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Khairul Nizam, AAOIFI

Financial disclosures, accounting standards and transparency
in Islamic finance: Meeting a global banking standard

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Content

- 1. Why specific accounting standards for Islamic finance?*
- 2. How AAOIFI accounting standards co-exist with conventional standards?*
- 3. How AAOIFI standards support Islamic finance industry?*
- 4. Conclusion*

Appendix – Overview of AAOIFI

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Why specific accounting standards for Islamic finance?

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Financial disclosures, accounting standards & transparency

Conventional
accounting
standards

Give guidance on, amongst others, how to:

1. Carry out accounting treatment for transactions; and
2. Report and disclose financial position or performance.

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Financial disclosures, accounting standards & transparency

AAOIFI
accounting
standards for
Islamic
financial
institutions
(IFIs)

Give guidance on, amongst other, how to:

1. Carry out accounting treatment for transactions; and
2. Ensure that transactions are Shari'a-compliant;
3. Report and disclose financial position or performance;
4. Deal with revenues and expenses that are not Shari'a-compliant; and
5. Determine basis for Zakah calculation.

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Financial disclosures, accounting standards & transparency

Rationale for
AAOIFI
accounting
standards for
IFIs

Accounting for Islamic finance places emphasis on:

- a) actual structures and flows of Islamic finance transactions – to help determine Shari'a compliance; and
- b) financial effects of those transactions.

Accounting treatment for Islamic finance transactions has impact on Shari'a compliance aspects of those transactions.

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*How AAOIFI accounting standards co-exist
with conventional standards?*

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AAOIFI and conventional standard-setters

AAOIFI	Conventional standard-setters
<ul style="list-style-type: none">• AAOIFI issues standards specific for Islamic finance industry; standards are based on Islamic finance requirement.	<ul style="list-style-type: none">• Conventional standard-setters issue standards for entire economic and social activities; standards are mainly generic and not industry-specific.
<ul style="list-style-type: none">• AAOIFI issues standards on Shari'a, accounting, auditing, ethics, and governance.	<ul style="list-style-type: none">• A conventional standard-setter usually issues type-specific standard (eg. IASB only issues accounting standards).

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Categories of accounting standards for IFIs

1. AAOIFI standards that are issued because conventional international standards cannot be adopted in whole by IFIs.
2. AAOIFI standards that are issued for specific Islamic finance practices not covered by conventional international standards.
3. Conventional international standards that can be adopted by IFIs (therefore AAOIFI does not issue similar ones and allows adoption of those standards).

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Categories of accounting standards for IFIs *(cont'd)*

1. AAOIFI accounting standards issued because conventional international standards cannot be adopted in whole by IFIs

- Due to Shari'a compliance issues or because conventional international standards do not fully cover characteristics of Islamic finance practices.
- In these cases, AAOIFI accounting standards are issued to apply to topics covered by the conventional international standards.
- Eg.: AAOIFI's FAS 1 (General Presentation and Disclosure in Financial Statements of IFIs) covers IAS 1, 7, 8, etc.

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Categories of accounting standards for IFIs *(cont'd)*

2. AAOIFI accounting standards issued for specific Islamic finance practices not covered by IFRS / IASB standards

- For financial transactions and practices unique to Islamic finance.
- In these cases, AAOIFI accounting standards are issued to apply to topics not covered by conventional international standards.
- Eg.:AAOIFI's FAS 2 (Murabaha & Murabaha to the Purchase Orderer), FAS 3 (Mudaraba Financing), FAS 4 (Musharaka Financing, etc.

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Categories of accounting standards for IFIs *(cont'd)*

3. Conventional international standards that can be adopted by IFIs

- These standards do not give rise to Shari'a compliance issues and are adequate to cover practices of IFIs. In these cases, AAOIFI does not issue equivalent standards
- IFIs adopting AAOIFI standards are allowed to also follow other standards if there are no equivalent AAOIFI standards.
- Eg.: IAS 10 (Events after Balance Sheet Dates), IAS 24 (Related Party Disclosures), etc.

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How AAOIFI standards support Islamic finance industry?

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How AAOIFI standards support Islamic finance industry

AAOIFI standards reflect concept and essence of Islamic finance transactions.

And bring about harmonisation of Islamic finance practices.

Enhance confidence of users of Islamic finance products.

Promote growth of demand for Islamic finance.

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How AAOIFI standards support Islamic finance industry *(cont'd)*

AAOIFI standards also ensure convergence of financial reporting by IFIs.

And introduce greater clarity to the financial reports of IFIs.

Promote better view of financial performance of IFIs.

Enhance transparency of financial reports.

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Conclusion

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Meeting a global banking standard

Need for
standardisation

- Convergence & uniformity of financial reporting – to ensure comparability, understandability & transparency of financial reporting.

Need for
specific
standardisation
for IFIs

- Intricacies of Islamic finance practices.
- True and fair view of IFIs' financial performance.

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Meeting a global banking standard *(cont'd)*

Moving forward

- **Compelling case for specific accounting standards for Islamic finance.**
- **Mutual recognition and co-existence of AAOIFI and conventional international standards.**

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Appendix

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Overview of AAOIFI

- AAOIFI is responsible for developing and issuing standards for international Islamic finance industry.
- Supported by over 200 institutional members from over 45 countries.
- Members are central banks, regulatory authorities, financial institutions, accounting & auditing firms, legal firms, etc.

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Overview of AAOIFI *(continued)*

- AAOIFI has issued a total of 81 standards comprising:
 - 41 Shari'a standards
 - 26 accounting standards
 - 5 auditing standards
 - 7 governance standards
 - 2 codes of ethics.
- In addition, new standards are being developed and existing standards reviewed.

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Overview of AAOIFI *(continued)*

- AAOIFI standards have been followed by leading Islamic financial institutions in, amongst others, Bahrain, Brunei, Dubai International Financial Centre, France, Indonesia, Jordan, Kuwait, Lebanon, Malaysia, Pakistan, Saudi Arabia, Qatar, Qatar Financial Centre, South Africa, Sudan, Syria, United Arab Emirates and United Kingdom as well as in Africa, Central Asia and North America.
- Also adopted by Islamic Development Bank Group.

 **AAOIFI** حیئة المحاسبة والمراجعة للمؤسسات المالية الإسلامية
Accounting & Auditing Organization for Islamic Financial Institutions

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Overview of AAOIFI *(continued)*

- Technical understanding and application of standards is supported by AAOIFI's professional development qualification programs:
 - Certified Shari'a Adviser and Auditor (CSAA).
 - Certified Islamic Professional Accountants (CIPA).
- Technical application of standards is further supported by AAOIFI's contract certification program.

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Thank you

www.aaofifi.com

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Accounting & Auditing Organization for Islamic Financial Institutions

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