Islamic Finance Consultative Group

Summary of meeting held on 13 July 2017 at the Mandarin Oriental Hotel, Jakarta, Indonesia

Attendees

Mr Faiz Azmi (Chair), PwC Malaysia
Mr Martin Edelmann (Vice-Chair), IASB

Standard-setter members

Prof Mahfud Sholihin, Ikatun Akuntan Indonesia (IAI)
Mr Jusuf Wibisana, Ikatan Akuntan Indonesia (IAI)
Mr Moch Muchlasin, Ikatan Akuntan Indonesia (IAI)
Mr Djohan Pinnarwan, Ikatan Akuntan Indonesia (IAI)
Ms Christine Lau, Malaysian Accounting Standards Board (MASB)
Ms Nadiah Ismail, Malaysian Accounting Standards Board (MASB)
Mr Muhammad Maqbool, Institute of Chartered Accountants of Pakistan (ICAP)
Mr Abdulrahman Alrazeen, Saudi Organization for Certified Public Accountants (SOCPA)
Mr Samet Arslan, Public Oversight, Accounting and Auditing Standards Board, Turkey (POA)
Dr Hamed Hassan Merah, Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)

Observing organisations

Dr Nurmazilah Mahzan, Malaysian Institute of Acccountants (MIA)
Dr Mohamad Akram Laldin, International Shari'ah Research Academy for Islamic Finance (ISRA)

Other IASB representatives

Ms Sue Lloyd, IASB Vice Chair
Mr Henry Rees, IASB Staff

Introduction

1. The Chairman and Vice-Chairman welcomed the attendees to the meeting. They explained that they were keen to reinvigorate the Group, noting that it should be seen as part of the IASB's strategy of providing more implementation support for IFRS Standards.

Status of IFRS adoption amongst IFCG members

2. The MASB representatives introduced a summary of the survey they had undertaken on the status of adoption of IFRS Standards in the member countries of the Group (Indonesia, Malaysia, Pakistan, Saudi Arabia, Turkey and UAE). The survey focussed on the application of IFRS Standards to Islamic Financial Institutions (IFIs) and the adoption of the new Standards: IFRSs 9, 15 and 16. It was noted that all countries either have adopted or are in the process of adopting these new Standards.

Implementing IFRS 9

3. The IASB Vice-Chairman introduced a paper on the implementation of IFRS 9 *Financial Instruments*. She drew attention in particular to the requirements for classifying financial instruments, focusing on the contractual cash flow test. She explained that the profit margin contemplated in the description of interest in a basic lending arrangement is the spread, but is not intended to capture a variable spread that introduces exposure to risks or volatility that is unrelated to lending (eg return based on changes in commodity prices).

4. The Group discussed and shared experiences on various matters arising in their jurisdictions, in particular with respect to the new expected credit loss model, such as the notion of undue cost or effort; the effect on the level of provisions (which varied amongst members including two member noting an expected decrease); consistency amongst companies in applying market data; and validation of credit models. Representatives from countries adopting IFRS 9 after the IASB's effective date noted that the main reason for a later effective date is because of the lack of readiness to implement the expected credit loss model.

5. The IASB representatives noted that a core competency of a bank is managing credit risk, so a bank would be expected to have some information that will provide a starting basis for measuring expected credit losses. Hence, the notion of undue cost or effort in paragraph 5.5.17(c) of IFRS 9 is a high hurdle.

6. The Chairman inquired whether IFIs have more difficulties in implementing IFRS 9 than other financial institutions. The Malaysian representatives noted that there were greater challenges for Malaysian IFIs addressing classification questions. The Indonesian representatives noted that Indonesian IFIs had already adopted the classification requirements of IFRS 9 in 2015. They noted challenges with the provisioning model in IFRS 9.

Implementing IFRS 15 and IFRS 16

7. IASB staff introduced papers on the implementation of IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases*.

8. Group members discussed a number of transactions, such as Murabaha, and considered whether an IFI would recognise revenue and provide disclosures applying IFRS 15 or instead would account for them solely as financing transactions. The Pakistan representative noted that in his jurisdiction the profit from such transactions is recognised evenly as the deferred payments are made.

9. The Chairman noted the need to tabulate the wide variety of transactions entered into by IFIs and suggested that some of them would be ideal candidates for discussion at future meetings (see below).

10. With respect to IFRS 16, members noted that the new lessee accounting model is a right to use model, which better aligns the accounting with the Islamic transaction Ijarah.

