AAOIFI Financial Accounting Standard 35

Risk Reserves

Contents

AAOIFI Financial Accounting Standard (FAS) *"Risk Reserves"* is set out in paragraphs 01-31. All the paragraphs have equal authority. This standard should be read in the context of its objective and the Conceptual Framework for Financial Reporting as endorsed by AAOIFI.

All AAOIFI FASs shall be read in conjunction with the definitions, Shari'ah principles and rules and key considerations provided by AAOIFI Shari'ah standards in respect of such products and matters.

Preface

PR1 Islamic financial institutions (IFIs) particularly Islamic banks have a distinct structure. A significant aspect of it is that the investment accounts and other significant means of capital and funding are based on profit and loss sharing or participation basis, which changes the overall risk profiles of such institutions. These fund providers share (or fully absorb) the risks and rewards related to the banking assets (including Islamic financing and investment instruments). The IFIs are also impacted by the industry factors and make efforts to maintain returns to such stakeholders on a smooth, as well as, market comparable basis, which add further distinct characteristics to the same.

PR2 In principle, safeguarding the long-term interest, as well as, smoothing the profit to investment account holders (IAHs) and other participating stakeholders are primary consideration for maintaining such reserves. This is generally done through the profit equalization reserve (PER).

PR3 The comprehensive project for the revision of FAS 11 "Provisions and Reserves" in line with improved global accounting, financial reporting and regulatory requirements including the futuristic approach for recognition of credit losses, resulted in the development of two different standards. The first, FAS 30 "Impairment, Credit Losses, and Onerous Commitments" provides the principles of accounting and financial reporting for impairment and credit losses on various Islamic financing, investment and other assets of IFIs and related provisions for onerous commitments. The Standard also specifies how impairment and credit losses shall be recognised and when and how they can be reversed.

PR4 The second part of the project is concluded with the issuance of this standard, covering the financial reporting and accounting for risk reserves.

Introduction

Overview

IN1 This standard, AAOIFI Financial Accounting Standard (FAS) 35 “Risk Reserves” aims to define the accounting and financial reporting principles for risk reserves to be in line with global best practices for accounting and risk management. This standard complements FAS 30 “Impairment, Credit Losses and Onerous Commitments” and they shall be adopted simultaneously.

IN2 Both of these standards FAS 30 and FAS 35 together supersede the earlier FAS 11 “Provisions and Reserves”.

IN3 A reserve technically differs from an allowance for impairment or credit losses etc., as the former is a component of equity that is used for profit smoothing and as a buffer against future decline in returns for participating stakeholders due to lower returns on assets and investments, while the latter is a charge in profit and loss account that approximate the anticipated and incurred losses arising from doubtful collectability or impairment of values. Hence, the sets of risks associated with, or relevant to, each of these two components are different and specific. This standard aims to provide reasonable guidance on maintenance of reserves against such risks.

IN4 The standard provides principle based guidance on maintaining reserves, including the approach for maintaining and utilizing reserves. The standard require IFIs to disclose in the financial statements the basis for determining the transfers in and out of reserves, thresholds for specific reserves and the use of specific reserves. Moreover, it provides guidance for assessment and accounting for various risks involved, and recognize the need for varying levels of reserves in line with the dynamism of risks across the financial calendar. It also creates a link between the allowances for impairment, credit losses and onerous commitments against the reserves to be maintained for the participating stakeholders.

Rationale for issuing this standard

IN5 AAOIFI Accounting Board (AAB / the board) while approving its strategy and plan for 2016 concluded that FAS 11 “Provisions and Reserves” requires revisions due to development in international standards and better industry practices. This is necessary to ensure a more robust financial reporting environment, including the consideration of the futuristic approach for determination of credit losses as adopted by the global accounting standards setters and regulatory authorities.

IN6 The board considered the need for revision, improvement and further elaborating the on accounting for reserves, which was included in the existing FAS 11. The board also considered that the existing standard does not provide any accounting treatment, including the measurement guidance, and it rather only deals with only classification and disclosure.

