

İSTANBUL TİCARET ÜNİVERSİTESİ – ISTANBUL COMMERCE UNIVERSITY
2021-2022 Akademik Yılı- Bahar Dönemi
2021-2022 Academic Year – Spring Semester

GNL 327 PARTICIPATION BANKING AND ISLAMIC FINANCE

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3.W.

24.02.2022

GOVERNANCE

Governance encompasses the system by which

- *an organisation is controlled and operates, and*
- *the mechanisms by which it, and its people, are held to account.*
- *Ethics, risk management, compliance and administration are all elements of governance.*

TWO BASIC TENETS OF GOVERNANCE ARE :

Transparency & Accountability



FIDUCIARY RELATIONSHIP REQUIRES GOOD GOVERNANCE

- A fiduciary is a person or organization that acts on behalf of another person or persons, putting their clients' interests ahead of their own, with a duty to preserve good faith and trust. Being a fiduciary thus requires being bound both legally and ethically to act in the other's best interests.*
- A fiduciary may be responsible for the general well-being of another (e.g. a child's legal guardian), but often the task involves finances; managing the assets of another person, or a group of people, for example. Money managers, financial advisors, bankers, insurance agents, accountants, executors, board members, and corporate officers all have fiduciary responsibility. (Source : Investopedia)*

Legal Definition of *fiduciary relationship*

A relationship in which one party places special trust, confidence, and reliance in and is influenced by another who has a fiduciary duty to act for the benefit of the party— called also confidential relationship, fiduciary relation

- A fiduciary relationship may be created by express agreement of the parties, or it may be imposed by law where established by the conduct of the parties.
- *Typical fiduciary relationships exist between agents and principals, attorneys and clients, executors or administrators and legatees or heirs, trustees and beneficiaries, corporate directors or officers and stockholders, receivers or trustees in bankruptcy and creditors, guardians and wards, and confidential advisors and those advised.*

Source : Merriam-Webster

Compliance

1. LAWS – Turkish Banking Law no: 5411

2. REGULATIONS :

- ***Pronouncements by Regulatory Authorities as Banking Regulation and Supervision Agency (BRSA=BDDK) and***
- ***Standards and Pronouncements by Public Oversight and Accounting Standards Authority***
in Turkey

International Standard Setting Organizations

*National Regulatory Authorities
adopt or adapt the relevant international standards
according to the needs of the country,
besides its own regulations*

Importance of Standards

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 ORGANIZATIONS FOR AUDITING & FINANCIAL REPORTING

CONVENTIONAL

- **IASB International Accounting Standards Board**
- **IAASB International Auditing and Assurance Standards Board**

ISLAMIC

- **AAOIFI Accounting and Auditing Organization for Islamic Financial Institutions**

STANDARD SETTING ORGANIZATIONS FOR REGULATION & SUPERVISION

CONVENTIONAL

BCBS Basel Committee on Banking
Supervision

IAIS International Association of
Insurance Supervisors

ISLAMIC

IFSB Islamic Financial Services
board

STANDARD SETTING ORGANIZATIONS FOR REGULATION & UNIFICATION OF MARKETS

CONVENTIONAL

- **ISDA** International Swaps and Derivatives Association
- International Capital Market Association
- **IOSCO** The Global Standard Setter for securities markets regulation(**IFSB also**)

ISLAMIC

IIFM International Islamic Financial Market



Standards Development

Standards Development

[Preparation of Standards](#)

[Published Standards](#)

[Technical Notes](#)

[Guidance Notes](#)

[Exposure Drafts](#)

[FAQs](#)

Standards Development > Published Standards

Published Standards

IFSB-23 (December 2021)

Revised Capital Adequacy Standard For Institutions Offering Islamic Financial Services [Banking Segment]

[[ENGLISH](#) | [ARABIC](#)]

IFSB-26 (December 2021)

Core Principles for Islamic Finance Regulation (Financial Market Infrastructures)

[[ENGLISH](#) | [ARABIC](#)]

IADI-IFSB (July 2021)

Core Principles For Effective Islamic Deposit Insurance Systems

[[ENGLISH](#) | [ARABIC](#)]

IFSB-25 (December 2020)

Disclosures to Promote Transparency and Market Discipline for Takāful/Retakāful Undertakings

[[ENGLISH](#) | [ARABIC](#)]

IFSB-24 (December 2020)

Guiding Principles on Investor Protection in Islamic Capital Markets

[[ENGLISH](#) | [ARABIC](#) | [FRENCH](#)]

IFSB-22 (December 2018)

Revised Standard on Disclosures to Promote Transparency and Market Discipline for Institutions Offering Islamic Financial Services [Banking Segment]

[[ENGLISH](#) | [ARABIC](#)]



Latest Press Release

9 February 2022

IFSB Signs MOU with INCEIF and IICSB to Further Expand Knowledge in Islamic Finance

4 February 2022

State Bank of Pakistan and Central Bank of Nigeria to Helm IFSB Chairmanship and Deputy Chairmanship for 2022

12 January 2022

The IFSB Issues Four New Working Papers on Assessing the Effectiveness of COVID-19 Policy Responses across the Islamic Banking, Islamic Capital Markets, and Takaful Industry

30 December 2021

The IFSB Disseminates PSIFIs Data for 2021Q3 for Islamic Banking Systems in Member Countries

22 December 2021

The IFSB issued the Ninth Edition of its Annual Flagship Publication: the Islamic Financial Services Industry (IFSI) Stability Report 2021

Date posted: 18 August 2021

18 August 2021, Kuala Lumpur - The Islamic Financial Services Board (IFSB) today issued the ninth edition of its annual flagship publication: the *Islamic Financial Services Industry (IFSI) Stability Report 2021*. The Report provides updates on the key trends in growth and developments, analytical and structural outlooks, as well as examines the resilience of the IFSI against the COVID-19 shock and other vulnerability factors across the Islamic banking, Islamic capital market and takāful segments.

