

Islamic Finance Consultative Group

Summary of meeting held on 27 March 2018 at the office of the Dubai Financial Services Authority (DFSA), Dubai, UAE

Attendees

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

Standard-setter members

Professor Maliah Binti Sulaiman, Malaysian Accounting Standards Board (MASB)
Ms Nadiyah Ismail, Malaysian Accounting Standards Board (MASB)
Mr Angus Thomson, Malaysian Accounting Standards Board (MASB)
Mr Jusuf Wibisana, Ikatan Akuntan Indonesia (IAI)
Mr Suhendar, Ikatan Akuntan Indonesia (IAI)
Mr Syed Najm ul Hussain, Institute of Chartered Accountants of Pakistan (ICAP)
Dr Abdulrahman Alrazeen, Saudi Organization for Certified Public Accountants (SOCPA)
Professor Mohammed Bahjatt, Saudi Organization for Certified Public Accountants (SOCPA)
Dr Hamad A. Al Oqab, Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)

Observing organisations

Mr Naweed Lalani, DFSA
Mr Basheer Ahmad, DFSA
[representing] Mr Obaid Saif Al Zaabi, Gulf Co-operation Council Accounting and Auditing Organisation (GCCAAO)

Other observers

Mr Yusuf Hassan, KPMG
Mr Ashruff Jamall, PwC
Mr Sharif Sikander, EY

Other IASB representatives

Mr Henry Rees, IASB Staff
Ms Elizabeth Figgie, IASB Staff

Introduction

1. Following a short welcome and introduction from the Chief Executive of the DFSA, Ian Johnston, the Chairman and Vice-Chairman welcomed the attendees and thanked the DFSA for hosting the meeting. They thanked attendees for contributing topics to the meeting's agenda and preparing papers for discussion. They noted that all papers (including the summary of the last meeting) are available on the IASB's website (www.ifrs.org).
2. The Chairman explained that the objective of the meeting was to understand the status of adoption of IFRS Standards in attendees' jurisdictions—specifically, for those that have

adopted to discuss issues that have arisen under new IFRS Standards and for those that have not adopted to discuss issues that have been an impediment.

3. The Chairman asked if there were any comments on the July 2017 meeting summary, and there were none. The summary was confirmed as accurate.

Islamic finance arrangements involving linked transactions

4. The MASB representatives introduced a paper that considered how the requirements in recently issued IFRS Standards—specifically IFRS 9 Financial Instruments, IFRS 15 Revenue from Contracts with Customers and IFRS 16 Leases—might apply to three examples of Islamic finance arrangements that are common in the Malaysian environment:
 1. Al-Ijarah Thumma al-Bai (AITAB);
 2. Tawarruq; and
 3. Musyarakah Mutanaqisah and Ijarah (MMI).
5. The paper addressed the accounting by the Islamic Finance Institution (IFI), and in each of the three examples, concluded that the IFI would apply IFRS 9 to recognise and measure a financial asset for the amount due from the customer.
6. The paper concluded that IFRS 15 and IFRS 16 would not apply to any of the three examples described. The MASB representatives explained their view that a key factor in reaching that conclusion was that the IFI did not obtain control of the underlying asset.
7. Group members shared experiences with, and views about, the three arrangements described in the paper. Some Group members noted that the fact patterns in the paper did not reflect standard arrangements in their jurisdictions; eg in some jurisdictions, the parties to the contract would have different risks compared to those described in the paper. Group members acknowledged that fact patterns could differ across jurisdictions and such differences could affect the accounting analysis and conclusion applying IFRS Standards. The Chairman emphasised that the details of a fact pattern are important for accounting purposes and noted that it would be inappropriate to use only a blanket analysis of ‘substance over form’.
8. Group members discussed the meaning of ‘riba’. Some members equated it with ‘making money with money’ and/or ‘usury’, rather than a blanket reference to ‘interest’ or ‘time value’. Some members acknowledged that the profit in, for example, Tawarruq and Murabahah arrangements is determined using interest rates from markets for conventional products, particularly when there is a need to compete with those products.
9. Group members generally agreed that the examples described in the paper were financing arrangements that would give rise to financial assets within the scope of IFRS 9, and determining whether the IFI obtains control of the underlying asset is a key consideration to decide whether the arrangement is also within the scope of IFRS 15. That is because, applying IFRS 15, an entity satisfies its performance obligation by transferring control of the underlying promised good (or service) to the customer. If the IFI does not obtain control of the asset, then it cannot transfer control of it to the customer. To assess

whether the IFI obtains control, group members discussed factors such as whether the IFI bears asset risk (eg what happens if the underlying asset is damaged before the IFI transfers it to the customer) and/or price risk (eg what happens if the value of the underlying asset decreases before the IFI transfers it to the customer).

10. The IASB representatives added that, even if the IFI obtains control of the underlying asset, further analysis may be required to determine whether the arrangement is within the scope of IFRS 15. For example, based on the fact pattern described in the paper, the IFI may obtain control of the underlying good (aluminium) in the Tawarruq arrangement but the arrangement still may not be within the scope of IFRS 15. That is because the arrangement may not be ‘a contract with a customer’ as described in IFRS 15 if the output of the IFI’s ordinary activities is the provision of Sharia-compliant financing, not the provision of the underlying good.
11. The IASB representatives noted that, applying IFRS 16, determining whether the IFI obtains control of the underlying asset is not the key consideration to determine whether the arrangement contains a lease. That is because a lessee may have the right to use the underlying asset even if the lessor never controlled the underlying asset.
12. Group members also observed that, depending on the fact pattern, other accounting requirements may apply. For example, this may be the case if the IFI obtains control of the underlying asset and still holds it at the end of the reporting period along with a forward contract to sell that asset to a customer.
13. A few Group members asked whether a flowchart could be developed to explain how to navigate the scope requirements of IFRS 15 and IFRS 16 (and other relevant IFRS Standards, as appropriate) in order to determine which standard applies to arrangements like those described in the paper. The Vice-Chairman observed that developing such a flowchart could be difficult due to the breadth of arrangements that fall within the scopes of IFRS 15 and IFRS 16, but observed that the meeting summary would set out the key considerations discussed by the Group. The representatives from the MASB said they would further consider the suggestion for a flowchart in light of resource constraints.

