

International Standards for Islamic Finance

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AAOIFI – Introduction

- Responsible for formulation and issuance of international Islamic finance standards.
- Has issued 68 standards: 25 accounting standards; 5 auditing standards; 6 governance standards (incl. on Shari'a supervision); 2 codes of ethics; and 30 Shari'a standards (rules for application of Shari'a).
- Also developing new standards and reviewing existing standards.
- Supported by over 165 institutional members from over 35 countries. Members include central banks and regulatory authorities; Islamic and conventional financial institutions; accounting and auditing professions; and Islamic financial support services providers.
- In order to support technical application of standards, AAOIFI offers the following professional qualification programs:
 - Certified Islamic Professional Accountants (CIPA), and
 - Certified Shari'a Adviser and Auditor (CSAA).

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AAOIFI & IFRS - Comparison on structural objectives

A. Differences on coverage of standards ...

| AAOIFI | IFRS |
|--|--|
| <ul style="list-style-type: none"> • Specific for Islamic finance industry. • Based on requirement of Islamic finance practices. | <ul style="list-style-type: none"> • For entire economic and social activities. • Generic, mostly not industry-specific. |

B. Differences on types of standards ...

| AAOIFI | IFRS |
|---|---|
| <ul style="list-style-type: none"> • All-encompassing. • Accounting, Auditing, Ethics, Governance, and Shari'a. | <ul style="list-style-type: none"> • Type-specific. • Accounting. |

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AAOIFI & IFRS - Categories of accounting standards for IFIs

In order to highlight the co-existence of AAOIFI accounting standards and IFRS / IASB standards, the standards can be segregated into 3 categories:

1. AAOIFI standards issued because IFRS / IASB standards cannot be adopted in whole by Islamic financial institutions (IFIs)

- In some cases, application of IFRS / IASB standards leads to Shari'a compliance issues. While in some other cases, IFRS/IASB standards do not fully cover characteristics of Islamic banking and finance. In all these cases, AAOIFI standards are issued to apply to topics covered by the IFRS / IASB standards.
- Eg.: AAOIFI's FAS 1 (General Presentation and Disclosure in Financial Statements of IFIs) covers IAS 1 (Presentation), 7 (Cash Flow), 18 (Revenue), etc.

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AAOIFI & IFRS - Categories of accounting standards for IFIs (continued)

2. AAOIFI standards issued for specific Islamic banking and finance practices that are not covered by IFRS / IASB standards

- Some financial transactions and practices are unique to Islamic banking and finance. In these cases, AAOIFI standards are issued to apply to topics not covered by IFRS / IASB standards.
- Eg.: AAOIFI's FAS 2 (Murabaha & Murabaha to the Purchase Orderer), FAS 7 (Salam & Parallel Salam).

3. IFRS / IASB standards that can be adopted by IFIs

- Application of some IFRS / IASB standards do not give rise to Shari'a compliance issues and can adequately cover practices of IFIs. In these cases, AAOIFI does not issue equivalent standards and IFIs are allowed to follow the relevant IFRS / IASB standards.
- Eg.: IAS 10 (Events after Balance Sheet Dates), IAS 24 (Related Party Disclosures).

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AAOIFI & IFRS - Examples of main differences

Investment Account Funds in Islamic Financial Institution (IFI)

- An IFI's major source of funds is 'unrestricted' investment account funds from its customers.
- These funds are generally managed by IFI based on *Mudaraba* investment management profit-sharing agreement.
- Under *Mudaraba* investment management, IFI is not liable for loss arising from investments (except due to IFI's misconduct, negligence, etc) – based on AAOIFI Shari'a standard.
- AAOIFI accounting standards require 'unrestricted' investment account funds to be presented in statement of financial position as a separate item between liabilities and owners' equity.
- In contrast, based on IFRS, these would be presented as liabilities (along with other deposits).

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AAOIFI & IFRS - Examples of main differences (continued)

Ijarah (Leasing)

- An IFI's major financing mechanisms are Operating *Ijarah* and *Ijarah Muntahia Bittamleek* (leasing that ends with transfer of asset ownership to lessee).
- For both, asset ownership rests with IFI throughout the lease term.
- In *Ijarah Muntahia Bittamleek*, there must be independent contract for transfer of asset ownership.
- AAOIFI accounting standards require both Operating *Ijarah* and *Ijarah Muntahia Bittamleek* to be treated similar to Operating Lease.
- In contrast, based on IFRS, both Operating *Ijarah* (especially if lease term is for major part of economic life of lease asset) and *Ijarah Muntahia Bittamleek* (due to the transfer of asset ownership by end of lease term) would normally be classified and treated as Finance Lease.

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Adoption of AAOIFI Standards

- AAOIFI standards are mandatory in 9 jurisdictions (and supra-national entity):
Bahrain, Dubai International Financial Centre, Jordan, Qatar, Qatar Financial Centre, Sudan, South Africa (for investment management), Syria, and Islamic Development Bank Group.
- AAOIFI standards are also adopted as guidelines or basis for national standards in jurisdictions including:
Brunei, Indonesia, Kuwait, Lebanon, Malaysia, Pakistan, Saudi Arabia, and United Arab Emirates.
- Overall, AAOIFI standards are used by all IFIs across the world.

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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 (continued)

AAOIFI standards also ensure convergence of financial reporting by IFIs.

And introduce greater clarity to the financial reports of IFIs.

Promote better view of IFIs' financial performances.

Enhance transparency of IFIs' financial reports.

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