AAOIFI Financial Accounting Standard (FAS) 45

Quasi-Equity (Including Investment Accounts)

Contents

AAOIFI Financial Accounting Standard (FAS) 45 "Quasi-Equity (Including Investment Accounts)" is set out in paragraphs 01-54. All the paragraphs have equal authority. This standard should be read in the context of its objective and the "AAOIFI Conceptual Framework for Financial Reporting". It shall also be read in conjunction with FAS 44 "Determining Control of Assets and Business" and FAS 46 "Off-Balance-Sheet Assets Under Management".

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

Preface

PR1 Under their unique business model, Islamic financial institutions (the institutions) issue investment instruments (including maintaining investment accounts and issuing other instruments / securities) under various profit or loss sharing (or taking) arrangements. Such arrangements are usually based on Shari'ah compliant participatory structures, such as Mudaraba, Musharaka or Al-Wakala Bi Al-Istithmar.

PR2 These participatory investment instruments represent funds received by an institution for investment on behalf of the investor(s) and may or may not include restrictions regarding how such funds are invested. The relationship between the institution and such investor(s) vary according to the terms of the respective contract.

PR3 The participatory investment instruments that establish control of the institution over the underlying assets (e.g., unrestricted investment accounts) normally qualify for on-balance-sheet accounting as quasi-equity as per AAOIFI's financial reporting framework.

PR4 This standard improves upon and aligns the requirements related to financial reporting of quasi-equity.

PR5 This standard along with FAS 46 "Off-Balance-Sheet Assets Under Management" supersedes the earlier FAS 27 "Investment Accounts".

Introduction

Overview

IN1 This standard prescribes the principles of financial reporting related to the participatory investment instruments (including investment accounts) in which an Islamic financial institution (IFI / the institution) controls the underlying assets (mostly, as a working partner), on behalf of the stakeholders other than the owners' equity. Such instruments (including, in particular, the unrestricted investment accounts) normally qualify for on-balance-sheet accounting and are reported as quasi-equity.

IN2 This standard provides the overall criteria for on-balance-sheet accounting for participatory investment instruments and quasi-equity, as well as, pooling, recognition, derecognition, measurement, presentation and disclosure for quasi-equity. It further addresses financial reporting related to other quasi-equity instruments and certain specific issues.

Rationale for issuing this standard

IN3 In view of the recommendations of the comprehensive AAOIFI FASs revision project, as well as, the need for alignment of existing AAOIFI FASs, the AAOIFI Accounting Board (AAB / the board) decided to revise FAS 27 "Investment Accounts".

IN4 The initial study identified various aspects in which the financial reporting requirements needed to be enhanced and specific aspects to be covered with regard to the quasi-equity and the off-balance-sheet assets under management, separately. The board particularly considered the need for alignment with certain changes brought in by FAS 1 "General Presentation and Disclosures in the Financial Statements" and recognised the increased significance of the subject with increasing use of Al-Wakala Bi Al-Istithmar by the institutions, including the situations of commingling of funds.

IN5 In view of the same, the board concluded that there is a need of a separate standard for assets managed in a fiduciary capacity without establishing control, which are subject to off-balance-sheet accounting. The board further considered that the requirements related to quasi-equity need to be reasonably enhanced, better described and aligned with the "AAOIFI Conceptual Framework for Financial Reporting[1]" (the conceptual framework) and FAS 1 "General Presentation and Disclosures in the Financial Statements". Accordingly, the board decided that the revision project shall result in two distinct standards, addressing the financial reporting for quasi-equity and for off-balance-sheet assets under management, respectively.

Significant changes from previous standard

IN6 This standard brings significant changes from its predecessor standard (FAS 27 "Investment Accounts"), inter alia, in the following aspects:

a. the definitions and reporting requirements are aligned with the "AAOIFI Conceptual Framework for Financial Reporting" and FAS 1 "General Presentation and Disclosures in the Financial Statements";

[1] "AAOIFI Conceptual Framework for Financial Reporting"

b. the broader concept of quasi-equity has been incorporated, instead of unrestricted investment accounts thereby enhancing the scope of the standard to include other quasi-equity instruments, e.g., quasi-equity Sukuk;

c. the requirements related to off-balance-sheet assets under management (including restricted investment accounts) have been moved to a separate standard;

d. the criteria for quasi-equity have been better defined with reference to the conceptual framework and other AAOIFI FASs particularly FAS 44 "Determining Control of Assets and Business";

e. additional guidance, as considered necessary, is provided in respect of certain treatments and disclosures while applying the requirements of FAS 31 "Investment Agency (Al-Wakala Bi Al-Istithmar)" in the case of funds commingled with Mudaraba based funds and thus qualifying for quasi-equity treatment;

f. accounting requirements, where applicable, have been defined at the level of an investment pool to ensure appropriate allocation of returns to the respective stakeholders;

g. the issue of currency of investment pool, and its accounting aspects have been included in line with the Shari'ah principles and rules;

h. alignment is performed with the requirements of FAS 30 "Impairment, Credit Losses and Onerous Commitments" and FAS 35 "Risk Reserves"; and

i. additional guidance has been provided for treatment and disclosures for certain specific aspects, such as Hiba and incentives.