IN7 The board concluded that due to the varying risk profiles of IAHs and similar fund providers on the basis of equity or quasi-equity, their interest need to be safeguarded by the IFIs. It includes maintenance of various risk reserves based on a robust methodology that takes into account the dynamic nature of the relationship between IFIs and their IAHs and the respective risk preferences and risk profiles of these IAHs. The existing FAS 11 is limited in its scope as it only covers recognition, classification and presentation requirements of reserves. Risk weightage and reserve calculations are not taken care of, and therefore a new standard is needed to define a more improved scope and to set on accounting treatments associated with proper risk management practices. This becomes further necessary as FAS 11 “Provisions and Reserves” needed significant overhaul and improvement with regard to the provisions (now called allowances for impairment and credit losses), which is now taken care of through issuance of a new standard on the topic i.e., FAS 30 “Impairment, Credit Losses and Onerous Commitments”.

IN8 As the existing FAS 11, was addressing the risk of future losses through the creation of investment risk reserve (IRR). However, it was deemed necessary to, reconsider the presentation of the same. Accordingly, the board decided to reduce the scope of IRR and to include a forward looking approach in the determination of expected credit losses, under FAS 30.

IN9 The board further concluded that accounting for reserves is linked with quasi-equity instruments rather than the asset balances. Therefore, it was considered appropriate to separate reserves accounting in FAS 30 and develop a separate standard for risk reserves.

AAOIFI Financial Accounting Standard 35

Risk Reserves

Objective of the standard

1. The objective of this standard is to establish the principles of accounting and financial reporting for risk reserves established to mitigate various risks faced by stakeholders, mainly the profit and loss taking investors, of Islamic financial institutions (IFIs / the institutions).

Scope

2. This standard shall apply to risk reserves that are established by an IFI (other than a Takaful (Islamic insurance) entity[1], to mitigate the credit, market, equity investment, liquidity, rate of return or displaced commercial risks faced by stakeholders (mainly the profit and loss taking investors). On the other hand, operational risk is the responsibility of the IFI itself, so this standard shall not be applied on any risk reserve created to mitigate the operational risk.

3. This standard does not mandatorily require the IFIs to maintain risk reserves. If an IFI established such reserves, it shall apply this standard in its entirety.

4. This standard shall not be applicable on regulatory, statutory and other similar reserves which are not appropriated from the income of the respective assets, and rather are appropriated from the equity.

5. This standard shall be applicable to any reserves, by whatever name called, if they meet the definition of any of the reserves covered by this standard.

Definitions

6. For the purpose of interpreting and applying this standard, the following short definitions are relevant:

    a. Investment risk reserve (IRR) – is the amount appropriated by an IFI out of the income arising from the assets pertaining to relevant profit and loss taking investors, in order to cushion against credit risk, market risk and equity investment risk mainly pertaining to residual future possible losses (after impairment and credit losses accounted for in line with the requirements of FAS 30 “Impairment, Credit Losses and Onerous Commitments”) for the respective stakeholders arising from the respective assets and investments;

    b. Profit and loss taking investors – are the investors providing funds to an IFI for investments in assets, business or ventures to share risks and rewards arising from those assets, business and ventures e.g. Mudaraba, Musharaka or Al-Wakala Bi Al-Istithmar (investment agency) including Investment Account Holders (IAH), Sukuk holders etc.;

    c. Profit equalization reserve (PER) – is the amount appropriated by an IFI out of the income arising from the assets pertaining to profit and loss taking investors, in order to maintain a

[1] Islamic insurance entities shall follow the FAS specifically addressing their risk reserves (presently being, FAS 15 “Provisions and Reserves for Islamic Insurance Companies”)

certain level of return on investment for such stakeholders (and the shareholders, as applicable) and hence is a tool for managing the rate of return risk (including the displaced commercial risk);

d. Reserve – is a component of equity (i.e., pertaining to shareholders, or non-controlling interest) or quasi-equity (i.e., pertaining to participatory profit and loss taking stakeholders such as unrestricted investment account holders) set aside by way of appropriations from respective earnings or retained earnings as well as value adjustments for the benefit of such respective stakeholders by way of managing various risks posed to such equity or quasi-equity balances or off-balance sheet items;

e. Risk reserves – are comprised of PER and IRR maintained under this standard in line with the Shari'ah requirements and contractual arrangements with respective stakeholders.

7. Different types of risks mentioned in this standard shall carry the meaning assigned to them in the relevant Islamic Financial Services Board (IFSB) Standards[2].