The IFSB Secretary-General, Dr. Bello Lawal Danbatta stated that "the issuance of the *IFSI Stability Report 2021* takes place at a time when the world is still faced with the challenges of the COVID-19 pandemic and its implications for the stability of the global financial system." He stated further that "despite an unclear pattern and duration of the pandemic, the IFSI sustained its growth momentum to an increased estimated worth of USD 2.70 trillion in 2020, and recorded a growth rate of 10.7% year-on-year (y-o-y) based on significant improvement across the three segments of the IFSI, especially in Islamic banking and the Islamic Capital Market."

Dr. Bello highlighted that based on various analyses contained in the IFSI Stability Report 2021, the performance of the global IFSI projected a sense of optimism in the short term. This will depend on, among other things, timely access to, and the efficient roll-out of, COVID-19 vaccines; jurisdictions' capital flows, fiscal and monetary policy spaces and capacity to recover from recession; digital transformation process; and the extent of contact-intensiveness of key economic sectors.

Key highlights of the IFSI Report 2020 include:

- The Islamic banking segment retained its dominance in the global IFSI. The domestic market share for Islamic banking in relation to the total banking segment continued to increase in at least 23 countries, among the 36 jurisdictions covered in the IFSI Stability Report 2021.
- The Islamic banking segment's performance grew by 4.3% in 2020, compared to 12.4% in 2019. As at 3Q20, the Islamic banking segment accounts for 68.2% (72.4% in 2019) of the total value of IFSI assets, the declining share being mainly due to increased prominence of the ICM segment.
- The ICM sector as at end of 2020 accounts for 30.9% of the global IFSI assets on the back of a positive performance due to the sovereign and multilateral sukūk issuances in key Islamic finance markets.
- Islamic funds also recorded a noteworthy growth of 31.9% in terms of the total value of assets under management, while the Islamic equity markets also rebounded in the later part of 2020 after the initial shock and volatility in 1Q20 due to the outbreak of COVID-19 pandemic.
- The share of global takāful industry in the global IFSI declined marginally to 0.9% with a -14.8%



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30 December 2021

The IFSB Disseminates PSIFIs Data for 2021Q3 for Islamic Banking Systems in Member Countries

20 December 2021

The IFSB issues Exposure Draft of Revised Standard on Solvency Requirements for Takaful/ Retakaful Undertakings

10 December 2021

The Council of the Islamic Financial Services Board (IFSB) has adopted two new standards



iifm.net/standards/published-standards

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UyumSoft

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Home

About IIFM

Standards

Events

Press & Media

Members

العربية

Hedging Standards

ISDA/IIFM IBOR Fallback Standard Documentation

IIFM Standard - 16

→ [Read More](#)

IBOR Transition

IIFM Risk-Free Rate (RFR) Solutions

IIFM Standard - 15

→ [Read More](#)

Sukuk Standards

IIFM Template Sukuk Al Mudarabah Tier1 Standard Documents

IIFM Standard - 14

Sukuk Standards

Sukuk Al Ijarah Documentation Templates

IIFM Standard - 13

All Standards →

Hedging Standards →

Liquidity Management Standards →

Sukuk Standards →

Trade Finance Standards →

IBOR Transition →

About IIFM

IIFM is a global standard-setting body of the Islamic Financial Services Industry (IFSI) focusing on standardisation of Shari'ah-compliant financial contracts and product templates.

IIFM is hosted by the Central Bank of Bahrain (CBB) and was established under Royal Decree No (23) Year 2002 of the Kingdom of Bahrain as a neutral and non-profit international Islamic infrastructure institution created by the collective efforts of the CBB (formerly Bahrain Monetary Agency), Islamic Development Bank, Bank Indonesia, Bank Negara Malaysia (delegated to Labuan Financial Services Authority), Central Bank of Sudan and Brunei Darussalam Central Bank (formerly Autoriti Monetari Brunei Darussalam).

Besides the Founding and Permanent Members, IIFM Board of Directors consist of Islamic and international banks namely Kuwait Finance House, Dubai Islamic Bank, Saudi National Bank, Bank ABC Islamic, Gulf Finance House, Standard Chartered Saadiq, Credit Agricole CIB and National Bank of Kuwait.

IIFM is also supported by certain regulatory and government bodies such as State Bank of Pakistan, National Bank of Kazakhstan and DIFC Authority as well as by a number of international and regional financial institutions and other market players active in Islamic finance.

Mandate

The core mandated area of IIFM to develop standardised Shari'ah-compliant Financial Documentation, Product Confirmations and Guidelines for the Islamic Financial Services Industry (IFSI).