AAOIFI Financial Accounting Standard (FAS) 45
Quasi-Equity (Including Investment Accounts)

Objective of the standard

1. The objective of this standard is to establish the principles of financial reporting related to instruments classified as quasi-equity, such as investment accounts and similar instruments invested with the Islamic financial institutions (IFIs / the institutions). Quasi-equity is an element of financial statements of an institution in line with the "AAOIFI Conceptual Framework for Financial Reporting[2]" (the conceptual framework).

Scope

2. This standard shall apply to all instruments that meet the definition of quasi-equity held with an institution in line with the conceptual framework, including, for example:

   a. the investment accounts based on Mudaraba contracts, including investment accounts that are placed for "short-term" (including overnight, seven days or one-month basis) by other financial institutions for the purpose of liquidity management;

   b. the investment accounts or similar instruments based on Musharaka (Shirkat-ul-Aqd);

   c. Sukuk based on participatory structures that do not meet the definition of equity or off-balance-sheet assets under management (see paragraphs 39-42); and

   d. the investment accounts resultant of commingling of Al-Wakala Bi Al-Istithmar funds with the funds of other quasi-equity investment accounts meeting the requirements of paragraph 37 of FAS 31 "Investment Agency (Al-Wakala Bi Al-Istithmar)" and paragraphs 12/1 and 12/1/1 of SS 46 "Al-Wakalah Bi Al-Istithmar (Investment Agency)".

3. This standard shall not be applicable to the following instruments or contracts of financial nature:

   a. equity instruments pertaining to the shareholders of the institution (owners' equity), e.g., common share capital;

   b. managed investment funds (being a separate legal entity, independent of the institution) subject to financial reporting for investment funds under the respective AAOIFI FAS[3];

   c. off-balance-sheet assets under management, e.g., off-balance-sheet investment accounts (based on restricted Mudaraba contracts) and Wakala and Al-Wakala Bi Al-Istithmar contracts other than those referred to in paragraph 2(d); and

   d. different types of liability-based accounts, deposits or instruments, e.g., current accounts, Murabaha, commodity Murabaha, Tawarruq or other similar contracts.

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[2] AAOIFI Conceptual Framework for Financial Reporting

[3] Presently, FAS 14 "Investment Funds". Also see [ED of] FAS __ "Financial Reporting for Islamic Investment Institutions (Including Investment Funds)"

Definitions

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

   a. Agent's remuneration – comprises the fixed fee and variable remuneration (if applicable) paid or payable to the agent in case of an Al-Wakala Bi Al-Istithmar arrangement;

   b. Commingled Al-Wakala Bi Al-Istithmar funds – are the funds of the principal maintained by the agent through a multi-level investment arrangement whereby such funds are invested in the investment pool managed by the agent on a Mudaraba basis with other investment accountholders[4].

   c. Control – is as defined in the respective AAOIFI FAS[5];

   d. Current account (based on Qard) – is a non-profit bearing, guaranteed loan received by an institution with the understanding that the same amount would be repaid on demand;

   e. Investment agency (Al-Wakala Bi Al-Istithmar) instrument (or arrangement) – being a type of Wakala, is an instrument in which the principal (Muwakkil) appoints an agent (Wakeel) to carry out investment on behalf of principal with or without conditions as regards to how the funds may be invested;

   f. Investment pool – is a virtual entity[6], at times a separate reporting entity, comprising distinct assets whose risks and rewards (wholly or proportionately) are attributable to the funding provided by respective quasi-equity investor(s). [Explanation: investment pool includes the general pool, as well as, other specific pools created by an institution];

   g. Investment risk reserve (IRR) – is the amount appropriated by an institution out of the income arising from the assets pertaining to relevant participatory investor(s), 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;

   h. Mudaraba – is a profit-oriented participation between capital and work. [Explanation: Generally, in the context of an institution, it is conducted between investment accountholders as owners of capital and the institution as a Mudarib. The institution announces its willingness to accept the funds of investment accountholders, the sharing of profits being as agreed upon between the two parties, and the losses being borne by the owner of funds except if these were due to misconduct, negligence or violation of the conditions agreed upon by the institution. In the latter cases, such losses would be borne by the institution.];

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[4] See paragraph 37 of FAS 31 "Investment Agency (Al-Wakala Bi Al-Istithmar)" and paragraphs 12/1 and 12/1/1 of SS 46 "Al-Wakalah Bi Al-Istithmar (Investment Agency)".

