General Council for Islamic Banks And Financial Institutions
Affiliated Institution to the OIC
Established under Royal Decree No 23 -2001

CIBAFI

المجلس العام للبنوك والمؤسسات المالية الإسلامية
مؤسسة منتمية لمنظمة التعاون الإسلامي
تأسست بمرسوم ملكي رقم ٢٣ لسنة ٢٠٠١م

Ref. 0421/990/MB
21st April 2021

Omar Mustafa Ansari
Secretary General
Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI)
Al Nakheel Tower
10th Floor, Office 1001, Building 1074
Road 3622, Seef Area 436
Manama
Kingdom of Bahrain

Dear Mr. Ansari,

السلام عليكم ورحمة الله وبركاته،،

CIBAFI Comments on the AAOIFI Exposure Draft on the Revised Financial Accounting Standard (FAS) 1: "General Presentation and Disclosures in the Financial Statements of Islamic Banks and Financial Institutions"

The General Council for Islamic Banks and Financial Institutions (CIBAFI) presents its compliments to the Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI) and takes this opportunity to express its appreciation of the work that the AAOIFI does to promote and enhance the Islamic financial services industry (IFSI).

CIBAFI is the official umbrella for all Islamic financial institutions, whose services and products comply with the Shariah rules and principles. CIBAFI acts as the voice of the Islamic finance industry, and our members comprise more than 130 Islamic banks and non-bank financial institutions, both large and small, from 34 jurisdictions.

We welcome this opportunity to offer our comments and recommendations on the AAOIFI exposure draft (ED) on the revised FAS 1: "General Presentation and Disclosures in the Financial Statements of Islamic Banks and Financial Institutions". The comments contained in this letter represent the views of the CIBAFI Secretariat and feedback received from our members. We are also attaching more detailed comments in the Appendix of this letter for AAOIFI's kind consideration.

First: CIBAFI and its members noted that there are some points where the language of the ED is somewhat unclear, including somewhere the meaning can be quite hard to discern. Examples are the final sentence of para 28 and the first sentence of para 53. Some other examples are referred to later. It would be helpful for the final standard to be revised by a professional copyeditor.

Second: the ED, to a greater extent than its predecessor, assumes that there may be cases where its requirements conflict with national law or regulations. Examples are in para 10 and 28. CIBAFI and its members believe that this is unusual because reporting standards are normally adopted on a national basis and are mandatory for those institutions covered by them. The implication is, therefore, that some institutions may be attempting to report both under AAOIFI standards and under those mandated in their jurisdiction. We suggest that further guidance/clarification on the above would be appropriate.

Third: the ED changes some of the definitions from those in the earlier version of FAS 1. Some CIBAFI members have raised certain concerns. The first concerns, in para 8 (o), where a definition of quasi-equity is introduced as a concept that will include "unrestricted investment accounts" but will also be somewhat broader. However, the revised definition appears to catch Mudaraba Alternative Tier 1 (AT1) Sukuk under this definition along with the Mudaraba and Wakala based investment accounts at which it is aimed. CIBAFI members believe that this may have major implications for Islamic financial institutions, particularly in countries where AAOIFI's FASs are enforced. This could, perhaps, lead to such an instrument losing its Tier 1 Capital status. This would affect the capital adequacy

ratio of the relevant Islamic financial institution, which would materially influence its growth potential. It may be that limb (iii) of the definition was intended to avoid this interpretation, but if so, it is not effective because the rights of Mudaraba AT1 holders are indeed different from those of ordinary shareholders, for example in voting. It is, therefore, proposed to place Mudaraba AT1 Sukuk instruments (and indeed other AT1 Sukuk) categorically and explicitly under equity.

Similarly, the wider term "off-balance sheet assets under management" is now being used instead of "restricted investment accounts". CIBAFI members believe it is not clear that the disclosures specified, in the latter case actually reflect the broader definition (see in particular para 135). That definition would include, for example, discretionary portfolio accounts managed for individual customers (rather than on a pooled basis), but the reporting does not appear well-matched to these. We suggest that further clarification on this would be appropriate.

Also, about definitions, CIBAFI and its members are of the view that the definition of a Special Purpose Vehicle (SPV), in para 8 (r), does not appear quite right, because in some legal systems a trust does not have its own legal personality. Some systems which do not recognise the concept of trust also use other alternatives to a normal SPV which again do not have a legal personality; the fonds de titrisation structure in Morocco may be an example. The definition needs to be amended to recognise such possibilities.

Fourth: members have some concerns about the change in the language used in relation to Murabaha, Musharaka and Wakala (referred to in paragraph BC9). The term normally used in Islamic banking for transactions using these forms is "financing", and they are different in character from those transactions normally described as "investment", for example, trade in equities or Sukuk, or capital participation in other institutions. This does not gainsay the fact that Islamic financing is different from conventional financing. But in attempting to avoid confusion between these two, the draft may introduce a worse confusion.

Finally, members are concerned about some of the disclosures related to Zakat and Shariah non-compliance, which at first sight may require inappropriate, or even impossible, amounts of detail. These may in part be matters of English usage and we deal with them in detail in the Appendix to this letter, where we also offer some other more detailed comments on the text.

We would like to express our appreciation to AAOIFI for its great effort and commitment with respect to developing standards that accommodate the interest of the global Islamic finance industry.

We remain at your disposal should you need any further clarifications on the above or the attached Appendix.

The General Council for Islamic Banks and Financial Institutions takes this opportunity to renew to the Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI) the assurances of its highest respect and consideration.