Value Proposition

Focus on providing well defined services to the IFSI as follows:

- I. Publish practical and ready-to-use globally standardised Shari'ah-compliant Financial Documentation, Product Confirmations and related Guidance Notes which are supported with the IIFM Shari'ah Board approval "Pronouncements" as well as jurisdiction specific Legal Opinions
- II. Create industry awareness and share technical knowledge on IIFM Standards by organizing specialized seminars, technical workshops and standardisation specific industry consultative meetings
- III. Practical Training for Professionals on IIFM Published Standards
- IV. Publish annual Sukuk Report and periodic Concept Papers on specific topics

IIFM Global Members

IIFM Founding and Permanent Members

CHAPTER 1:

Overview Of The Global Sukuk Market

- 1.1 Record Breaking Sukuk Issuances
- 1.2 Global Sukuk Issuances
- 1.3 International Sukuk Issuances
- 1.4 Domestic Sukuk Issuances
- 1.5 Short Term Sukuk Market
- 1.6 Distribution of the Global Sukuk Issuance by Issuer Status
- 1.7 Anatomy of International Sukuk Issuances
- 1.8 Anatomy of Domestic Sukuk Issuances
- 1.9 Structural Break-up of Global Sukuk Market
- 1.10 Geographical Break-up of Global Sukuk Market
- 1.11 Sukuk Maturities 2020 through 2022
- 1.12 Sukuk Outstanding

CHAPTER 2:

IIFM Published Sukuk Standards - Al-Ijarah and Al-Mudarabah Tier1: Considerations and Significance

- Preamble

IIFM Template Sukuk Al Ijarah Standard Documents

- Introduction
- Documentation
- Guidelines Regarding Shari'ah Compliance

CHAPTER 3:

SELECTED SUKUK ISSUANCES (CASE STUDIES CONTRIBUTION)

- 3.1 The Government of Dubai USD 1 billion Sukuk due 2030
- 3.2 The National Commercial Bank USD 1.25 Billion Additional Tier 1 Sukuk
- 3.3 Saudi Electricity Company USD 1.3 billion Dual tranche USD Green Sukuk
- 3.4 Pakistan Energy Sukuk II: A landmark PKR 200 billion Sukuk issuance through a book building process
- 3.5 Oman Sovereign Sukuk: Series 4 & Series 5
- 3.6 ICD Five-Year USD 600 Million Sukuk

CHAPTER 4:

ARTICLE CONTRIBUTION

- 4.1 Sukuk Silver Linings Amid Coronavirus Storm
- 4.2 ESG and the Islamic Capital Markets: Evolving Sukuk to Ensure Effective Balance of Environmental, Social and Governance Priorities
- 4.3 Yields & The Yield Curve - Commentary: 2020 to March 2021
- 4.4 Sukuk Development with A View to Transformation
- 4.5 Sustained Growth Lies Ahead for Sustainable Sukuk Sector
- 4.6 Opportunities for New Sukuk Issuers: Systemic Trends and A Drive for Democratisation
- 4.7 Sukuk Lead the Sustainable and Green Revolution

Arabic language

Invitation

Organised by



Virtual Public Hearing on exposure draft of AAOIFI Financial Accounting Standard (FAS)

“Interim Financial Reporting”

28 February 2022, 10:00 am – 12:00 pm Bahrain time (GMT +3)

To register, please click on: <https://bit.ly/3rV5tfA>

For any enquiries: ph@aaoifi.com

Live stream



zoom

To register



AAOIFI

The Accounting and Auditing Organization for Islamic Financial Institutions(AAOIFI)
is

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

Professional qualification programs (notably CIPA, the Shari'a Adviser and Auditor "CSAA", and the corporate compliance program) **are presented now by AAOIFI in its efforts to enhance the industry's human resources base and governance structures.**

AAOIFI

As an independent international organization,

AAOIFI is supported by institutional members **(200 members from 40 countries, so far)**

including

central banks,

Islamic financial institutions, and

other participants from the international Islamic banking and finance industry, worldwide.

STANDARDS BY AAOIFI

«Accounting and Auditing Organization for Islamic Financial Institutions» promulgated 5 group of Standards :

1.Sharia Standards (Standards on Islamic Law)