[5] See paragraph 5 of FAS 44 "Determining Control of Assets and Business".

[6] A virtual entity comprises a distinct set of assets and liabilities pertaining to unique set of stakeholders, without taking the form of a legal entity.

i. On-balance-sheet participatory investment instruments (including investment accounts) – are the participatory investment instrument (including investment accounts) whereby an institution controls the underlying assets in line with the requirements of the relevant AAOIFI FASs, including in particular, unrestricted investment accounts;

j. Participatory investment instruments – in the specific context of this standard, include all instruments (particularly including investment accounts) whereby the investors are entitled to share / take the profit and bear the risk of loss and are entitled to a residual interest in the underlying assets or business (commonly referred to as an investment pool), in line with Shari'ah principles and rules;

k. Profit equalisation reserve (PER) – is the amount appropriated by an institution out of the income arising from the assets pertaining to participatory investors, in order to maintain a 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);

l. Quasi-equity – is an element of the financial statements that represents participatory contributions received by an institution on a profit sharing or participation basis. It has:

   i. primary characteristics of equity, i.e., in case of loss (unless negligence / misconduct / breach of contractual terms is proved), the institution is not liable to return the lost funds to the fund providers and the fund providers share the residual interest in the underlying assets or business;

   ii. certain characteristics of a liability, i.e., it has a maturity or a put option of redemption / liquidation; and

   iii. certain specific features, i.e., the rights of the fund providers are limited only to the underlying assets or business and not on the whole of the institution, as well as, they do not have certain rights associated only with owners' equity; and

m. Reserve – is a component of equity (i.e., pertaining to shareholders, or non-controlling interests) or quasi-equity (i.e., pertaining to participatory stakeholders such as unrestricted investment accountholders) 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;

Classification of investment accounts and other instruments: on-balance-sheet vs. off-balance-sheet

Assets under control of the institution: subject to on-balance-sheet accounting

5. Underlying assets of a participatory structure that are under the control of an institution in line with the requirements of respective AAOIFI FAS[7], and hence corresponding participatory investment instruments, shall be considered as on-balance-sheet.

6. The on-balance-sheet assets and corresponding participatory investment instruments shall be presented under appropriate headings in line with relevant AAOIFI FASs[8].

Judgement (of control) by the institution

7. The judgement as to whether participatory investment instruments (including investment account) are on-balance-sheet is primarily based on establishing whether the institution has control over underlying assets of such participatory investment instruments.

8. An institution shall make its judgement as to whether the underlying assets of a participatory investment instrument are under its control in line with the requirements of the respective AAOIFI FAS[9], while duly considering the following factors into account:

   a. returns generated by the available funds;

   b. frequent transfers of funds or assets between the participatory investment instruments and owners' equity;

   c. investments commingled with those of the institution; and

   d. refund of funds to holders of such participatory investment instruments at amounts that are in excess of their cash equivalent value.

Assets not under control of the institution: subject to off-balance-sheet accounting

9. Underlying assets of a participatory structure that are not under the control of an institution in line with the requirements of respective AAOIFI FAS [10], and hence corresponding participatory investment instruments, are considered as off-balance-sheet. These off-balance-sheet assets and corresponding participatory investment instruments shall be accounted for and presented in line with the requirements of the respective AAOIFI FAS[11].

Allocation of assets to investment pools pertaining to quasi-equity

10. The participatory investment instruments of quasi-equity nature (including on-balance-sheet investment accounts) shall be classified and pooled together in one investment pool(s) or more.

[7] FAS 44 "Determining Control of Assets and Business"
[8] FAS 1 "General Presentation and Disclosures in the Financial Statements" and other relevant AAOIFI FASs
[9] FAS 44 "Determining Control of Assets and Business"
[10] FAS 44 "Determining Control of Assets and Business"
[11] FAS 46 "Off-Balance-Sheet Assets Under Management"

11. Each investment pool shall have distinct assets, liabilities (in rare cases), revenues (including gains) and expenses (including losses), as well as, distinct sources of funding including quasi-equity and owners' equity (where applicable).