Frequency of assessment for adequacy of risk reserves

8. An IFI shall assess, at the end of each reporting period, the adequacy of the risk reserves established in line with the accounting policies developed according to the principles defined by this standard.

9. Notwithstanding the requirement of paragraph 8, at an interim financial reporting date, an IFI may decide to follow a quick update approach (see paragraph 10) for assessment of adequacy of risk reserves.

10. Under the quick update approach, IFI may, instead of comprehensively revisiting all estimates and computations, perform a quick analysis of significant changes in assumptions, estimates and parameters followed in the last comprehensive assessment. Unless these changes are significant, only the update of numerical values (of e.g. assets and investments balances) may be sufficient to assess the adequacy of the risk reserves at such interim financial reporting dates.

Accounting for risk reserves

Establishing accounting policies for risk reserves

11. An IFI shall develop, on the application of this standard, the accounting policies for maintaining risk reserves in line with the principles defined in this standard which shall include the risk management, risk reporting and objective risk valuation methodologies.

12. Once accounting policies are developed as required under paragraph 11, an IFI shall apply the same consistently.

[2] IFSB Standard No. 1 "Guiding Principles of Risk Management for Institutions (Other Than Insurance Institutions) Offering Only Islamic Financial Services" read with IFSB Guidance Note No. 3 "Guidance Note on the Practice of Smoothing the Profits Payout to Investment Account Holders". Most recent IFSB standards may be referred to at IFSB website.

Principal guidance for developing accounting policies for risk reserves

13. An IFI shall develop suitable accounting policies for development and maintenance of risk reserves so that:

    a. the same are expected to provide just and equitable treatment for the respective class and classes of stakeholders over longer periods of time;

    b. risk reserves are maintained at adequate level as per the IFI's risk management policy and contractual arrangements, if any; and

    c. in case of shortfall in the risk reserves, there exists a defined plan to bring the risk reserves to the adequate level, as determined by the IFI.

14. For the purpose of paragraph 13(c), suitable period for achieving the adequate level shall be defined by the IFI under the respective accounting policies (see Appendix C: Application Guidance).

Adequate level of risk reserves

Profit Equalization Reserve (PER)

15. PER maintained in line with the requirements of this standard, for each category of stakeholders, shall be considered adequate, if it is sufficient to absorb the combined monetary effect of rate of return risk and displaced commercial risk applicable to such category of stakeholders. Such combined monetary effect shall be calculated according to the respective accounting policies of the IFI. A sample computation approach is provided in Table "A" of Appendix C. Such policies shall be developed according to the best practices of risk management and shall reflect a prudent approach towards risk management.

Investment Risk Reserve (IRR)

16. IRR maintained in line with the requirements of this standard, for each category of stakeholders, shall be considered adequate, if it is sufficient to absorb the combined monetary effect of credit risk, market risk and equity investment risk applicable to such category of stakeholders. Such combined monetary effect shall be calculated according to the respective accounting policies of the IFI. A sample computation approach is provided in Table "B" of Appendix C. Such policies shall be developed according to the best practices of risk management and shall reflect a prudent approach towards risk management.

Contributions to risk reserves and their utilization and other adjustments

Contributions to risk reserves

17. Contributions to risk reserves shall be accounted for as an appropriation of the income of respective pool attributable to such stakeholders (commonly referred to as "profit and loss pool" or "investment pool").

Attribution of contributions to risk reserves

18. Contributions to risk reserves shall be attributed to respective stakeholders and shareholders in line with the contractual terms and Shari'ah principles.

19. PER shall always be created from and attributed to the income attributable to both the relevant stakeholders and the shareholders (in capacity of Mudarib or working partner, as well as, in capacity of investor in case of commingling of funds).

20. IRR shall, in line with the relevant contractual terms and Shari'ah requirements, either be:

a. created from and attributed to the income attributable to the relevant stakeholders and the shareholders (in capacity of Mudarib or working partner, as well as, in capacity of investor in case of commingling of funds); or

b. created from and attributed to the income attributable to the relevant stakeholders and the shareholders (in capacity of investor in case of commingling of funds but not in the capacity of Mudarib or working partner).