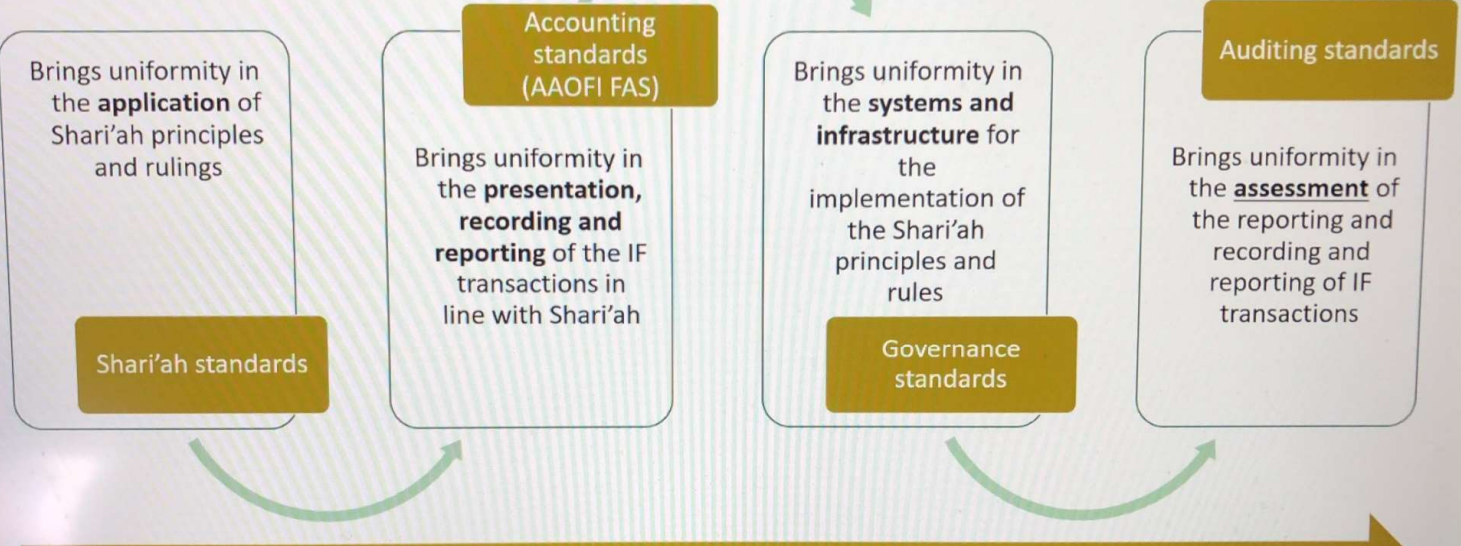
2.Accounting Standards

3.Auditing Standards

4.Governance Standards

5.Ethics Standards

5 areas of standards development



Ethics brings unity and uniformity in the letter and spirit of application of all standards

Capacity building programs



Talking: Dr. Rizwan Malik

Launched in 2006

Revamped and relaunched in 2017

1000+ CIPA fellows all over the world

4 Modules, Study texts, and exams

1 year practical experience requirement (PER)

30+ Education Partners

30+ exam centers

Presently offered only in English language (Russian in process)

Launched in 2006

800+ CSAA fellows all over the world

Currently being revamped

- CSAA will be split into two separate fellowships:
- Certified Shariah Advisor (CSAD)
 - Certified Shari'ah Auditor (CSAU)

Both fellowships will be offered in Arabic language



Recording You are viewing Dr. Rizwan Malik's screen View Options View

AAOIFI – the standards development process (simplified)