12. Owners' equity may be contributed to an investment pool either directly through equity (including through reserves) or through other funds available at owners' disposal, being under their liability, e.g., current accounts. An investment pool may also have reserves attributable to quasi-equity and / or owners' equity.

13. An institution shall allocate each participatory investment instrument to a specific investment pool at the time of initial recognition (see paragraphs 15-21). Similarly, whenever a new financing or investment asset is created, the same shall be allocated immediately to an investment pool or to the owners' equity, depending on the source of funding used (or allocated).

14. In case of transfer of quasi-equity instrument or underlying assets from one investment pool to another, the requirements of the respective AAOIFI FAS on transfer of assets[12] shall be followed.

Recognition, measurement and derecognition

Initial recognition

15. An institution shall initially recognise the participatory investment instruments of a quasi-equity nature, when the following criteria are met:

    a. cash or cash equivalents have been received by the institution under a legally enforceable contract meeting the definition of quasi-equity; or

    b. when funds received under another contract (which is not eligible to be accounted for as quasi-equity per se) are transferred to, or commingled with, the quasi-equity becoming eligible to be accounted for as quasi-equity under the requirements of the respective AAOIFI FAS[13]; and

    c. the respective contract has no other precondition to come into effect.

16. The initial recognition of the quasi-equity shall be at the fair value of the consideration received on the date the contract becomes effective.

17. Where the institution keeps the funds received for quasi-equity in a current or similar account, on a temporary basis, the quasi-equity shall be recognised at the time:

    a. the contract becomes effective; and

    b. the funds are transferred to the investment pool.

[12] FAS 47 "Transfer of Assets Between Investment Pools"

[13] For example, the funds received under Al-Wakala Bi Al-Istithmar are commingled with unrestricted investment accounts (see paragraphs 37-38 of FAS 31 "Al-Wakala Bi Al-Istithmar (Investment Agency)".

Accounting for underlying assets

18. New assets acquired by the investment pool, and investments made therein, shall be recognised, measured and valued according to relevant AAOIFI FASs applying the respective accounting policies consistent with the accounting policies of the institution.

19. Assets acquired through transfer from other pools (or from the owners' equity) shall be recognised, measured and valued according to the accounting policies developed and consistently applied in line with the Shari'ah principles and rules[14] and the requirements of the respective AAOIFI FAS[15].

20. Accounting and financial reporting for such transfers shall be made according to the requirements of this standard and the respective AAOIFI FAS[16].

21. An institution may keep cash (or cash equivalents) available in the investment pool to comply with the regulatory requirements (including liquidity management norms), in line with contractual arrangements.

Accounting subsequent to initial recognition

22. Subsequent measurement of participatory investment instruments of quasi-equity nature at the end of a reporting period shall be made on the basis of underlying assets and performance of the respective investment pool.

23. The following adjustments are generally made to initially recognised periodic balances:

    a. additional funds received during the period;

    b. any share of profits allocated and reinvested;

    c. withdrawals / divestments and maturities during the period;

    d. net profits or (losses) during the period including impairments (net of reversals);

    e. transfers (to) / from the reserves; and

    f. institution's share of profit / loss (in different capacities, adjusted for Hiba, etc.) or fee (fixed and / or variable, as applicable) – on a net basis.

Net profit or net loss determination

24. The net profits and / or net losses of each investment pool shall be computed applying the respective accounting policies of the institution (or mutually agreed accounting policies, in certain circumstances), in line with relevant AAOIFI FASs, considering each pool as a virtual reporting entity.

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[14] Timing and valuation of such transfer of the assets are considered to be business decisions made in accordance with relevant Shari'ah principles and rules, regulatory requirements and contractual arrangements.
[15] FAS 47 "Transfer of Assets Between Investment Pools"
[16] FAS 47 "Transfer of Assets Between Investment Pools"

25. The following are deducted from the investment pool before the allocation of the profits to the institution as Mudarib or equivalent:

   a. net transfer to profit equalisation reserve, or other special reserves created specifically for the quasi-equity in line with the requirements of the respective AAOIFI FAS[17] (also see paragraph 29); and

   b. net transfer to any fair value reserves arising on fair valuation of the underlying assets in line with the requirements of relevant AAOIFI FASs (irrespective of being classified as at fair value through statement of income or at fair value through other comprehensive income), which according to the mutual agreement, or according to Shari'ah principles and rules, are not considered presently distributable. Such reserves shall be recorded and presented separately in line with the requirements of this standard.

