

Application of Malaysian Financial Reporting Standards to Islamic Social Finance Transactions

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The slides are prepared by MASB staff for the November 2022 Islamic Finance Consultative Group meeting.

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Background and Introduction

- Accounting for Islamic Social Finance (“ISF”) under the Malaysian Financial Reporting Standards (MFRSs) is one of the medium-term Islamic research projects by MASB
 - MFRSs are word-for-word IFRS Accounting Standards issued by the IASB
 - Financial statements that assert compliance with MFRSs shall also assert compliance with IFRS Accounting Standards
- Why MASB embarks on this project?
 - ISF is gaining traction and it has been promoted as an integral part of Islamic finance ecosystem in Malaysia
 - Lack of clear accounting, reporting and disclosure guidance to Islamic Financial Institutions (IFIs) extending ISF to targeted customer segments, warrants MASB to conduct the research project and establish proper guidance

Background and Introduction...*con't*

- The output of research project will be translated into issuance of MASB's Issues Bulletin (IB)
- The IB comprises the following areas:
 - ✓ Objective, scope and research methodology
 - ✓ Definition of ISF and its ultimate outcome
 - ✓ Overview of ISF programme
 - ✓ Observations on current accounting, reporting and disclosure practices
 - ✓ Proposed accounting considerations and disclosures

Objective, Scope and Research Methodology

- **Objective:** The IB aims to provide accounting, reporting and disclosure guidance to IFIs extending ISF to targeted customer segments i.e., B40 and micro entrepreneurs.
- **Scope:** Current ISF programmes funded by *zakat* (compulsory donation), *sadaqah* (voluntary donation), investment account placement and CSR fund, offered under the Bank Negara Malaysia (BNM)'s iTEKAD Programme
- **Research and methodology:**
 - Review of publicly available materials, e.g., disclosures in general-purpose financial statements, Sustainability Reports, Shariah Committee Reports or integrated Annual Reports
 - Engagement with key stakeholders specifically selected IFIs, regulators, auditors and an industry association
 - Technical references: MFRSs and other regulatory policy documents

Definition of ISF and its Ultimate Outcome

- **Definition of ISF**

- The IB defines “social finance” as:

- financial structures and business models that aim to generate sustainable financial returns while delivering tangible social outcomes by mobilising philanthropic capital – this includes Islamic financial instruments such as *sadaqah* (voluntary donation), *wakaf* (endowment) and *zakat* (compulsory donation)

[adopted from: Social finance as an enabler of social development in Malaysia, BNM's Financial Sector Blueprint 2022 – 2026]

- **Ultimate outcome: nurturing the unbanked to become bankable**

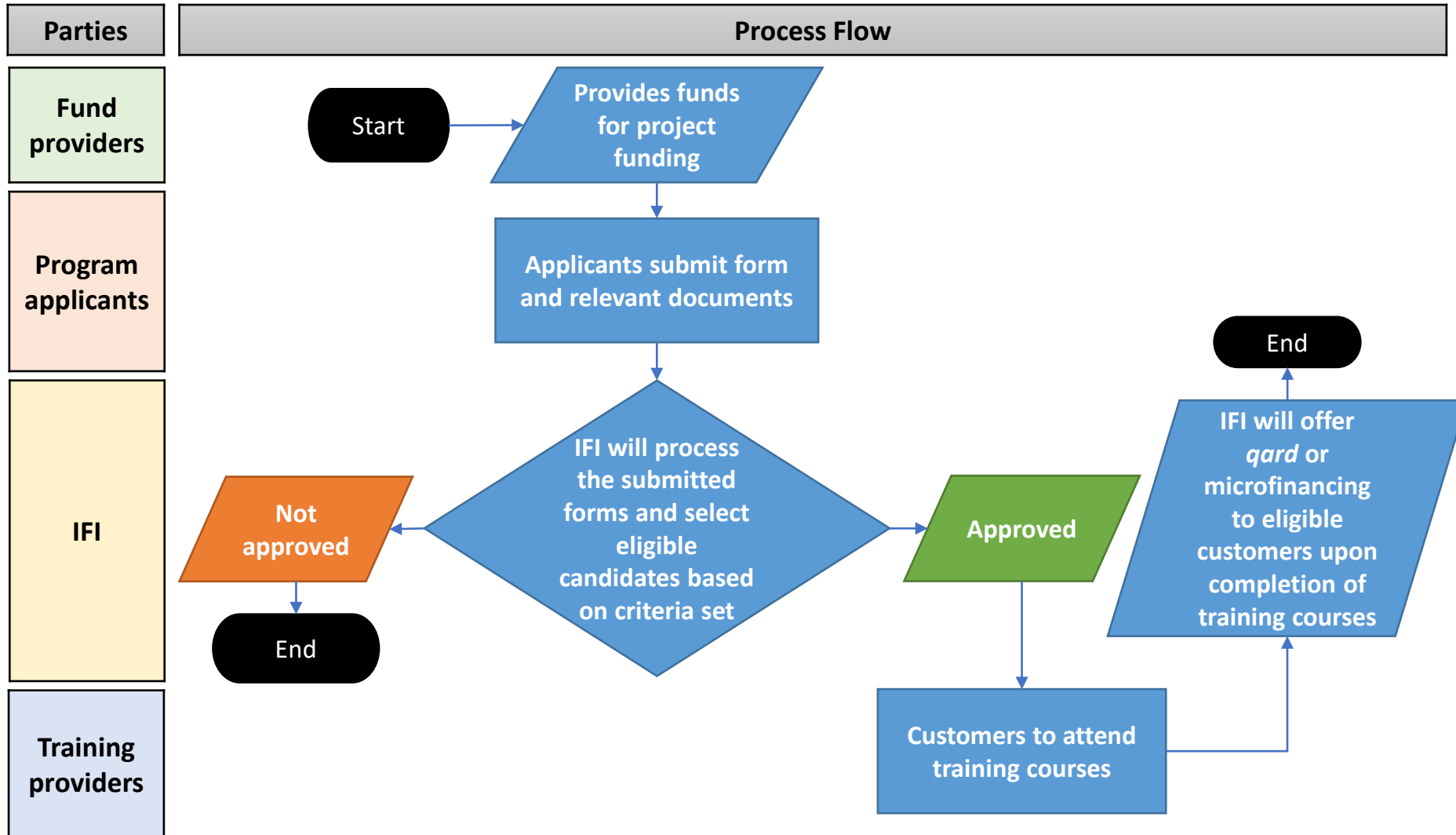
- ISF programmes as an alternative financial solution for B40 and micro entrepreneurs for funding options beyond traditional debt-based financing to sustain or expand their businesses