17
AAOIFI

Talking: Dr. Rizwan Malik

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graph TD
    subgraph Row1
        R1_1[Identification of the projects: by Secretariat / Technical Board] --> R1_2[Working group formation]
        R1_2 --> R1_3[Executive team formation]
        R1_3 --> R1_4[Preliminary study & consultation note (in one or two steps)]
        R1_4 --> R1_5[Presentation before technical board for principle setting (in one or two steps)]
    end
    subgraph Row2
        R2_1[Workshop(s) (if needed)] --> R2_2[Draft standard for technical board]
        R2_2 --> R2_3[Review of draft standard by technical board]
        R2_3 --> R2_4[Exposure draft]
        R2_4 --> R2_5[Review of exposure draft by Shari'ah committee (if applicable)]
    end
    subgraph Row3
        R3_1[Public hearing (s)] --> R3_2[Review of exposure draft by PIMCC (if applicable)]
        R3_2 --> R3_3[Review of the final standard by the working group with industry comments]
        R3_3 --> R3_4[Review of the final standard by technical board with industry comments]
        R3_4 --> R3_5[Final standard]
    end
    R1_5 --> R2_1
    R2_5 --> R3_1
  
```

Unmute Start Video Participants 229 Q&A 1 Chat 3 Share Screen Record Leave



Purpose of public hearings

Talking: Dr. Rizwan Malik

- An opportunity for both AAOIFI to present its exposure draft and for the industry stakeholders to offer their comments and feedback on it.
- The role of AAOIFI is to explain and elaborate on the core content of the standard, assist in its understanding and answer any questions you may have – that is our job.
- Your role as attendees is to provide comments, opinions, recommendations, views, and suggestions on this exposure draft.
 - This can be in terms of highlighting missing something important completely or covering it inadequately or if certain point covered is wrong or factually incorrect, or if a better word could be used in the standard or even highlighting grammatical mistakes.
- More feedback we receive, the better for the standard. So let us have this as an interactive discussion session for the benefit of the industry.
- You can also share your feedback or comments on the exposure draft after the session on accounting@aaofii.com.

Accounting Standards

Conceptual Framework for Financial Reporting by Islamic Financial Institutions
Financial Accounting Standard No. (1) General Presentation and Disclosure in the Financial Statements of Islamic Banks and Financial Institutions
FAS 1 (Revised 2021) - General Presentation and Disclosures in the Financial Statements
Financial Accounting Standard No. (3) Mudaraba Financing
Financial Accounting Standard No. (4) Musharaka Financing
Financial Accounting Standard No. (7) Salam and Parallel Salam
Financial Accounting Standard No. (8) Ijarah and Ijarah Muntahia Bittamleek
Financial Accounting Standard No. (9) Zakah
Financial Accounting Standard No. (10) Istisna'a and Parallel Istisna'a
Financial Accounting Standard No. (12) General Presentation and Disclosure in the Financial Statements of Islamic Insurance Companies
Financial Accounting Standard No. (13) Disclosure of Bases for Determining and Allocating Surplus or Deficit in Islamic Insurance Companies
Financial Accounting Standard No. (14) Investment Funds

Financial Accounting Standard No. (15) Provisions and Reserves in Islamic Insurance Companies

Financial Accounting Standard No. (16) Foreign Currency Transactions and Foreign Operations

Financial Accounting Standard No. (18) Islamic Financial Services Offered by Conventional Financial Institutions

Financial Accounting Standard No. (19) Contributions in Islamic Insurance Companies

Financial Accounting Standard No. (20) Deferred Payment Sale

Financial Accounting Standard No. (21) Disclosure on Transfer of Assets

Financial Accounting Standard No. (22) Segment Reporting

Financial Accounting Standard No. (23) Consolidation

Financial Accounting Standard No. (24) Investments in Associates

Financial Accounting Standard No. (26) Investment in Real Estate

Financial Accounting Standard No. (27) Investment accounts

Financial Accounting Standard No. (28) Murabaha and Other Deferred Payment Sales

Financial Accounting Standard No. 30 Impairment, credit losses and onerous commitments

Financial Accounting Standard No. 31 Investment Agency (Al-Wakala Bi Al-Istithmar)

Financial Accounting Standard 32 Ijarah

Financial Accounting Standard No. 33 Investments in Sukuk, shares and similar instruments	
Financial Accounting Standard No. 34 Financial Reporting for Sukuk-holders	
Financial Accounting Standard No. 35 Risk Reserves	
FAS 36 – First Time Adoption of AAOIFI Financial Accounting Standards	
FAS 37 – Financial Reporting by Waqf Institutions	
FAS 38 – Wa’ad, Khiyar and Tahawwut	
FAS 39 - Financial Reporting for Zakah	
FAS 40 – Financial Reporting for Islamic Finance Windows	

Notes:

The previous FAS 5: “Disclosure of Bases for Profit Allocation Between Owners’ Equity and Investment Account holders” and FAS 6: “Equity of Investment Account holders and their Equivalent” have been replaced and superseded by FAS 27: “Investment Accounts”.

The previous FAS 17: “Investments” has been replaced and superseded by FAS 25: “Investment in Sukuk, Shares and Similar Instruments” and FAS 26: “Investment in Real Estate” and later on the previous FAS 25: “Investment in Sukuk, Shares and Similar Instruments” has replaced and superseded by FAS 33 “Investments in Sukuk, shares and similar instruments”.

FAS 2: “Murabaha and Murabaha To The Purchase Orderer” and FAS 20: Deferred Payment Sale was replaced and superseded by FAS 28: “Murabaha and Other Deferred Sales”.