26. Net profits are appropriated between holders of quasi-equity instruments and the owners' equity in the following sequence:

   a. proportionately based on the relative amount of funds invested by the quasi-equity and the owners' equity in the respective investment pool; and

   b. out of the proportionate share of quasi-equity (as computed according to (a) above), at the contractual ratio of the Mudarib's share of profits as a Mudarib (or in other capacity, as applicable).

27. Net losses are allocated between holders of quasi-equity instruments and the owners' equity proportionately based on the relative amount of funds invested by each party in the respective investment pool.

28. Appropriated but unpaid profits, due for payment to quasi-equity, shall be accounted for as follows:

   a. appropriated, but not due for payment, shall be considered either reinvested or retained in the respective investment pool – with or without eligibility for returns, in line with the contractual arrangements;

   b. appropriated, and due for payment, which are not reinvested as per mutual agreement shall be recognised and disclosed as a liability by the institution;

   c. appropriated, and due for payment, which are reinvested as per mutual agreement shall be either retained in the same investment pool or may be transferred to another investment pool and reported as quasi-equity, if so prescribed by the respective contractual arrangements.

29. A part of unpaid or undistributed profits or gains may be set aside from the investment pool in the form of IRR in line with the requirements of the respective AAOIFI FAS[18]. In such cases, the IRR shall remain part of the investment pool till it is utilised or reversed (transferred) out / to the income from which it was created.

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[17] FAS 35 "Risk Reserves"

[18] FAS 35 "Risk Reserves"

Impairment and credit losses attributable to quasi-equity

30. Impairment and credit losses attributable to the underlying assets corresponding to the quasi-equity shall be taken to the statement of income and attributed to the respective investment pool.

31. Loss resulting from transactions in an investment pool (that is recognised during a period other than that in which final settlement of the quasi-equity is made) should:

    a. initially, where available, be adjusted against available IRR (through reversal of IRR);

    b. then, be charged to the income of the respective investment pool;

    c. then, if inevitable, be deducted from the respective quasi-equity and the owners' equity, proportionately according to each party's contribution to the joint investment.

32. Loss due to misconduct or negligence on the part of the institution, as established in line with the Shari'ah principles and rules, shall be borne by the institution, and hence shall not be recorded as a loss in the investment pool.

Derecognition

33. Participatory investment instruments of quasi-equity nature are derecognised when they satisfy the following criteria:

    a. the equivalent value of the underlying assets (either as per the constructive liquidation according to the respective accounting policies, or the exit value as mutually agreed in line with the terms of the contract) is determined and fully settled and discharged by the institution or transferred to another (current or investment) account on the instructions of the quasi-equity holder; and

    b. the underlying contract is terminated and there are no further legally enforceable obligations.

Revocation of the contract

34. If the underlying contract of quasi-equity (e.g., Mudaraba contract) is revoked due to non-fulfilment of its terms and conditions by the institution, returning the funds become a liability of the institution (kept on trust, till repaid). The same shall be transferred to, and reported as, a liability.

35. The value of the fund on the date of revocation shall be measured in accordance with paragraph 33(a).

Commingling of Al-Wakala Bi Al-Istithmar

36. An institution, acting in the capacity of an agent, may maintain multi-level investment arrangements. An example of such an arrangement is the investment of funds received by the institution through an Al-Wakala Bi Al-Istithmar arrangement by commingling the funds in the investment pool managed by the institution (on a Mudaraba basis). In such a case:

    a. the funds received under the investment agency arrangement, and invested in the investment pool shall be considered as investment made by an investment accountholder(s)

– being the principal(s) of the investment agency arrangement in this case. The investment agent has merely taken a decision about where to invest these funds;

b. the fund invested (or commingled) in the investment pool shall remain under the ownership of the principal, who will be responsible for any risk or reward consequent to the investment. Commingling, in such a case, does not signify control over the funds; and

c. in line with the requirements of paragraph 12/1/1 of AAOIFI SS 46 “Al-Wakalah Bi Al-Istithmar (Investment Agency)”, the profit on the Mudaraba investment pool (before Mudarib’s share) will be shared between all investors (including the principal(s) of the investment agency arrangement) according to the standard method of profit allocation.

37. The primary transaction of the arrangement referred to in paragraph 36 shall be recognised in line with the respective AAOIFI FAS[19].

38. The secondary transaction, where the funds based on Al-Wakala Bi Al-Istithmar are commingled in the investment pool, shall be recognised in the books of account of the institution as a part of quasi-equity.

Quasi-equity Sukuk and other instruments

Quasi-equity Sukuk

39. There is a rebuttable presumption that Sukuk structured on a Musharaka and Mudaraba basis shall be classified as quasi-equity, if these do not meet the criteria for classification as equity or for accounting as off-balance-sheet assets under management.