Utilization of risk reserves

21. In case of a situation mandating utilization of the respective risk reserve, the same shall be reversed (transfer-out) income of the respective pool, and shall not be directly netted-off with the respective loss.

Other adjustments to risk reserves

22. A risk reserve previously maintained may become no more needed and may require a reversal (transfer-out). This situation may arise as either of the following, and shall be recognised, when the respective event of reversal (transfer-out) occurs:

a. the amount of reserve maintained being more than the amount actually needed i.e., partial reversal (transfer-out) – whereby the event of reversal (transfer-out) is a comprehensive reassessment of the adequate level of reserve as of the given date;

b. when the respective investment instruments are liquidated in full – whereby the event of reversal (transfer-out) is the actual liquidation and full settlement of the respective investment instrument; or

c. if the IFI changes its risk management policies with respect to one or more risks for one or more categories of stakeholders being no more required or a regulatory imposition disallows maintaining such reserve.

23. Reversal (transfer-out), being partial or full, shall be recognised when the event of reversal (transfer-out) occurs. These shall be reversal (transfer-out) to the respective income from where these were created, unless a contractual term or Shari'ah principles mandates otherwise.

24. When allowed by contractual terms and Shari'ah principles, if the class of stakeholders which is beneficiary of the utilization of risk reserves is different from the class of stakeholders from whose income such reserve was originally created, appropriate disclosures of transfers and adjustments along with the justification of the same shall be made (including the Shari'ah supervisory board's opinion on its permissibility).

25. Any adjustments and transfers between reserves shall be accounted for when they occur, in line with the contractual terms or Shari'ah principles applicable, including the adjustments and transfers

required under transitional provisions of FAS 30 “Impairment, Credit Losses and Onerous Commitments”.

Presentation and disclosure

Presentation

26. The share of risk reserves attributable to each class of stakeholders shall be shown as an addition to the equity of respective class of stakeholders (normally appearing as different categories of quasi-equity), whereas any portion of the same attributable to the shareholders shall be shown in the owners’ equity.

27. The risk reserves attributable to investments kept *off-balance-sheet* shall be disclosed in the statement of *off-balance-sheet* investments.

Disclosure

28. An IFI, in respect of each type of risk reserves, for each category of stakeholders to whom they relate, shall disclose the following:

    a. the accounting policies adopted for the risk reserves and any changes thereto;

    b. a movement, providing the summary of opening and closing balances, along with the amounts attributed to such reserves by respective class of stakeholders (as well as shareholders where applicable), utilization of such reserves, return on their investment, as well as any other adjustments including transfers duly describing the nature of the same;

    c. any policy in line with contractual terms and Shari’ah principles, in respect of investment of such reserves; and

    d. the shortfall against the adequate level and the defined plan to bring the risk reserves to the adequate level, as determined by the IFI.

Effective date

29. This standard shall be effective for the annual financial periods beginning on or after 1 January 2021. Early adoption is permitted, only if the IFI decided to early adopt FAS 30 “Impairment, Credit Losses and Onerous Commitments”.

Transitional provisions

30. This standard shall become effective along with FAS 30 “Impairment, Credit Losses and Onerous Commitments” and its adoption shall be subject to the transitional provisions provided in the said standard.

Amendments to other standards

31. This standard, along with FAS 30 “Impairment, Credit Losses and Onerous Commitments”, supersedes the earlier FAS 11 “Provisions and Reserves”.

Appendices

Appendix A: Adoption of the standard

This standard was discussed in multiple meetings of the AAOIFI Accounting Board and was duly approved by circulation on 22 Ramadan 1439H, corresponding to 6 June 2018.

Members of the board

1. Mr. Hamad A. Al Oqab – chairman
2. Mr. Mohamed Bouya Ould Mohamed Fall – deputy chairman
3. Mr. Abdelhalim Elsayed Elamin
4. Dr. Abdulrahman M. Alrazeen
5. Dr. Bello Lawal Danbatta
6. Mr. Firas Hamdan
7. Mr. Hondamir Nusratkhujaev
8. Mr. Irshad Mahmood
9. Mr. Mohamed Ibrahim Hammad
10. Mr. Muhammad Jusuf Wibisana
11. Mr. Nader Yousif Rahimi
12. Dr. Saeed Al-Muharrami
13. Mr. Sulaiman AlBassam
14. Mr. Syed Najmul Hussain
15. Mr. Tarik Bolukbas

Reservation

The standard was approved unanimously.