FAS 11: “Provisions and Reserves” was replaced and superseded by FAS 30: “Impairment, Credit Losses and Onerous Commitments” and FAS 35: “Risk Reserves”.

The previous Accounting Guidance Note No. 1 “Guidance Note on First Time Adoption of AAOIFI Accounting Standards by an Islamic Financial Institution” was replaced and superseded by FAS 36 “First Time Adoption of AAOIFI Financial Accounting Standards”

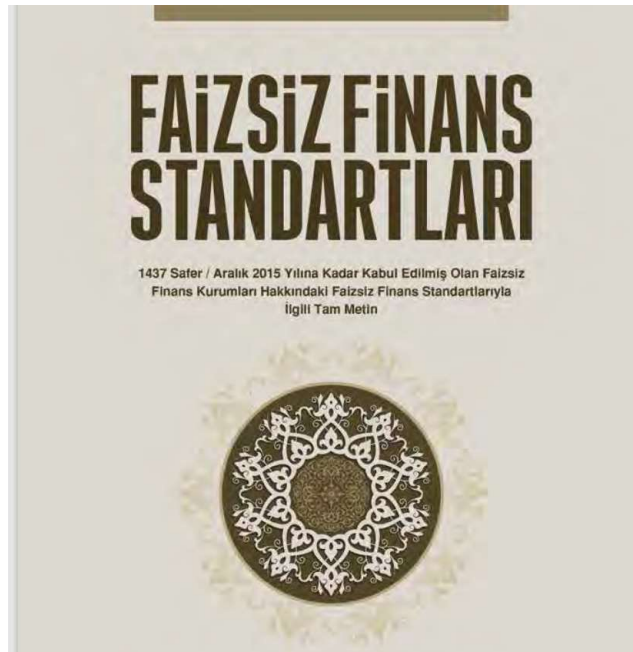
Issued Standards

- **AAOIFI Conceptual Framework for Financial Reporting (Revised 2020)**
- **FAS 28 – Murabaha and other deferred payment sales**
- **FAS 30 – Impairment and Credit Losses and Onerous Commitments**
- **FAS 31 – Investment Agency (AI – Wakala Bi-AI – Istithmar)**
- **FAS 32 - Ijarah**
- **FAS 33 – Investment in Sukuk, Shares and Similar Instruments**
- **FAS 34 – Financial Reporting for Sukuk-holders**
- **FAS 35 – Risk Reserves**
- **FAS 36 – First Time Adoption of AAOIFI Financial Accounting Standards**
- **FAS 37 – Financial Reporting by Waqf Institutions**
- **FAS 38 – Wa’ad, Khiyar and Tahawwut**
- **FAS 39 – Financial Reporting for Zakah**
- **FAS 40 – Financial Reporting for Islamic Finance Windows**
- **FAS 1 (Revised 2021) – General Presentation and Disclosures in the Financial Statements**

Reflection of AAOIFI standards in Turkey

Law Standards

- *Translated by BDDK & TKBB and available at web site of tkbb*



Accounting, Auditing & Ethics Standards

- *Translated by Turkish Public Oversight and Accounting Standards authority (= Kamu Gözetim ve Muhasebe Standartları Kurumu)*
- *Accounting Standards are published in Turkish Official Gazette to be in effect by January1, 2020 **VOLUNTARILY***



İngilizce Türkçe
Google Translate



Auditing Standards
Accounting Standards

Recently Published

News

Kavramsal Çerçeve

KÇ FAİZSİZ FİNANS KURULUŞLARININ FİNANSAL RAPORLAMASINA İLİŞKİN KAVRAMSAL ÇERÇEVE

Faizsiz Finans Muhasebe Rehberi

FAİZSİZ FİNANS MUHASEBE REHBERİ 1: FAİZSİZ FİNANS MUHASEBE STANDARTLARININ FAİZSİZ FİNANS KURULUŞLARI TARAFINDAN İLK KEZ UYGULANMASI

Faizsiz Finans Muhasebe Standartları

FFMS 1 FİNANSAL TABLOLARDAN GENEL SUNUM VE AÇIKLAMA

FFMS 3 MUDÂREBE FİNANSMANI

FFMS 4 MÜŞÂREKE FİNANSMANI



1



2



3

Faizsiz Finans Muhasebe Standardı 27

Yatırım Hesapları

Standards for Islamic Banking which we will refer are :

REGARDING RESOURCES

- *FAS 3 Mudaraba Financing*
- *FAS 4 Musharaka Financing*
- *FAS 7 Salam and Parallel Salam*
- *FAS 10 Istisna and Parallel Istisna*
- ***FAS 28 Murabaha and Other Deferred Payment Sales***
- *FAS 32 Ijarah*

REGARDING SOURCES

- *FAS 27 Investment Account*

AAOIFI-Financial Accounting Standard No. 27
Investment Accounts

TURKISH PUBLIC OVERSIGHT
Accounting and Auditing Standards Authority
(Kamu Gözetim Kurumu)

Accounting Standard for Interest Free Finance No: 27
(Faizsiz Finans Muhasebe Standardı No: 27)

*Relevant Regulations:
Standards by AAOIFI &
Turkish Oversight Authority (=Kamu Gözetim Kurumu)*

- AAOIFI Statement of Accounting Standard No:1
- AAOIFI- Financial Accounting Standard No:27

AAOIFI definition : Investment Account

An Account
for the holder of an instrument
under a **Mudarabah** or its equivalent
representing funds
received by the *Islamic Financial Institution (=Participation Bank)* **for investment**
on behalf of the other party (rab al maal)
with or without conditions
as regards how the funds may be invested
(AAOIFI-FAS 27,Prg.3)

Scope of the standard FAS 27

This standard shall apply to

✓ *on-balance sheet* and

✓ *off-balance sheet,*

unrestricted and

restricted investment accounts

managed by Islamic Financial Institutions.

Profit Sharing Mudarabah Based investment Account

Provide Authority to IFI

***Equity of investment
accountholders***

On Balance Sheet

Do not provide Authority to IFI

**Equity of investment
accountholders**

Off Balance Sheet

Mudarabah is categorized into two types:

(a) Unrestricted *Mudarabah* is a contract in which the fund provider permits the *mudarib* to manage the *mudarabah* capital ***without any specific restriction***.

(b) Restricted *Mudarabah*

(i) A restricted *mudarabah* is a contract in which the fund provider imposes specific restriction on the *mudarabah* terms.

(ii) The capital owner may specify conditions restricting the *mudarib* such as :

- **the determination of location,**
 - **period for investment,**
 - **type of project and**
- **commingling of funds (Mixing the own capital of the bank and funds of investment account holder)**

FAS 27

Prefers to use the criteria of
«Authority provided to IFI»
instead of
«Restriction»

«Restricted investment Accounts» is referred among definitions,
in context of those shall be presented as on-balance sheet investment account
if they meet the conditions in the standard.

Focus is on disclosure either «On» or «off» Balance Sheet by Authority Criteria

Definition of «Malaysia Islamic Financial Act»: Investment Account

- An Account under which money *is* paid and accepted ***for purposes of investment***, including for the provision of finance (to enter into business), in accordance with Sharia on terms that ***there is no expressed or implied obligation to repay the money in full and the Account holder may not receive Any return.***

Either *only the profits*** or ***Both the Profits or Losses***, thereon shall be SHARED.....

(IFSA 2013, section 2/1,p.27)

Attributes of Investment Account

- It is a «Profit (andLoss) Sharing Account based on s a Mudarabah Contract
- **Principal Non-guaranteed**
- **Can be «Restricted» or « Unrestricted»**