Yours sincerely,

Dr. Abdelilah Belatik
Secretary General

هاتف: ٣٠١ – ٣٠٠ ٣٥٧ ١٧ ٩٧٣+ فاكس : ٩٠٢ ٣٢٤ ١٧ / ٣٠٧ ٣٥٧ ١٧ ٩٧٣+ ص.ب: ٤٥٦ ٢٤ المنامة مملكة البحرين
Tel: +973 17 357 300 - 301 Fax: +973 17 357 307 / 17 324 902 P.O Box 24 456 Manama, Kingdom of Bahrain
C.R. No 47423 www.cibafi.org Email: cibafi@cibafi.org

Appendix

Detailed Comments on AAOIFI's Exposure Draft on FAS 1: "General Presentation and Disclosures in the Financial Statements of Islamic Banks and Financial Institutions"

CIBAFI's analysis has identified the following comments with regards to the specificities in the ED of the revised FAS 1.

True and Fair Presentation

The ED, in para 29, states that in the extremely rare situation where management of an institution assesses that compliance with any AAOIFI FAS will result in misleading information, the management may decide to depart from the requirement of the FAS. Moreover, the ED (in para 31) mentions that the override is not allowed on any of the Shariah rules and principles and in any event, requires consent from the Shariah board. A somewhat similar point appears in para 50 in relation to adjustments to current period balances. CIBAFI and its members agree that if a departure from Shariah rules and principles were at issue, the Shariah board should be involved. However, the provisions appear to extend the Shariah board's remit beyond that, into some purely accounting areas; this does not appear appropriate.

In addition, para 10 indicates that the accounts should disclose the significant departures and deviations from the AAOIFI FASs (though it gives no indication of how significance is to be assessed). The concept of significance appears to be missing from the discussion in paragraphs 27-31.

Disclosures for sources and application of Zakah and charity

The ED, in para 56, uses the phrase "application of Zakah" which appears to be referring to how Zakah would be disbursed by the Islamic financial institutions. This would typically be to a charity or in some cases a state-operated fund, and the bank might not have transparency as to the final application to individuals. CIBAFI members are of the view to replace this phrase with "disbursement of Zakah funds" for clarity. This may also be amended in the heading and other occurrences in para 25 and BC 17.

Similarly, in para 59, the phrase seems to be referring to how charity funds are to be disbursed by Islamic financial institutions. CIBAFI members are of the view to replace the phrase "application of charity" with "disbursement of charity funds" for clarity.

Shariah non-compliant transactions

In para 79, ED requires institutions to "disclose the amount and nature of earnings from sources or means that are not Shariah-compliant, along with the reasons for entering into such transactions." CIBAFI members consider that the last part of this would be difficult to implement and could have major ramifications in terms of the disclosure of internal management issues. Such information may of course be disclosed on a confidential basis to auditors and regulators, including any national Shariah authority, but disclosure of the forfeited profit amount is normally considered adequate in the public financial statements.

Further, para 80 is entirely unclear. We and our members arrived at different interpretations as to whether it was concerned with financings provided for non-Shariah-compliant purposes, or disbursements (to charity) of forfeited funds. It should be redrafted to make its purpose clear.

CIBAFI members noticed that, in para 81, the institutions are advised to disclose how they intend to dispose of the assets generated by the Shariah non-compliant earnings or acquired through Shariah non-compliant expenditures. CIBAFI members believe that this requirement, however, can have major ramifications. For example, if a major investment has become non-compliant as a result of some action by the investee, notification of how the bank intends to dispose of it, before that action is completed, could rank as market-sensitive information. Again, this goes beyond normal public disclosures, though again it may be disclosed privately to regulators etc.

Some of the CIBAFI members noticed that the ED, in para 82, gives the impression that the amount of funds to be donated to charity may be only part of the funds that should be forfeited. This cannot be right, and there must therefore be a drafting issue here.

We note that the disclosures recommended in the ED in relation to Zakat and non-compliant income naturally overlaps with those specified by the Islamic Financial Services Board in its disclosure standard IFSB-22, Section 7. We are aware that this standard was the subject of substantial debate and public consultation and has arrived at the language which, in this area, appears clearer and more appropriate than that which has caused the difficulties we describe above. AAOIFI may wish to consider adopting a similar language for FAS 1.

Segment Reporting

The ED, in BC 27 (Appendix B), states that the institutions may decide to report segments even when they do not meet the reporting threshold if the management believes that giving additional information is beneficial for the users of the financial statements. CIBAFI and its members agree with this view but note that the point is not made in the reporting segment of the ED itself (paragraphs 70-78). They consider that it could appropriately be added to para 73.

Statement of financial position

The ED, in para 141, refers to the treatment of customers' Qard accounts. Some banks provide similar (chequing) accounts based on Wadiah, and CIBAFI members, therefore, suggest that it may be appropriate to mention these too.

Moreover, para 143 refers to disclosures of Tier 1 equity and Tier 2 equity. However, we wonder why the opportunity has not been taken to align this para with the prudential disclosures under Basel III and IFSB-22 by requiring the Tier 1 capital to be split between Common Equity Tier 1 and Additional Tier 1. It is, therefore, recommended to align the disclosures of Tier 1 equity and Tier 2 equity with the prudential disclosure requirements under Basel III and IFSB-22.

هاتف: ٣٠١ – ٣٠٠ ٣٥٧ ١٧ ٩٧٣+ فاكس : ٩٠٢ ٣٢٤ ١٧ / ٣٠٧ ٣٥٧ ١٧ ٩٧٣+ ص.ب: ٤٥٦ ٢٤ المنامة مملكة البحرين
Tel: +973 17 357 300 - 301 Fax: +973 17 357 307 / 17 324 902 P.O Box 24 456 Manama, Kingdom of Bahrain
C.R. No 47423 www.cibafi.org Email: cibafi@cibafi.org