Working group members

1. Mr. Hamad A. Al-Oqab – chairman
2. Mr. Faheem Ahmed
3. Ms. Farah Khan
4. Mr. Muhammad Nadeem Aslam
5. Mr. Yaser Mudhaffar

Executive team

1. Omar Mustafa Ansari (AAOIFI)
2. Mohammad Majd Bakir (AAOIFI)
3. Zahra Jassim AlSaraifi (AAOIFI)
4. Farida Cassim (AAOIFI)

Appendix B: Basis for conclusions

Need for a financial accounting standard on "reserves”

BC1 The board assessed the requirement for reserves including IRR and PER (or any other reserve) particularly those for safeguarding the interest of the respective stakeholders. The Board considered the matter in the light of new accounting approach and determined that there might still be a need to maintain PER and to some extent IRR (even if it is not mandatory). For IRR, the board considered that the expected losses approach and other approaches are based on the best estimates of future losses and not the worst-case scenario and certain jurisdictions have a requirement of maintaining IRR based on income rather than the balances; hence there might still be a need to maintain IRR in certain, if not all institutions. For PER however there is no debate as it is required to be maintained for managing the rate of return risk (including in particular, the displaced commercial risk). The board focused on the consistency for application of the accounting and financial reporting, if reserves are maintained rather than mandating the same as a necessary requirement, as there was a view within the Board that mandating the same would be more of a business and regulatory decision, rather than an accounting matter.

BC2 The board also considered that the existing standard does not provide any accounting treatment including the measurement guidance and rather it deals only with classification and disclosure. The board further discussed that the accounting for reserves is linked more with quasi-equity instruments rather than the asset balances so it might not be justified to include the reserves accounting in this standard. Accordingly, the board decided that there is a need for a separate standard on reserves which shall deal with these matters.

Scope

BC3 The board decided to use the term “risk reserves” as a title for the standard instead of “technical reserves”, as it is more specific and comprises the PER and IRR that are supposed to be handled under the standard. However, detailed disclosures etc. about risk will be addressed in the FAS 1 revision project. The board apprised that the accounting approach with regard to the classification and measurement used in AAOIFI FASs is at times different from conventional accounting standards. The formation of reserves under these standards cannot be applicable on the Islamic finance transactions in the same manner.

BC4 Hence, the board decided that the classification and measurement of reserves formed for various assets and balances shall be based on realistic risk-based computations, rather than arbitrary, across-the-board ratios and percentages. Risk reserves shall take into consideration the genuine impacts of risks faced by the IFI’s stakeholders in relation to their invested funds including credit, market, equity investment, liquidity, rate of return or displaced commercial risks.

BC5 The board decided to scope out operational risk as no risk reserves will be needed to mitigate a risk element that falls within the responsibilities of the IFI rather than stakeholders (mainly the profit and loss taking (at times referred to as participatory) investors). The board also decided that the standard shall not tackle prudential and systemic risks which an IFI is required to set up by law or regulations, because these are regulatory, and not accounting requirements.

Scope of reserves

BC6 The board decided to relate the amount of IRR to profit and loss taking investors as this grouping includes investment account holders (IAHs) whose funds are mobilized on the basis of a profit and loss taking arrangement such as Mudaraba, Musharaka, or investment agency, in addition to similar types of equity holdings.

BC7 IRR aims to provide a cushion against credit risk, market risk and equity investment risk mainly relating to any residual losses that may arise in the future, after accounting for impairment and credit losses as prescribed by FAS 30.

BC8 To eliminate situations of overlapping, the board decided that IRR under this standard tackles any residual future losses after accounting for impairment and credit losses in line with the requirements of FAS 30 and there shall be no duplicate recording.

BC9 The board decided that reserves will cover profit and loss taking stakeholders or investors as well as stakeholders whose participations / investments are classified as *off-balance sheet*. This will help manage various risks associated with equity, quasi-equity balances or *off-balance sheet* items. The risk reserves consist of PER and IRR as defined and scoped by this standard and in line with Shari'ah requirements and Shari'ah compliant contractual arrangements with respective stakeholders which implies that the consent of the respective stakeholder is also required.