- difficulties in accessing formal financial services due to lack of business and financial track records, inadequate business skills

Overview of ISF Programme

- **BNM's iTEKAD programme as a pilot ISF programme – launched in May 2020**
 - a social finance pilot programme that blends **financial and non-financial services i.e. financing and structured training programme**
 - used as a platform to accelerate the mobilisation of Islamic financial instruments in **offering seed capital** to targeted customer segments
 - IFIs with implementation partners, such as State Islamic Religious Councils (SIRCs), donors and investors would offer **blended financial solutions** i.e. seed capital, micro-financing and structured training
 - approved applicants would undergo **structured training** conducted by appointed training providers - upon completion of the training, **financing** would be offered to eligible applicants
 - sources of funds for the financing could be sourced from SIRCs, IFIs' own allocated/CSR funds, public donors, investors

Overview of ISF Programme...*con't*



Observations on Current Accounting and Reporting Practices

- Sources of funds, which **are not controlled by IFIs** e.g. funds that are provided by third parties rather than from IFI's own account, are recognised as an off-balance sheet item
 - E.g., *wakalah zakat* fund allocated to IFIs for ISF programmes are managed and controlled by SIRC and IFIs are obliged to transfer *wakalah zakat* fund to the identified beneficiaries of ISF programmes
- ISF programmes **are considered “outside”** from IFI's main business model/stream, which does not have impact (or little impact) on IFIs' business risk
- One IFI recognised the BNM's **Micro Enterprises Facility (MEF) fund as a liability** under the Government financing scheme for SME financing based, measured at the financing amount claimed from BNM
- Fund received from SIRC (e.g., *wakalah* fee for managing *wakalah zakat* fund on behalf of an SIRC) may be used to **cover training cost and expenses** and hence may be treated as off-balance sheet item

Observations on Current Disclosure Practices

- Lack of disclosures specifically on the following:
 - Utilisation of *wakalah zakat* for the purpose of ISF programmes despite disclosure of *zakat* paid to SIRCAs;
 - Income derived and operational expenses of the ISF programmes e.g., training costs borne by IFIs;
 - Financing amount extended under ISF programmes; and
 - IFIs' risks and obligations to the fund providers
- ISF programmes are mainly disclosed in the Sustainability Report, Shariah Committee Report or part of Integrated Report rather than financial statements

Proposed Accounting Considerations

- **Consideration on principles outlined under MFRS 15 *Revenue from Contracts with Customers***
 - IFI to consider MFRS 15 in making assessment on **contractual relationship** between IFIs and fund providers;
 - IFI to consider **rights and obligations** (explicit or implied) established between IFI and fund providers – whether it is acting as an agent or as a principle;
 - If IFI is a **principal**, it applies MFRS 15 to the contract between itself and fund providers
 - **any financial instrument that arises from the agreement is accounted for in accordance with MFRS 9 *Financial Instruments* – the initial recognition applies in recognising a financial asset or a financial liability in the statement of financial position**

Proposed Accounting Considerations...*con't*

- If IFI is an **agent**, it applies MFRS 15 to the contract (explicit or implied) between itself and fund providers
 - recognises **any fees received** from acting as an agent once the performance obligation is satisfied in accordance with MFRS 15
- Key consideration in making the **judgments** of whether the IFI is a principal or an agent depends on:
 - which party bears the substantial risks and rewards of the activities; and
 - which party controls the activities (an entity controls an activity if it has the present ability to direct the activity and obtain the economic benefits that may flow from it)

Proposed Disclosures

- **Guiding principle:**
 - Application of MFRSs with additional disclosures when necessary is presumed to result in financial statements to achieve a fair presentation
 - Consideration on materiality concept in making disclosure
- **Proposed disclosures items in the financial statements:**
 - Amount of *wakalah zakat* received from SIRCAs that have been utilised for ISF programmes;
 - SME financing amount extended under the ISF programmes;
 - Income and/or expenses in relation to the ISF programme;
 - Financing extended and its Shariah contracts adopted;
 - Off-balance sheet financing extended using crowdfunding platform/extended by a separate entity which is managed by IFIs

Thank You

Questions and Answers