40. Certain Sukuk structured on the basis of Al-Wakala Bi Al-Istithmar that do not meet the criteria of off-balance-sheet accounting shall be classified as on-balance-sheet quasi-equity Sukuk[20], if they meet the criteria described in paragraph 15.

41. The accounting treatments prescribed in the respective AAOIFI FAS[21] applicable to Sukuk issuance shall be applicable in priority to the requirements of this standard.

Other instruments of quasi-equity

42. General requirements of this standard shall apply to all types of quasi-equity. However, the following specific requirements shall be applicable on instruments of quasi-equity, other than investment accounts:

a. instruments of quasi-equity other than investment accounts shall be separately disclosed in the financial statements; and

b. their significant terms and conditions shall be disclosed in case such instruments are material in amount.

[19] FAS 31 “Al Wakala Bi Al-Istithmar (Investment Agency)”
[20] [Revised ED of] FAS 29 “Sukuk in the Books for the Originator”
[21] [Revised ED of] FAS 29 “Sukuk in the Books for the Originator”

Currency for quasi-equity

43. Quasi-equity instruments (including investment accounts) might be denominated in different currencies. In case of application of more than one currency, an institution shall clarify the currency of each investment pool, whereby the quasi-equity denominated in each currency shall be attributed to the respective investment pool only. Generally, all underlying assets of the respective investment pool shall also be denominated in the same currency.

44. In case where the currency of investment pool is different from the currency of denomination of the quasi-equity or the currency of denomination of one or more of the underlying assets, the following shall apply:

    a. any underlying assets in a different currency shall be converted and accounted for in the respective currency of the investment pool, whereby any exchange difference on the translation of underlying assets on a periodic basis (for the purpose of constructive liquidation) shall be attributable to the investment pool; and

    b. any quasi-equity shall be converted in the respective currency of the investment pool once received, and henceforth shall be accounted for in a manner as if it was always in the currency of the investment pool. Any withdrawals and maturities shall take place by converting the respective balances in the currency of investment pool to the currency of original investment (if required contractually) at the rates of exchange prevailing at the time of withdrawals or maturities.

Presentation and disclosures

Presentation

45. The quasi-equity, including the investment accounts, shall be presented in the statement of financial position of an institution placed between the owners' equity and liabilities, categorised into line items based on the respective nature of the instruments and their materiality.

Statement of income and attribution to quasi-equity

46. An institution shall prepare and present a statement of income and attribution to quasi-equity in line with the requirements of the respective AAOIFI FAS[22], as well as, with the requirements of this standard.

Disclosures

47. The general disclosures prescribed in FAS 1 "General Presentation and Disclosures in the Financial Statements" shall be applicable on the quasi-equity accounts and other instruments.

48. Accounting policies in respect of the following matters shall be disclosed:

    a. the bases applied by the institution in the allocation of profits between the different stakeholders, including the Mudarib and unrestricted investment accounts (URIA);

    b. the bases applied by the institution for charging expenses to URIA;

[22] See paragraph 148 of FAS 1 "General Presentation and Disclosures in the Financial Statements".

c. the bases applied by the institution for charging provisions, including impairment and credit losses;

d. the funds in the nature of current account held by the institution that are invested in the investment pool;

e. the bases of giving priority to a party (owners' equity or quasi-equity) while making investments in case the institution is unable to utilise all funds available for investment;

f. policies related to transfer of assets between investment pools and different categories of stakeholders, in line with the requirements of the respective AAOIFI FAS[23];

g. different types of Hiba; and

h. the parties to whom provisions for non-performing accounts revert once they are no longer required.

49. The following significant information shall be disclosed:

a. description of the range of products, and the general characteristics of investors for whom these products are suitable for;

b. brief description of account opening, redemption and distribution of profit mechanism;

c. governance and Shari'ah compliance arrangements applicable to the quasi-equity accounts and instruments;

d. investment policy;

e. policy to establish reserves (including prudential reserves) and the policy of creation and maintenance of PER, IRR and any other reserve; and

f. the treatment of quasi-equity from regulatory capital adequacy / maintenance perspective, particularly where specific treatment / flexibility is applicable.

