

INTERNATIONAL REGULATORY INITIATIVES TO ENHANCE GLOBAL FINANCIAL STABILITY

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OUTLINE

- 1. FSB's initiative for global standards
- 2. Standard Setting Bodies
- 3. Debatable Issues & Comparisons
- 4. Efforts for Convergence of Financial Reporting issues relating to Islamic Finance to IFRS
- 5. Conclusion
- 6. References

Transparency – Financial Stability

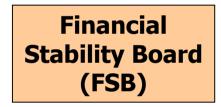
Hans Hoogervorst – Chairman of the IASB "Without transparency, there can be no enduring stability". This not only holds for financial reporting, but also more broadly for securities markets supervision.



Reform Initiatives in the Financial Sector

G-20 Leaders

G-20 Finance Ministers and Central Bank Governors



Group of Governors and Heads of Supervision (GHOS)

Standard Setting Bodies (IOSCO, IASB, IAASB, IAIS etc.)

Basel Committee on Banking Supervision (BCBS)

International Organizations (IMF, WB)

Committee on Payment and Settlement Systems (CPSS)

National Authorities

Working Area 12 Key Stand	<u>Issuing Body</u>	
Macroeconomic Policy and Data Transparency		
Monetary and financial policy transparency		IMF
Fiscal policy transparency		IMF
Data dissemination		IMF
Financial Regulation and Supervision		
Banking supervision		BCBS
Securities regulation		IOSCO
Insurance supervision	IAIS	
Institutional and Market Infrastructure		
Crisis resolution and deposit insurance		BCBS/IADI
Insolvency		World Bank
Corporate governance		OECD
Accounting and Auditing	International Financial Reporting Standards (IFRS)	IASB
	International Standards on Auditing (ISA)	IAASB
Payment, clearing and settlement		CPSS/IOSCO
Market integrity		FATF



Development, adoption, and successful implementation of international standards yields both national and international benefits Promote

international financial stability by facilitating better-informed lending and investment decisions, improving market integrity



Standard Setting Bodies

Conventional

- IOSCO,
- IASB,
- IAASB (auditing)
- IAIS (insurance)
- Asian Oceanian Standard Setters Group

<u>Islamic</u>

- IFSB
- AAOFIFI
- MASB
- ICAP
- IAI

Asian Oceanian Standard Setters Group

- AOSSG is a grouping of the accounting standard-setters in the Asian-Oceanian region
- The group has been formed to discuss issues and share experiences

on the adoption of International Financial Reporting Standards (IFRS) and

to contribute to the development of a high-quality set of global accounting standards The AOSSG plans to play an important role in encouraging the adoption of IFRSs in the region. **WEACCOUNTING and Auditing Organisation for Islamic** Financial Institutions (AAOIFI)

An Islamic international autonomous non-for-profit corporate body that prepares accounting, auditing, governance, ethics and Sharia'a standards for Islamic financial institutions and the industry.



AAOIFI

It was founded in 1991 and ,has so far

issued a total of 80 standards covering the areas of accounting, auditing, ethics, and governance for Islamic financial institutions

- 26 accounting standards,
- 5 auditing standards,
- 7 governance standards (incl. on Shari'a supervision),
- 2 codes of ethics, and
- 40 Shari'a standards (rules for application of Shari'a).

B MASB MERKEZ BANKASI Malaysian Accouting Standards Board

- Statement of Principles SOP
 SOP i-1 : Financial Reporting from an
 Islamic Perspective
- Technical Release TR

TR i-1 : Accounting For Zakat on Business TR i-2 : Ijara

TR i-3 : Presentation of Financial Statements of Islamic Finacial Institutions

TR i-4 : Sharia Compliant Sale Contracts

ICAP Institute of Chartered Accountants of Pakistan

Islamic Financial Accounting Standard (IFAS)

IFAS 1: Murabaha IFAS 2: Ijarah



IAI

Indonesian Accounting Institute

IAI-Sharia Accounting Standards Board

- A framework for Preparation and Presentation of Shariah Financial Statemets
- PSAK- Pernyataan Standar Akuntasi Keuangan