- **Restriction is about authority over Decisions with regards to USE&DEPLOYMENT of Funds Provided to IFI (Part.Bank) or not**
- **Can be disclosed on Balance Sheet or Off Balance Sheet**
 - If on Balance Sheet of the Participation Bank (Islamic Financial Institution) disclosed
: **Under title of Quasi Equity as**
«Equity of Investment Account holders»

Two sides in Mudarabah Contract

Entrepreneur(THE ISLAMIC BANK)

- *If no ignorance and negligence,
do not bear loss*

Capital Owner (The Investment Account Holder)

- ***Loss is beared by capital owner***

Attributes of Mudarabah Contract

Profit Sharing

The mudarib (Bank) shall not guarantee any profit.

Fund Provider and mudarib

shall share profit

based on a ratio mutually

agreed between them

Loss Bearing

Loss shall be born by the Fund Provider up to the capital value.

The mudarib (BANK) may voluntarily absorb the loss upon the maturity or dissolution of mudarabah

According to legal Structure of the «Mudarabah Contract»
Loss is not shared but born by Capital Owner

Mudarabah is a contract
between a **FUND provider** (*rabbul mal*) and
an *entrepreneur* (*mudarib*)

under which *the fund provider brings money* to be managed by the *entrepreneur* (*Participation BANK **) and *any profit generated from the operation is shared between the fund provider and the Participation Bank according to mutually agreed profit sharing ratio (PSR)*

whilst financial losses are borne by the Fund Provider

*Assuming that such losses are not due to the
mudarib's (Bank's) misconduct, negligence or breach of specified terms .*

*** When mudaraba contract is used for collecting funds by the participation bank**

(Sharia Standard on Mudarabah-Bank Negara Malaysia)

When Mudarabah Contract is used to Collect Funds by Islamic Financial Institutions – (IFIs)

*A Mudarabah is an agreement between
the IFI s and a Fund Provider*

*whereby the Fund Provider delivers some amount of Funds to IFI (Mudareb/Bank) for
management with or without any conditions.*

*Profits Generated by IFIs are shared in accordance with the terms of the
Mudarabah agreement,*

Losses are to be born solely by the Fund Provider

*unless the losses are due to Mudarib IFI's misconduct, negligence or breach of
contracted terms*

Good for «Loss Absorbing Capacity»

- *In the field of bank resolution and recovery,*

Loss Absorbing Capacity is the ability of a bank to suffer losses without failing below regulatory minimal of capital and requiring re-capitalisation or resolution.

(wiki.treasurers.org)

- ***Loss Absorbing Capacity of Mudaraba based Investment Account**
Makes «Bail in» possible instead of «Bail out»*

In case of insolvency of a Bank (i.e.during Banking Crisis)

BAIL IN

- *The Bank and Depositors should absorb the loss*
- **PREFERRED BY BASEL RULES**

BAIL OUT

- *The Bank and Depositors are supported by Government Funds (Taxpayers' Money)*

However «Displaced Commercial Risk» is needed to be applied

The extent of additional risk
borne by an IFI's shareholders
in comparison to the situation where
the IAH assume all commercial risks

associated with the assets financed by their funds

Displaced commercial risk is a unique risk applicable to an Islamic bank particularly in a dual banking environment.

- *Displaced Commercial Risk (DCR) is defined as*
“the risk arising from assets managed on behalf of Investment Account Holders which is effectively transferred to the Islamic Financial Institutions own capital because the Institution forgoes (give up) part or all of its Mudarib’s share (profit) on such fund, when it considers this necessary as a result of commercial pressure in order to increase the return that would otherwise be payable to Investment Account Holder’s” (IFSB 2005/2-Standard para76).

In other words DCR is the risk accrued to Islamic banks due to the commercial pressure of having to pay a rate of return equivalent to a competitive rate of return and absorb a portion of losses which normally would have been borne by investment account holders in order to prevent massive withdrawal of funds.

*As a compromise
loss is also shared by the
Bank*

AAOIFI Statement of Accounting Standard No:1;
CONCEPTUAL FRAMEWORK for
FINANCIAL REPORTING BY ISLAMIC FINANCIAL INSTITUTIONS
(in effect Jan.2011)

Prg. 6.3. Equity of investment account holders

Refers to funds

received for the purpose of investment
on a *profit sharing or participation* basis
under MUDARABA arrangements

Prg. 6.3. Equity of investment accountholders

**The IFI is not obliged
to return the funds it has received
in case of loss**

unless the loss is due to its negligence and, accordingly,

equity of investment accountholders

is not considered a liability of the IFI

Prg. 6.3. Equity of investment accountholders

Likewise, **equity of investment account holders** is *not considered as owners' equity*

since the holders of these accounts

do not enjoy the powers and ownership rights, for example, voting rights held by owners.

THEREFORE

**«EQUITY OF INVESTMENT ACCOUNT HOLDERS»
SHOULD BE DISCLOSED SEPERATELY**

Prg. 6.3. Equity of investment accountholders

Equity of investment accountholders are **considered on-balance sheet**

if the IFI has the authority over decisions

with regards to

- *the use of and*
- *deployment of the funds it has received*

Figure 18.4 The Accounting Equation

In conventional framework-based financial reporting:

$$\text{Assets} = \text{Owners' equity} + \text{Liabilities}$$

In AAOIFI-based financial reporting:

$$\text{Assets} = \text{Owners' equity} + \text{Equity of investment account holders} + \text{Liabilities}$$

Exhibit 18.8 Difference Between the IFRS- and AAOIFI-based Financial Reporting

