Financial Accounting Standard No. (21)

Disclosure on Transfer of Assets

Contents

Preface

The purpose of this standard is to establish the rules that regulate the disclosure of the transfer of assets operations between different investment accounts that are conducted by the Islamic financial institutions (institution/institutions).[1]

(1) Referred to hereafter as institution or institutions including Islamic banks.

Statement of the Standard

1. Scope of the Standard

This standard shall apply to the operations of transferring assets between different investment accounts conducted by institutions. These transfers shall include the following:

1/1 The transfer of assets from Unrestricted Investment Accounts to Restricted Investment Accounts and vice versa.

1/2 The transfer of assets from Investment Accounts (Restricted or Unrestricted) to Owners' Equity and vice versa.

1/3 The transfer of assets from Restricted Investment Accounts to other Restricted Investment Accounts, taking into consideration the differences in restrictions in the accounts.

1/4 The transfer of assets from Investment Accounts and Owners' Equity to the Investment Funds and/or Special Purpose Vehicles (SPV) and vice versa.

The assets to be transferred shall include all tangible and financial assets.

Should the requirements of this standard be in conflict with the institution's charter or the laws and regulations of the country in which it operates, a disclosure shall be made of the conflict. (para. 1)

2. Disclosure Requirements in the Financial Statements

2/1 Disclosure shall be made of the accounting policies adopted in the transfer of assets from unrestricted investment accounts to restricted investment accounts and vice versa. (para. 2)

2/2 Disclosure shall be made of the accounting policies adopted in the transfer of assets from investment accounts (restricted or unrestricted) to owners' equity and vice versa. (para. 3)

2/3 Disclosure shall be made of the accounting policies adopted in the transfer of assets between restricted investment accounts. (para. 4)

2/4 Disclosure shall be made of the accounting policies adopted in the transfer of assets from investment accounts and owners' equity to the investment funds and/or special purpose vehicles (SPV) and vice versa. (para. 5)

2l5 Disclosure shall be made of the bases and reasons that govern the transfer of assets between different investment accounts. (para. 6)

2/6 Disclosure shall be made of the bases applied by the institution in valuing the assets to be transferred. (para. 7)

2/7 Disclosure shall be made of the valuation differences resulting from the transfer of assets in foreign currencies and the financial effect of these transfers. (para. 8)

2/8 Disclosure shall be made of the nature and terms of the assets transferred and whether these assets are divisible/separable and any related provisions applied. (para. 9)

2/9 Disclosure shall be made of the commitments and restrictions applied by the contractual relationship between the investment accountholders and the institution, if any. (para. 10)

2/10 Disclosure shall be made of the movement of the transfer of assets between different investment accounts (including Investment Funds and Owners' Equity), each separately, indicating the balance at the beginning of the financial period, the changes during the current period and the balance at the end of the financial period. Disclosure shall be made of the financial effect of these transfers, if any. (para. 11)

2/11 Disclosure shall be made of all transfer of assets transactions conducted with related parties, indicating the nature of the relationship, type of transactions, the total value of these transactions at beginning and end of the financial period and the financial effect. (para. 12)

3. General Disclosure Requirements

3/1 The disclosure requirements stated in Financial Accounting Standard No. (1): General Presentation and Disclosure in the Financial Statements of Islamic Banks and Financial Institutions shall be observed. (para. 13)

3/2 The disclosure requirements stated in Financial Accounting Standard No. (14): Investment Funds shall be observed. (para. 14)

4. Effective Date

This Standard shall be effective for financial periods beginning 1 Muharram 1426 A.H. or 1 January 2005 A.D. (para. 15)

Adoption of the Standard

The Standard on Transfer of Assets was adopted by the Accounting and Auditing Standards Board in its meeting No. (27) held on 20-21 Jumada I, 1425 A.H., corresponding to 8, 9 June 2004 A.D.

Members of the Board

1. Mr. Amer Sulaiman Al-Beireqdar	Chairman
2. Mr. Essa Abdullah Zainal	Deputy Chairman
3. Mr. Ebrahim Sidat	
4. Mr. David Vicary	
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12. Mr. Mohammed Said Abdel-Wahab	
13. Dr. Nordin Mohammed Zain	
14. Dr. Mohamed Nedal Alchaar	Secretary General / Rapporteur

Appendix (A)
Brief History of the Preparation of the Standard

In its meeting No. (16) held in Jeddah in Saudi Arabia on 8-9 Ramadan 1419 A.H., corresponding to 26-27 December 1998 A.D., the Accounting and Auditing Standards Board decided to give priority to the preparation of a standard on Transfer of Assets.