Frequency of assessment for adequacy of risk reserves

BC10 Adequacy of risk reserves was decided to be assessed on a more frequent basis (interim reporting) using a quick update approach that involves conducting a quick analysis of significant changes in the estimates and parameters defined earlier and applied in the last assessment. This is in line with best practices and bears no Shari'ah non-compliance.

Establishing accounting policies for risk reserves

BC11 The board discussed the need for establishing accounting policies for risk reserves and decided that, in line with mainstream practices which pose no Shari'ah non-compliance, the accounting policies for risk reserves are established by the IFI once it adopts this standard either by the effective date or prior thereto in cases of early application. This should be in line with the principles set out herein, including risk management, risk reporting and risk valuation methodologies. The board determined that it is more appropriate to allow for flexibility through adoption of consistent accounting policies rather than prescribing strict rules for computation.

Principal guidance for developing accounting policies for risk reserves

BC12 The board noted that the developed accounting policies should provide just and equitable treatment for all respective stakeholders according to their respective classes over longer periods. This serves the purpose and objectives of Shari'ah as it is meant to guarantee that rights are assigned to their respective owners. The risk reserves formed under these policies should take into consideration adequacy in light of risk management framework and contractual arrangements, if available.

Reversals (transfer-out) and other adjustments to risk reserves

BC13 The board further discussed the issue of any remaining balance in reserves or allowances for that purpose, when they are no longer needed, and noted that there are different Shari'ah views on this matter. While Shari'ah supervisory boards have allowed their return to the respective stakeholders or to donate it for charitable purposes in line with the decision of their respective Shari'ah boards and in such situation, it is a business and Shari'ah matter and not an accounting matter and hence only a disclosure is required in this respect.

BC14 The board discussed the issue of any remaining balance in reserves or allowances for that purpose, when they are no longer needed, and noted that according to Shari'ah standards (SS) 40, mutual relief from commitments in case of exit should be used to the extent that the existing party relieves the accountholders from commitment towards their rights in the remaining part of the reserves for investment risks and rate of return, and the remaining part of allocations for debts. Likewise, the accountholders relieve the exiting party from commitment towards any losses that have not yet become apparent. On liquidation of the investment pool, the remaining parts of the above-mentioned reserves and allowances shall be donated to charitable purposes.

Reserves versus allowance

BC15 The board discussed the conceptual differences in maintaining reserves versus maintaining allowances against potential losses and certain risks. The board also evaluated the impact on the investment account holders and other quasi-equity instruments. The board was of the view that whatever is just and equitable as a charge under the accounting principles may be charged to the statement of income subject to the approval by Shari'ah and the consent of the investors.

BC16 The board further discussed and decided that reserves shall be maintained on an equitable and justifiable basis, over and above the established allowances (which are charged to income statement), as appropriation of the profits of respective stakeholders, subject to their consent in line with the already established Shari'ah principles.

Transitional provisions and effective date

BC17 The board discussed the issue with regard to a major impact that certain institutions may face on the initial application of FAS 30, as well as this standard, and decided that it is necessary to allow for transitional provisions. The board initially considered that the transitional provisions for this standard and FAS 30 shall be simultaneously applied, as both are significantly linked together. Particularly, the initial impacts of FAS 30 may require transfers from IRR (or at times PER) on a one time basis. However, due to market need FAS 30 was finalized earlier and was allowed to be implemented before finalization of this standard whereby, for the intervening period, risk reserve related sections of FAS 11 were considered applicable to FAS 30. The board further decided to allow an additional year in the implementation date to build reserves as needed.

Appendix C: Application guidance

The impact computations in line with the sample "Table A" and "Table B" shall be made according to the best practices of risk management.