50. The following disclosures shall be made:

a. the minimum percentage of quasi-equity accounts that the institution has agreed with the accountholders, in line with Shari'ah principles and rules, to invest in order to produce returns for them (see paragraph 21);

b. total administrative expenses charged to quasi-equity accounts along with a brief description of their major components;

c. minimum and maximum percentages (weightages) for profit allocation between Mudarib and the quasi-equity accounts that were applied in the current financial period, in cases where amounts are material;

[23] FAS 47 "Transfer of Assets Between Investment Pools"

d. the percentage(s) of profit charged by the institution as Mudarib during the financial period;

e. in case where the current accounts have been included in the investment pool for investment purposes, the return earned on these current accounts and its respective allocations;

f. the types, amounts and bases of sharing of revenue in cases where the institution is sharing revenue from banking operations (e.g., fee and commission income) with quasi-equity accountholders;

g. in case where the institution is unable to utilise all funds available for investment, the party to which priority was given (owners' equity or quasi-equity) while making investments and amongst the investment pools;

h. in case cash or cash equivalents are kept as assets of the investment pools related to quasi-equity as a regulatory requirement or for liquidity risk management purposes, in line with the relevant contractual agreements, the ratio and / or the amount of the same (also see paragraph 50(a) and paragraph 21); and

i. the amount and description of any incentive / Hiba.

51. The following quantitative ratios shall be disclosed:

a. the ratio between the total PER and total IRR to the total investment pool, distinct for each investment pool;

b. ratio of profit distributed by each type of quasi-equity investment account; and

c. average rate of return of quasi-equity investment accounts classified on the basis of maturity.

52. The following disclosures shall be provided for the commingled Al-Wakala Bi Al-Istithmar:

a. the amount of Al-Wakala Bi Al-Istithmar funds commingled, as at the end of period;

b. the amount (and rate) of profit distributed to such funds, classified for each class of investors, unless undue costs and resources are required to collect such information;

c. the amount of Wakala fee, both fixed and variable, receivable against the commingled Al-Wakala Bi Al-Istithmar by the institution; and

d. the amount of any form of Hiba distributed to the commingled Al-Wakala Bi Al-Istithmar.

Effective date

53. This standard shall be effective for the financial reporting periods beginning on or after 1 January 2026. Early adoption is encouraged.

Amendments to other standards

54. This standard along with FAS 46 “Off-Balance-Sheet Assets Under Management” supersedes FAS 27 “Investment Accounts”.

Appendices

Appendix A: Adoption of the standard

This standard was presented for approval in the 36th AAOIFI Accounting Board meeting held on 12-13 Jumada II 1445H, corresponding 25-26 December 2023 and was duly approved.

Members of the board

1. Mr. Hamad Abdulla Al Oqab – chairman
2. Mr. Syed Najmul Hussain – deputy chairman
3. Mr. Abdelhalim Elsayed Elamin
4. Mr. Abdulmalik Alsuwayni
5. Dr. Abdulrahman M. Alrazeen
6. Ms. Amal Al Masri
7. Dr. Bello Lawal Danbatta
8. Mr. Firas Hamdan
9. Mr. Hondamir Nusratkhujaev
10. Mr. Imtiaz Ibrahim
11. Mr. Irshad Mahmood
12. Dr. Muhammad Albeltagi
13. Mr. Saud Al Busaidi
14. Mr. Sezayi Toprak
15. Mr. Yusuf Ahmed Ibrahim Hasan

Reservation

The standard was approved unanimously.

Working group members

1. Ms. Amal Al Masri – chairperson
2. Mr. Ali Chreif
3. Dr. Anwar Misbah Soubra
4. Mr. Dalip Kaul
5. Mr. Imtiaz Ibrahim
6. Dr. Inza Putra
7. Mr. Jamil Ahmed Shaikh
8. Mr. Mahesh Balasubramaniam
9. Mr. Mohammed J. Hassan Ebrahim
10. Mufthi Irshad Ahmed Aijaz
11. Mr. Muhammad Islam Ahmed
12. Mr. Pravin Manik
13. Mr. Saud Al Busaidi
14. Dr. Yosita Nur Wirdayanti
15. Mr. Yusuf Ahmed Ibrahim Hasan

Executive team

1. Mr. Omar Mustafa Ansari (AAOIFI)
2. Mr. Mohammad Majd Bakir (AAOIFI)
3. Mr. Haroon Tabraze (Senior Consultant-Researcher)
4. Ms. Farida Cassim (AAOIFI)
5. Ms. Saira Shamsie (Senior Consultant-Researcher)

Appendix B: Basis for conclusions

Concept and classification of quasi-equity

BC1 The first and foremost reason for the development of this standard considered by the AAOIFI Accounting Board (the board) was alignment with the newer AAOIFI pronouncements, introducing and clarifying the concept of quasi-equity which addresses the fundamental characteristic of Islamic finance business model (particularly, the Islamic banking model) based on participation. The concept of quasi-equity is unique to Islamic finance, and hence is normally considered as a fundamental difference between the AAOIFI's financial accounting framework and the generally accepted accounting principles.