On Sha'ban 1423 A.H., corresponding to 9 November 2002 A.D., a consultant was commissioned to prepare a preliminary study on the accounting aspects of the standard.

The Accounting Standards Committee discussed in its meeting No. (36) held in the Kingdom of Bahrain on 22 Rabi' I, 1424 A.H., corresponding to 22 June 2003 A.D., the preliminary study and made the necessary amendments. The Committee also discussed the revised accounting study and the exposure draft of the standard in its meeting No. (37) held in the Kingdom of Bahrain on 22 Jumada I, 1424 A.H., corresponding to 23 July 2003 A.D., and requested the consultant to make the necessary amendments in light of the comments made by the members.

The revised exposure draft of the standard was discussed by the Accounting Standards Committee meeting No. (38) held in Kingdom of Bahrain on 10 Rajab 1424 A.H., corresponding to 7 September 2003 A.D., and the necessary amendments were made. The Accounting Standards Committee also discussed the revised exposure draft in its meeting No. (39) held in Kingdom of Bahrain on 2 Sha'ban 1424 A.H., corresponding to 28 September 2003 A.D., and requested the consultant to make the necessary amendments in light of the comments made by the members.

The exposure draft of the standard was discussed by the Shari'a Committee for Standards in its meeting No. (8) held in Kingdom of Bahrain on 10 Sha'ban 1424 A.H., corresponding to 6 October 2003 A.D., and some additional amendments were made.

The amended exposure draft was discussed in the Accounting and Auditing Standards Board meeting No. (26) held in the Kingdom of Bahrain on 15-16 Shawwal 1424 A.H., corresponding to 9-10 December 2003 A.D. The Accounting and Auditing Standards Board made some amendments to the exposure draft and decided that it should be distributed to specialists and interested parties to obtain their comments on the exposure draft in order to discuss them in a listening session.

The Accounting Standards Committee held its meeting No. (40) on 28 Shawwal 1424 A.H., corresponding to 22 December 2003 A.D., and its meeting No. (41) on 19 Dhul-Hajjah 1424 A.H., corresponding to 10 February 2004 A.D., in Bahrain to discuss the comments made on the exposure draft. The Committee made the necessary amendments, which it deemed necessary in light of the discussions that took place in the listening session and the Accounting Standard Board meeting.

The Accounting and Auditing Standards Board adopted the proposed standard in its meeting No. (27) held in Bahrain on 20, 21 Jumada I, 1425 A.H., corresponding to 8, 9 June 2004 A.D.

Appendix (B)
Juristic Rules for Disclosure on Transfer of Assets

The purpose of disclosures in the transfer of assets operations is to avoid affecting various existing rights, including that of the shareholders and various accounts holders. This is because transfer is (I) an execution of sale and investment (Musharaka), (II) a set-off, or (III) otherwise. The principles of Shari'a require that the outcome of executing these actions be fairly disclosed as ordered by Allah, the Almighty. It is also required that the reality in respect to the process of executing these actions is disclosed with truth as required by the Prophetic hadith regarding contracting parties…: *"...if they act truthfully and disclose (the reality), their sale contract would be blessed. But if they conceal and lie, the blessing of their sale contract would be effaced"*.(2) The institution is entrusted to reveal all rights when embarking on the process of transfer. It is thus obliged to disclose these rights to ensure that there is no flaw or injustice in the process of assigning rights. This is evidenced by the hadith that says, *"Assign each person the right he/she deserves"*.(3)

The disclosure of the valuation differences resulting from the transfer of assets in foreign currencies is a requirement of Shari'a for translating currencies so that the process of transfer does not affect rights. Here, the process of transfer is not a currency exchange; rather, it is an accounting procedure necessary to meet the above-mentioned objective.

(2) The hadith has been related by Al-Bukhari and Muslim and is narrated by Hakim Ibn Khuzam (Al-Maqdisi, *"Umdat Al-Ahkam"*, 161).