Indonesian Accounting Institute-PSAKs

PSAK 101: Presentation of Sharia Financial Statements PSAK 102: Accounting For Murabaha PSAK 103: Accounting For Salam PSAK 104: Accounting For Istishna PSAK 105: Accounting For Mudarabah PSAK 106: Accounting For Musarakah PSAK 107: Accounting For Ijarah PSAK 108: Sharia Insurance Transactions



Accounting For Islamic Financial Transactions

View A Such Transactions can generally be accounted for using IFRS

View B

A seperate set of Islamic accounting standards would be required to report Islamic Financial Transactions



AAOIFI

Review the standards which have been developed by prevailing accounting thought (ie,IFRS) test them against Sharia and then adopt those which are consistent with the sharia and exclude those which are not



AAOIFI

IFRS / IASB standards can be adopted by IFIs AAOIFI standards issued because IFRS / IASB standards cannot be adopted in whole by Islamic financial institutions (IFIs) **AAOIFI** standards are issued for specific Islamic banking and finance practices which are not covered by **IFRS / IASB standards.**



MASB

Malaysian Accouting Standards Board

- The Financial Reporting priciples in the IFRS do not conflict with Sharia
- Financial Reporting is recording function that would neither sanctify nor nullify the Sharia validity of transaction
- The primary difference is not that of recognition and measurement, but the extent of information that needed to be provided to users

Two Main Debatable Issues

Time Value of Money

Is it appropriate to reflect a time value of money in reporting an Islamic Financial

Transaction ?

Substance Over Form

Is there any priority of

The Form of the Contract

over its economic substance?

MERKEZ BANKASITIME Value of Money

View A It is inappropiate to reflect a time value of money in reporting an islamic financial transaction when no overt interest is chaged or incurred in such transactions

View B Although charging interest on a loan is prohibited Showing the financial effect of a transaction would not be so would provide information that would benefit users



Recognizing a Financing Effect

Conventional

In sale of good with deferred payment, IAS 18 requires the difference between the fair value and the nominal amount of consideration is recognized as interest revenue

<u>Islamic</u>

AAOIFI FAS 2 ON Murabaha refers to profit and requires either;

"proportionate allocation of profits over the period of credit" or

" as and when instalments are received"



Conventional

Deferred Payment Fee is "interest"

<u>Islamic</u>

Deferred Payment Fee is "profit"

Malaysian Shariah Advisory Council of BNM

<u>Time Value of Money</u> TVM is recognised in Sharia May be applied to contracts of exchange Economic value to time Fuqaha had long accepted that there is an economic value to time permits an increase in value due to lapse of time



Substance Over Form

View A

The recognition and measurement of an Islamic Financial Transaction should give prominence to its LEGAL FORM to differentiate it from a perceived equivalent

<u>View B</u>

To show the economic substance of an Islamic Financial Transaction Users will benefit more information about legal form can be disclosed at footnotes

AAOIFF – Statement of Financial Accounting No 2 Concepts of Financial Accounting for Banks & Financial Institutions

(Superseded by "Conceptual Framework" as Jan1,2011)

Reliability means that based on all the specific circumstances surrounding a particular transaction or event, the method chosen to measure and/or disclose its effects produces information that reflects the substance of the event or transaction. Estimates and judgments in applying accounting methods are not inconsistent with Shari'a principles which permit the use of persuasive evidence in the absence of conclusive evidence. (para111)

Example for Substance over time contradiction

AAOIFI standards

Both Operating *Ijarah* and

IjarahMuntahia Bittamleek

to be treated similar to

Operating Lease.

In contrast, based on IFRS,

Ijarah

(especially if lease term is

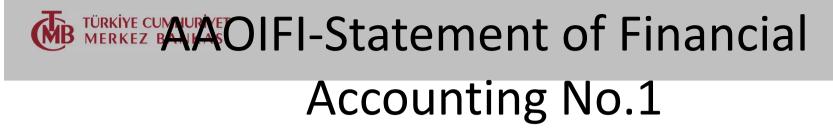
for major part of economic life of lease asset)

and IjarahMuntahia Bittamleek

(due to the transfer of asset ownership by the end of lease term)

would normally be classified and treated as

Finance Lease.



CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING BY ISLAMIC FINANCIAL INSTITUTIONS

in effect by Jan.1 2011 Supersedes SFA 1 and SFA2

WERKEZ AAOIFI-Statement of Financial Accounting No.1

A paragraph is available for "Substance over Form" : 8 / 3 / 3

8.3.3 Substance and form

If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with its substance and economic reality as well as the legal form. Financial reporting involves consideration of the substance of an economic phenomenon as well as its legal form.



Substance vs. Form

Substance	>	Form	IFRS
Substance	<	Form	XXX
Substance	=	Form	Islamic(*)

(*) AAOIFI Revised Framework

AOSSG working Group on Financial Reporting Relating to Islamic Finance

The Working Group was set up to provide input and feedback on the adequacy and appropriateness of proposed and existing IFRS to Islamic financial transactions and events. The Working Group comprises staff from

the standard-setters of Australia, China, Dubai, Indonesia,Korea, Malaysia, Pakistan, and Saudi Arabia.

AOSSG working Group on Financial Reporting Relating to Islamic Finance

Publications

- <u>AOSSG Survey Accounting for Islamic Financial Transactions and Entities</u> Dec 2011
- <u>Financial Reporting Issues relating to Islamic Finance</u> Oct 2010

Submissions to IASB

- <u>Comments on IASB ED/2011/6 *Revenue from Contracts with Customers* <u>AOSSG</u>20 Mar 2012</u>
- <u>Comments on IASB Exposure Draft ED/2011/1 Offsetting Financial Assets</u> <u>and Financial Liabilities</u> 28 Apr 2011
- <u>Comments on IASB Supplement to Exposure Draft ED/2009/12 Financial</u> <u>Instruments: Impairment</u> 1 Apr 2011
- <u>Comments on ED/2010/13 *Hedge Accounting* 9 Mar 2011</u>
- <u>Comments on IASB ED/2010/9 Leases</u> 14 Dec 2010



Source: Deloitte-IAS Plus-Mar 26, 2012

The Islamic Finance Working Group of the Asian-Oceanic Standard-Setters Group (AOSSG)

- has submitted a comment letter to the IASB on ED/2011/6
- 'Revenue from Contracts with Customers', noting
- "gaps in guidance for Islamic finance transactions".



Source: Deloitte-IAS Plus-Mar 26, 2012

The Working Group comment letter, which is in addition to the main AOSSG submission on the exposure draft, notes a number of issues.

Some of these issues were previously raised in response to the earlier revenue recognition exposure draft (ED/2010/6).

WERE MEAS Sues raised in the comment letter include

- The ED could result in a sale that is a financing transaction being reported differently from other financings under IAS 39
- The application of 'enforceable' and 'unconditional' in relation to promises to repurchase must be clear
- Contracts with multiple unrelated parties can still be 'a single contract'. Also, what constitutes 'a contract' may be interpreted differently in Islamic finance
- The description of a customer appears to exclude commercial customers
- It would be useful to include an example of a deferred payment sale in the Illustrative Examples



CONCLUSION 1

- 1. After Global Financial Crisis G 20-FSB took initiative for global standards
 - 2. "Rapid growth of Islamic finance

is increasing pressure for the industry

to enter the accounting mainstream,

by seeking guidance from the International Accounting Standards Board (IASB),

the global body which sets the tone for book-keeping in conventional finance" (Reuters Apr 5, 2012)



CONCLUSION 2

- Asean Ocean standard setters group lead by Malaysian Accounting Standards Board making efforts for convergence
- Contradictory issues may be resolved by integrating several standards relevant to Islamic Finance to IFRS



References

- 1. AAOIFI, Statement of Financial Accounting No1. <u>Conceptual Framework for Financial Reporting by</u> <u>Islamic Financial Institutions</u>
- 2. Asian-Oceanian Standard Setters Group, <u>Research Paper, Financial Reportinissues</u> <u>relating to Islamic Finance</u>
- 3. <u>www.iasplus.com/en /resources/resource64</u>
- 4. <u>www.coffis.fr/coffis/index/.php?option..file...</u> <u>islamic_finance</u>



THANK YOU

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