ABC Islamic Bank
Statement of Financial Position Excerpt
As at 31 December 2015

	AAOIFI-based financial reporting	IFRS-based financial reporting
	USD million	USD million
Total assets	908	908
Liabilities	381	383
Equity of investment account holders	2	-
Owners' equity	525	525
Total equity and liabilities	908	908

BALANCE SHEET OF PARTICIPATION BANKS -SOURCES – Complying with AAOIFI

1. **LIABILITIES**

Current Accounts

2. **QUASI EQUITY**

Equity of Investment Account Holders

(Participation to profit and loss Account in Turkey)

3. **Shareholders Equity**

Capital

Retained Earnings

SOURCES part of the *BALANCE SHEET*

Two different views

According to Turkish Financial Reporting Standards(TFRS)-***Present Practice***

1. ***Debts (Liabilities)***
 - 1.1. ***Current Accounts***
 - 1.2. ***Participation Accounts***
2. ***Shareholders' Equity***
 - Capital***
 - Retained Earnings***

According to AAOIFI Standards

IDEAL DISCLOSURE

1. ***Debts (Liabilities)***
 - 1.1. ***Current Accounts***
2. **QUASI EQUITY = Equity of Investment Account Holders**
 - Participation Accounts***
3. ***Shareholders' Equity***
 - Capital***
 - Retained Earnings***

KATILIM BANKALARININ BİLANÇOSU

Kaynaklar

Türkiye Finansal Raporlama Standartlarına (TFRS)göre

1. **BORÇLAR (Yükümlülükler)**
 - 1.1.Cari Hesaplar
 - 1.2.Kâr – Zarara Katılım Hesabı
2. **Öz kaynaklar**
 - Sermaye
 - Dağıtılmamış Kârlar

AAOIFI Standartlarına göre

1. **BORÇLAR (Yükümlülükler)**
 - Cari Hesaplar
2. **SERMAYE BENZERİ (QUASI EQUITY)**
 - Yatırım Hesabı (Katılım Hs.) Sahiplerinin hakları
(Türkiye’de Kâr – Zarara Katılım Hesabı)
3. **Öz kaynaklar**
 - Sermaye
 - Dağıtılmamış Kârlar

*Consequences of depending of INVESTMENT ACCOUNT
on «MUDARABA» CONTRACT*

- 1. Although it is not legally necessary, the Islamic Bank also shares the loss if occurs*
- 2. «Equity of investment account holders» should be disclosed seperately on the Sources Part of the Balance Sheet of the Islamic Bank*
- 3. Regulatory Capital Requirement of the Islamic Bank is lower than Conventional Bank*

Capital Adequacy Ratio

in the numerator OF THE RATIO : SHAREHOLDERS' EQUITY

in the denominator of the RATIO:

Total Risk weighted Assets

**Assets financed by Profit Sharing Investment Accounts
are deducted from RISK WEIGHTED ASSETS**

Because the capital amount of Profit Sharing Investment Account (PSIA) is not guaranteed by the IIFS due to the profit-sharing nature of the underlying muḍārabah contract.

However a proportion of the RWA funded by UPSIA is required to be included in the denominator of the CAR as a result of DCR* commercial risks of assets financed by UPSIA are considered to be borne proportionately by both the UIAH and the IIFS.

* **Displaced Commercial Risk**



ISLAMIC FINANCIAL SERVICES BOARD

IFSB-23

**REVISED CAPITAL ADEQUACY STANDARD
FOR INSTITUTIONS OFFERING ISLAMIC
FINANCIAL SERVICES**

[BANKING SEGMENT]

IIFSB 23- 4.4.2

Adjustment to the Capital Ratio Denominator

406. The capital amount of Profit Sharing Investment Account (PSIA) is not guaranteed by the IIFS due to the profit-sharing nature of the underlying muḍārabah contract.

(The Unrestricted Profit Sharing Investment Account (UPSIA) holders have an ownership claim as rabb al-māl to the net asset value of their funds, and in this respect do not rank pari passu with shareholders. Shareholders are, on the other hand, liable up to the amount of their capital in the IIFS for amounts deposited by current account holders and other creditors of the IIFS.)

Therefore, any losses arising from investments or assets financed by PSIA are to be borne by the IAH. Nevertheless, IAH are not liable for any losses arising from the IIFS's negligence, misconduct, fraud or breach of its investment mandate, which is characterised as a fiduciary risk and considered part of the IIFS's operational risk.

*Assets financed by unrestricted or restricted PSIA do not represent risks for the IIFS's own (shareholders') capital; **except DISPLACED COMMERCIAL RISK***

407. *In principle, assets financed by unrestricted or restricted PSIA do not represent risks for the IIFS's own (shareholders') capital and thus would not entail a regulatory capital requirement for the IIFS. This implies that assets funded by PSIA would be excluded from the calculation of the denominator of the capital adequacy ratio; that is, IIFS would not be required to hold regulatory capital in respect of risk arising from PSIA-funded assets.*

408. **In practice, however,** an IIFS may be compelled to smooth the profits payout to UIAH (and, where applicable, to RIAH) due to commercial pressure, regulatory requirements or management strategy using various smoothing techniques. A necessary consequence of some of these smoothing practices adopted by IIFS is that a portion of risk (i.e. volatility of the stream of profits) arising from assets managed on behalf of UIAH is effectively transferred to the IIFS's own capital, ***α*** ***phenomenon known as displaced commercial risk.*** *As a result of DCR commercial risks of assets financed by UPSIA are considered to be borne proportionately by both the UIAH and the IIFS. Hence, instead of excluding all the assets funded by PSIA from the denominator of the CAR discussed in paragraph 407 to reflect DCR, a proportion of the RWA funded by UPSIA is required to be included in the denominator of the CAR. This portion of RWA is denoted by the Greek letter "alpha". The quantification and use of this alpha parameter in the CAR calculation are subject to supervisory discretion. (See section 4.4.5 for a discussion of the calculation of alpha.)*

END OF W 3