Table A: sample computation for adequate level of PER		
	The best estimate of maximum impact of rate of return risk i.e., change in average rate of return – on asset side	A
Add:	The best estimate of maximum impact of rate of return risk i.e., change in average rate of return – on investment accounts (deposit) side	B
Add:	Additional impact of displaced commercial risk (including, where applicable, liquidity considerations) – if any	C
	Total possible impact	D=A+B+C
	The expected level of absorption of "A" by IRR related to the respective class of stakeholders – subject to the maximum amount of IRR actually maintained	E
Add:	The expected level of absorption of "A" by combined amount of allowances for credit losses, impairment, NRV adjustment and provisions developed in line with the requirements of FAS 30 "Impairment, Credit Losses and Onerous Commitments"	F
	Total expected possible impact absorption by "E" and "F" (limited to a maximum amount being equivalent to "A"	G=E+F (but in no case more than A)
	Adequate level of PER	D-G

Table B: sample computation for adequate level of IRR		
	The best estimate of maximum impact of credit risk	A
Add:	The best estimate of maximum impact of market risk – based on value at risk	B
Add:	The best estimate of maximum impact of equity investment risk – based on value at risk and the business risk	C
	Total possible impact	D=A+B+C
Less:	The expected level of absorption of "D" by combined amount of allowances for credit losses, impairment, NRV adjustment and provisions developed in line with the requirements of FAS 30 "Impairment, Credit Losses and Onerous Commitments"	E
	Adequate level of IRR	D-E

The above tables shall, in all cases, be considered as a sample computation guidance only, and IFIs are independent to adopt any suitable computation methods in line with best practices of risk management.

Guidance for determining period of building up reserves – see paragraphs 13(c) and 14

Period under which, an IFI may build-up reserves to an adequate level shall generally be linked with suitable timing which can generally be a proportion of the weighted average liquidity profile of the respective stakeholders' investments. For example, it can be a period equal to 3 or 5 times the average liquidity profile of the respective stakeholders’ investments if these are mostly short-term investment accounts. Any other suitable approach is also considered acceptable.

Appendix D: Brief history of the preparation of the standard

H1 The 2nd meeting of the AAB was held on 25 and 26 Shawwal 1437H, corresponding to 30 and 31 July 2016 in the Kingdom of Bahrain. In this meeting the board discussed the broad scope of the IFRS 9 project.

H2 In its 3rd AAB held on 22-23 Dhul-Hijjah 1437H, corresponding to 24-25 September 2016 at the AAOIFI head office in the Kingdom of Bahrain, it was decided that the development of standard for IFRS 9 would supersede the earlier FAS 11 “Provisions and Reserves”.

H3 AAB held its 4th meeting on 16-17 Rabi’ II 1438H, corresponding to 15-16 January 2017 at the premises of Islamic Development Bank (IDB), Jeddah, Kingdom of Saudi Arabia. In this meeting, one of the main areas discussed was the scoping of the standard on impairment which included IFRS 9 and related coverage, classifications of Islamic financing and investment assets, IRR and PER. This resulted in the board decision for a separate standard for Reserves. The expected implementation date was to be the same as FAS 30 ‘Impairment, Credit Losses and Onerous Commitments’.

H4 At the 6th AAB meeting held on 20-21 Shawwal 1438H, corresponding to 15-16 July 2017 at the AAOIFI head office in the Kingdom of Bahrain, it was confirmed the project on Reserve would go ahead and the need and importance of the standard was further discussed.

H5 The 1st working group meeting was held on 29 Dhul-Hijjah 1438H, corresponding to 20 September 2017 and the working group made necessary changes in the draft of the standard and advised the secretariat to incorporate such changes before taking the same to the AAB.

H6 The exposure draft of the standard along with the consultation notes were presented to the AAB at the 7th meeting held on the 2-4 Muharram 1439H, corresponding to 22-24 September 2017 in Bahrain.

H7 The standard was discussed with and reviewed by the committee of the Shari’ah board for review of accounting and governance standards in respect of conformity with Shari’ah on 23 Rajab 1439H, corresponding to 9 April 2018.

H8 The public hearings for the standard were conducted in Pakistan (Islamabad) and Bahrain during the months of February to May 2018. The exposure draft together with comments received from the public hearing events and comments and views received in writing from industry participants was presented to the working group on 27 Sha’ban 1439H, corresponding to 13 May 2018 for discussion and conclusions. After due deliberation, the working group forwarded the standard with its recommendations to the AAB for approval by circulation.

H9 AAB through a resolution by circulation, approved the standard after incorporating all changes on 22 Ramadan 1439H, corresponding to 6 June 2018.