt Gamble and Dr Mohammed F. Bahjatt raised the issue of quality control, with Mr Matt Gamble suggesting that the advisory group set parameters for the papers to be published. Mr Wayne Upton said he foresaw that IASB staff would take the main responsibility for that, taking the advisory group's views into consideration.
- 4.5 With regards to topics for research, participants suggested the following:
- 4.4.1 *Mudarabah* financing: Mr Wayne Upton noted that Ms Tan Bee Leng once asked IASB staff whether a *mudarabah*-based financing arrangement qualified for measurement at amortised cost; a question which is still unanswered.
- 4.4.2 Disclosures: Mr Obaid mentioned that GCC stakeholders would like to see more disclosures for Islamic financial institutions that apply IFRS.
- 4.4.3 Non-IFIs: Mr Abdurrahman Al-Razeen said he would like the research to extend beyond accounting by Islamic financial institutions.
- 4.4.4 Terminology: Mr Wayne Upton said that an ACCA roundtable, many thought that terminology and how they apply to an Islamic transaction was important.
- 4.4.5 Survey: Mr Jaseem Ahmad suggested undertaking a survey to gauge public needs, and suggested that AAOIFI can be the driver of the survey.
- 4.6 The meeting recessed from 10.30am to 10.45am.

## **Session Two (10.45 am – 12.30 pm)**

### **5.0 Topic 4: Possible Subjects for Papers**

- 5.1 Mr. Wayne Upton suggested focussing on what he considered to be four major topics:
- 5.1.1 the application of IFRS 9's classification and measurement principles;
- 5.1.2 the application of the proposed lease standard to *ijarah*;
- 5.1.3 whether restricted and unrestricted investment accounts are to be presented on- or off- balance sheet; and
- 5.1.4 profit equalization reserves (PER) because of significant differences in practice.

- 5.2 Dr. Mohammed F. Bahjatt said that before the advisory group starts on specific topics, it needed to identify three things: firstly, which matters which fall within the scope of ethical accounting, rather than financial reporting; secondly, which Islamic transactions pose a problem in reporting under an IFRS framework; and finally, the mechanism for setting the accounting requirement for these transactions. He suggested that the advisory group can enlist AAOIFI's help since it has a mandate to set the framework for standard-setting.
- 5.3 Mr Abdul Rahman Al-Razeen said that all permissible trade are "Islamic" hence there is no need to develop a special framework for perceived "Islamic transactions". Mr Matt Gamble added that as a standard setter, IASB should only be concerned with reporting a transaction; whether it is Shariah compliant should not be a concern and should be left to Shariah scholars.
- 5.4 Dr. Mohammed F. Bahjatt clarified that the advisory group needed to determine which Islamic finance transactions are similar to those already dealt with under IFRS, and which ones are unique and not adequately dealt with under IFRS.
- 5.5 Mr Mohammad Faiz Azmi said that the group should prioritise imminent issues relating to IFRS 9 and the proposed lease standard. Refining the group's conceptual approach can be done at a later stage. Mr Rashid Rahman Mir and Mr Matt Gamble expressed general agreement.
- 5.6 Mr Obaid Saif Al-Zaabi said that since Islamic finance has become global, many would accept IFRS but with some changes for Islamic precepts. He noted that all AAOIFI standards clearly differentiated between conventional and Islamic banks.
- 5.7 Mr Jusuf said that in Indonesia, fair value measurement in an inactive market is an issue. *Sukuk* are not actively traded in Indonesia, hence fair value is determined using valuation techniques. Some scholars will accept this for accounting purposes, but if the *sukuk* is based on profit-sharing, then returns calculated using interest, e.g. in the capital asset pricing model (CAPM), may constitute *riba*. Additionally, it is difficult to determine profit-share on *sukuk* issued by the coal industry because of price fluctuations. Mr Rashid Rahman Mir said that applying a discount rate is only a mathematical process and not an issue; the issue is determining the discount rate to apply. Mr Ian Mackintosh noted that determining the discount rate is a universal problem, and not unique to the Muslim world.
- 5.8 Mr. Wayne Upton urged the group to re-focus on accounting for *ijarah* in the context of the revised exposure draft. Mr Obaid Saif Al-Zaabi said that there was a difference in the method of asset transfer between conventional leases and *ijarah*. Dr Mohammed F. Bahjatt, Mr Jusuf Wibisana and Mr Matt Gamble cited the issue of whether substance or form should prevail in accounting for *ijarah*.
- 5.9 Mr Abdurrahman Al-Razeen said that he found the revised exposure draft on leases to be closer to the substance of *ijarah*.

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- 5.10 Mr Rashid Rahman Mir said that, in Pakistan, it may be difficult for a lessee to measure the lease liability because “the rate the lessor charges the lessee” is not clearly stated in the *ijarah* contract. Moreover, it is unclear whether a lessor needs to include late payment penalties in its measurement of lease payments because, in Pakistan, such penalties must be given away to charity.
- 5.9 Mr Obaid Saif Al-Zaabi suggested that the advisory group use the International Islamic Fiqh Academy (IIFA) and the AAOIFI Sharia Standards as Shariah references. Mr Mohammad Faiz Azmi disagreed to using them as definitive standards because they are not universally accepted by all Muslim-majority jurisdictions. Mr Wayne Upton and Mr Abdurrahman Al-Razeen expressed views that the advisory group should focus on accounting issues. Mr Ian Mackintosh said the advisory group would need to deal with all accounting issues brought to its attention, regardless of whether the transaction was approved by AAOIFI or not.
- 5.10 Other possible topics include: *takaful*, as suggested by Mr Mohammad Faiz Azmi; and asset derecognition by an originator and recognition by a special purpose vehicle in a *sukuk* structure, as suggested by Mr Abdellilah Belatik.

## 6.0 Conclusion

- 6.1 Mr Wayne Upton thanked participants for their suggestions for membership and asked participants whether they agreed to leave the final decision to the Chair. Participants expressed agreement.
- 6.2 Mr Wayne Upton said he would circulate the first few topics for discussion to participants, and the advisory group would then agree on specific details. He also noted that the frequency of meetings needs to be determined.
- 6.3 Mr Wayne Upton suggested that the IASB issue a communique or press release on this meeting. Participants expressed general agreement.
- 6.4 The meeting ended at 12.30pm.