(3) The hadith has been related by Al-Bukhari and Muslim. The text was said by Salman and was approved by The Prophet (peace be upon him) when he said after this hadith: *"Salman has said the truth"*.

The disclosure that shows that the transferred assets are receptive to partition is the ground for permissibility of allocating shares in common or undivided ownership, because what is not subject to partition should be sold and the revenue be distributed between parties accordingly. The provisions assume rules of their underlying objectives and for this reason disclosure is required too.

The requirement that commitments and restrictions are disclosed is based on the principle established by the hadith: *"Muslims are bound by the conditions they made"*.(4) This is because commitments and conditions have impact on the value of a financial right.

The requirement to disclose the transfer of assets operations with the related parties is to avoid conflict of interest and this is based on the principle that blood relations affect the judicial evidence of relating parties for each other.

(4) This hadith has been related by Al-Tirmidhi who deemed it good. Also, it has been related by Al-Tabrani with different text. See: *"Fath Al-Qadir"* [6: 272].

Appendix (C)
Reasons for the Standard

The transfer of assets operations that are undertaken by IFI between restricted, unrestricted investment accounts, owners equity, investment funds and are not adequately transparent as a financial information that are required by the users of the financial statements. Currently, it is difficult to find in the financial statements disclosures on these operations, their values, reasons for the transfers or objectives and the accounting treatments. The inadequate transparency will negatively affects the faithful representation of the IFI's financial statements and hence will not assist users of financial statements in their economic decision-making.

Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) have received queries from IFIs on the accounting treatment of transfer of assets operations which trigger the need to prepare a standard on this issue. From the survey conducted on a number of IFIs, it has been revealed that there were rare disclosures on this issue and majority of IFI's considered the treatment of transfer of assets as purely management issue associated to investments managers. Therefore the inadequate disclosures confirm the differences in the financial information issued by the IFIs and hence being comparable.

Appendix (D)
Basis for Conclusions

The conclusions reached by this standard mainly emanate from the application of the objectives of financial reports and the concepts of financial accounting for Islamic financial institutions on the companies to the extent applicable. Such objectives are geared to the needs of the categories of the users of such reports as specified in the previous Statement of Financial Accounting No. (1): Objectives of Financial Accounting for Islamic Banks and Financial Institutions (Statement of Objectives), and the previous Statement of Financial Accounting No. (2): Concepts of Financial Accounting for Islamic Banks and Financial Institutions (Statement of Concepts).

Accordingly, the standard requires:

a) Disclosure of the accounting policies adopted to the transfer of assets between unrestricted investment accounts and restricted investment accounts, between investment accounts (restricted or unrestricted) and owners' equity, between the restricted investment accounts themselves and between investment accounts and owners' equity and investment funds and/or SPVs. It requires disclosure of the bases that govern the transfer of assets between different investment accounts, the nature and conditions of the assets to be transferred, the movements of the transfer between different investment accounts each separately and the financial effects of these transfers. It also requires the disclosure of reasons and importance of performing the transfers, the undertakings and restrictions applied by the contractual relationship between the investment accounts and owners' equity. This complies with the previous Statement of Concepts, which states that information should reflect a faithful representation of what it purports to represent. It also complies with the previous Statement of Objectives, which states that financial reporting shall determine the rights and obligations of all interested parties. Therefore, the disclosure of the transfers between the different investment accounts, the importance of these transfers, the conditions of these transfers and the resulting financial effects will faithfully present the financial statements by determining the rights of the concerned parties.

b) Disclosure of the bases applied in valuing the assets to be transferred, the valuation differences resulting from the transfer of assets in foreign currencies and the financial effects of these transfers, and the transfer of assets operations with the related parties. This complies with the previous Statement of Objectives which states that financial reports should provide information on the institution's economic resources and its related obligations, and the effects of transactions, and other events and circumstances on the institution's economic resources and obligations. This information should assist users of the financial statements in assessing the inherent risk of their investment.

Appendix (E)
Definitions

Transfer

The movement of assets from one investment account to another (including Investment Funds and SPVs) by way of sale or investment or clearing or others.

Tangible Assets

Any asset that is touchable or physical such as property, plants and equipments.

Financial Assets

Any asset that is:

a) Cash; or
b) Contractual right to receive cash or another financial asset from another enterprise; or
c) Contractual right to exchange financial instruments with another enterprise; or
d) Any equity instrument of another enterprise.