Mudarabah and expected credit loss model

11. The MASB representatives introduced a paper on the interaction of Mudarabah and the expected credit loss model in IFRS 9. The objective of the paper was to determine whether any jurisdictions had difficulties charging impairment losses arising under the expected credit loss over the life of a Mudarabah contract. Members did not note any concerns in their jursidictions. However, some questioned why the Mudarabah transaction described in the paper was classified at amortised cost.

Classification of Musyarakah financing under IFRS 9

12. The MASB representatives introduced a paper on the classification of Musyarakah financing applying IFRS 9. The objective of the paper was to discuss whether the financial asset arising from such an arrangement meets the criteria for amortised cost measurement, specifically whether the returns are solely payment of principal and interest on the principal amounts outstanding. The MASB representatives noted that the investing parties typically obtain the rate of return indicated by the bank because, in practice, the bank will waive their share so that customers obtain that return.

13. The IASB representatives noted that the key question is whether the investors are obtaining a return that is consistent with a basic lending arrangement. They also noted that the analysis applying IFRS 9 is based on the contractual terms rather than the expected behaviours of the contracting parties (eg practice of waiving contractual rights).

IASB Discussion Paper Principles of Disclosure

14. The MASB representatives introduced a paper raising some concerns about aspects of the IASB's preliminary views in chapter 4 of the Discussion Paper *Disclosure Initiative—Principles of Disclosure* (DP). (The DP is open for comment until 2 October.) The concern is that some information that might currently be provided to help users understand the nature of Islamic transections could be considered to be 'non-IFRS' information (described as Category C in the DP) and, hence, subject to the proposed disclosure requirements in paragraph 4.38 of the DP.

15. Members noted the importance of providing additional disclosures to assist users of financial statements to understand Islamic transactions. They also said that in their view it is important for this information to be provided in the financial statements rather than separately.

16. IASB representatives emphasised that the Board's thinking was not to withdraw the principle of paragraph 17(c) of IAS 1 about providing additional information to enable users to understand the effect of particular transactions. However, they acknowledged the comments about having to distinguish information that is necessary to comply with IFRS Standards from other information (ie distinguishing between Categories B and C in the DP).

Future agenda

17. The Chairman introduced a discussion about the future agenda for the Group. He asked for suggestions about possible agenda items for future meetings. To prompt discussion, he asked the countries that have not adopted IFRS Standards for IFIs to highlight the aspects of the Standards that prevent their adoption.

18. Responding to this, Indonesian representatives explained that they used IFRS Standards for Islamic transactions so long as they fit. However, they explained the need for distinct accounting to demonstrate the difference between Islamic transactions and non-Islamic transactions, commenting that the form of the contract is as important as the substance.

19. The Chairman noted that the MASB staff had tried in c.2010 to compile a list of the aspects of IFRS Standards that the Islamic scholars or practitioners considered to be problematic. He suggested it might be useful to update this for a discussion at a future meeting. He also suggested that Indonesia and Pakistan compile an analysis of the main differences between their Islamic standards and IFRS Standards, highlighting the main 'deal breakers', ie the main requirements of IFRS Standards that are considered not to be suitable for Islamic transactions.

20. The representative from AAOIFI explained that the Trustees of his organisation are currently undertaking a strategic review of its operations. He suggested that the Group could discuss AAOIFI's interaction with the IFRS Foundation once this review has progressed further and there is more clarity about the future of AAOIFI.

21. The Chairman noted that the Group's discussions earlier in the day relating to IFRSs 9 and 15 highlighted the need to consider questions relating to the appropriate Standards to be applied in transactions involving the transfer of property. He suggested that members collate information about the range of transactions IFIs in their countries are entering into.

22. The Vice-Chairman observed that it would be interesting to discuss further the reason why some countries are unable to apply IFRS Standards in IFIs. However, he also observed that this is a separate question from addressing the challenges arising applying IFRS Standards to Islamic transactions, including discussing differences of views about how those Standards would be applied. He noted that there are banks that have both Islamic and non-Islamic transactions.

23. The Chairman closed the main part of the meeting by thanking the Indonesian Standard Setters for hosting the meeting and Monika Nabillya, Corporate Secretary of the IAI, for all of her help with the administrative arrangements.

Next meetings

24. The Chairman suggested organising a short outreach meeting in Dubai to coincide with the IFRS Foundation Conference to be held there on 4 and 5 October 2017. The next full meeting of the Group is likely to be in Q1 2018.

Standard-setters meeting

25. The standard-setter members of the Group held a short closing discussion with the IASB representatives. The IASB explained the IASB's recently enhanced focus on interaction with national setters, although all agreed that meetings of the Group should remain the first forum for discussing Islamic finance implementation questions.