IFRS 17 Insurance Contracts

14. The Vice-Chairman provided a briefing on the new insurance contracts Standard, IFRS 17.
15. Group members provided updates on the adoption of IFRS 17 in their jurisdictions. They also discussed their experiences with Takaful arrangements and their views on the applicability of IFRS 17 to Takaful.
16. It was suggested that the Group discuss IFRS 17, vis-à-vis Takaful, at one of its next meetings.

Accounting treatment of Islamic products that require payment of full profit on prepayment

17. The KPMG observer introduced a paper that discussed whether a particular Islamic-structured product (Murabahah) could meet the ‘solely payments of principal and interest’ (SPPI) condition in IFRS 9 for measurement at amortised cost. For the purposes of discussion, the paper assumed that the asset was held in the appropriate business model.
18. The Murabahah arrangement described in the paper required the customer to pay the full fixed profit (ie the total amount of interest that would be earned over the full contractual term of the arrangement) if the customer prepays the contract. The KPMG observer explained that such a prepayment amount would not meet the SPPI condition.
19. However, the KPMG observer noted that in some jurisdictions, such as in the UAE, local law requires the IFI to provide a refund to the customer for the unearned portion of interest. The KPMG observer said that, in such circumstances, the legally enforceable prepayment amount would meet the SPPI condition.
20. The KPMG observer explained that, in other jurisdictions, such a refund is at the discretion of the IFI and, while there may be a past practice of providing the refund, it is not legally enforceable. Consequently, the prepayment amount would not meet the SPPI condition.
21. Group members discussed their experiences with the prevalence and legal enforceability of such refunds in their respective jurisdictions. There was a range of fact patterns discussed with regards to whether the provision of the rebate was explicit in the contract, enforceable by law, or only expected based on past practice (but not enforceable). In some cases mentioned, the rebate may be offered only to particular types of customers.
22. The MASB representatives asked whether it would be appropriate to look to IFRS 15 for guidance on the meaning of ‘contractual’. IASB representatives noted that IAS 32 provides the relevant guidance related to assessing the meaning of ‘contractual’ and the role of enforceability in respect of financial instruments. They also noted that the SPPI condition in IFRS 9 requires the assessment of the specific contractual terms of each financial asset, and therefore the different fact patterns described by Group members could result in different accounting conclusions.

Accounting Standards for Islamic Financial Transactions in Pakistan

23. The Chairman noted that the meeting would now change focus to discuss impediments to adopting IFRS Standards in particular jurisdictions.
24. The ICAP representative provided a briefing on challenges related to applying IFRS Standards to Islamic financial transactions in Pakistan. The representative explained that there is no clear timeline for adoption of IFRS Standards in full in Pakistan. Three areas were mentioned as particular impediments to full adoption, especially in relation to Islamic transactions: accounting for separate agreements as if they are a single agreement (applying the notion of substance over form), the acceptability of reflecting the time value of money in Islamic financing transactions and the acceptability of applying the effective interest method.

25. The Group discussed the challenges explained by the ICAP representative. It was noted that additional disclosures in the financial statements explaining how IFRS is applied to Islamic transactions can be useful.
26. The Chairman inquired about how to move forward, for example whether further engagement with Islamic scholars would be beneficial.

Accounting for Islamic based transactions—Indonesian experiences

27. The IAI representatives provided a briefing on challenges applying IFRS Standards to Islamic financial transactions in Indonesia. The representatives shared some examples of Islamic products that they consider to be unique in their jurisdiction, which in their view may not have a comparative conventional product. They noted that further analysis was required on whether IFRS Standards could faithfully represent the nature of such products and what information best serves users of financial statements in Indonesia.

Updated AOSSG report Reporting Islamic Financial Transactions under IFRS

28. The Chairman explained that this report was presented at the AOSSG Annual meeting in November 2017. It is intended to facilitate a comparison between the issues identified in 2010 and the current positions under the newly issued IFRS Standards, mainly IFRS 9, IFRS 15 and IFRS 16. The Chairman welcomed Group members to submit any comments on the paper to MASB representatives for consideration at the next meeting.

Close of the meeting

29. The Chairman thanked the DFSA for hosting the meeting. The Chairman also thanked members for their active participation in the discussion. The Chairman and the Vice Chairman observed that it had been a productive meeting, in particular, because the discussion focused on well-prepared papers that Group members had the opportunity to read in advance of the meeting.
30. The Chairman asked the Group for input on future agenda topics and the timing for the next meeting for the Group. The next full meeting of the Group is likely to be in Q1 2019 in Malaysia. Issues related to the application of IFRS 16 and IFRS 17 were suggested by Group members as possible agenda items for future meetings. In addition, it was suggested that the observer from PwC prepare a paper on the use of, and accounting for, Wakala.