BC2 The basis for conclusion of the “AAOIFI Conceptual Framework for Financial Reporting" with regard to the classification of quasi-equity (see paragraphs BC18-BC22) are considered relevant for the purpose of understanding the conceptual underpinnings behind this standard.

Scope: accounting for the holders of / investors in quasi-equity instruments

BC3 A question arose as to whether the standard should encompass the accounting treatment in respect of quasi-equity for counterparties (i.e., the holders of / investors in the quasi-equity instruments), in addition to the accounting treatment for the institutions.

BC4 The board contemplated the matter, especially in light of the strategy applied by the board for developing the new AAOIFI FASs, duly applied in respect of most of the recently issued FASs, e.g., FAS 28 “Murabaha and Other Deferred Payment Sales” and FAS 32 “Ijarah”, whereby each of such FASs provide the accounting treatments for the counterparties.

BC5 After due deliberation, the board clarified that this standard's objective and scope pertain solely to institutions who issue quasi-equity instruments. Therefore, it was concluded that accounting guidelines for the counterparty shall not be provided, which are partially discussed in relevant AAOIFI FASs addressing different types of participatory structures (some of which are presently undergoing a revision process).

Scope: Sukuk based on participatory structures eligible to be classified as equity

BC6 The working group and the board, deliberated as to whether, and to what extent, it would be appropriate to include the Sukuk based on participatory structures eligible to be classified as equity within the scope of this standard. This was considered particularly significant in the situations where such Sukuk have the characteristics similar to those of quasi-equity (till the time the additional conditions related to subordination, perpetuity and / or convertibility are invoked), and at times these Sukuk share the underlying assets of the investment pools pertaining to the quasi-equity.

BC7 After due deliberation the board concluded that this issue needs to be addressed in the [ED of] FAS 29 “Sukuk in the Books for the Originator”, since the title and the scope of this standard are primarily quasi-equity and hence, it does not seem appropriate to include the accounting for the equity-type Sukuk in this standard. Moreover, it may create confusion regarding the classification of such equity-type Sukuk for the purpose of presentation in the financial statements.

BC8 The board further concluded that Sukuk based on participatory structure classified as equity, insofar as and to the extent (and till the time) that, such Sukuk carry the characteristics of quasi-equity instruments and / or have funds commingled with the investment pools pertaining to quasi-equity, untill the issuance of final FAS 29 “Sukuk in the Books of the Originator” shall be subject to the requirements of this standard in line with the hierarchy defined in paragraph 7 of “AAOIFI Conceptual Framework for Financial Reporting” (being a FAS on similar matters), with regard to initial recognition, subsequent measurement and disclosures (but not presentation and classification).

Applicability of this standard to Takaful institutions

BC9 The board considered as to whether this standard shall be applicable to the Takaful institutions, particularly with regard to the participants’ investment funds (PIFs).

BC10 After due deliberations, the board reiterated the conclusions reached while developing the respective AAOIFI FAS[24], whereby PIFs shall generally be considered as off-balance-sheet managed assets, as these do not meet the criteria for control. However, in rare circumstances, if they meet such criteria (particularly, on account of commingling), these may be subject to accounting as on-balance-sheet quasi-equity instruments, in line with the requirements of this standard.

BC11 Moreover, the board concluded that since Sukuk based on participatory structures are partially subject to requirements of this standard, hence, the Takaful institutions, should follow the requirements of this standard if they issue Sukuk based on such structures. (Also see paragraphs BC7-BC10 of FAS 42 “Presentation and Disclosures in the Financial Statements of Takaful Institutions”).

Commingling of Al-Wakala Bi Al-Istithmar based funds with URIA

BC12 The board noted a growing trend of commingling of funds procured by the institutions on the basis of Al-Wakala Bi Al-Istithmar with those of unrestricted investment accounts (URIA), specifically in certain markets adopting AAOIFI FASs. Al-Wakala Bi Al-Istithmar, when considered independently, does not meet the criteria for on-balance-sheet presentation according to the relevant AAOIFI FASs[25], and hence does not meet the definition of quasi-equity. This is because the institution does not establish control over these funds. However, specific circumstances outlined in the respective AAOIFI FAS[26] prescribe an on-balance-sheet accounting treatment in case of such commingling, by virtue of investment of such funds in quasi-equity based investment pool.

BC13 AAOIFI secretariat, in the recent past, received multiple queries / observations from the market players on this issue seeking clarification and further guidance with regard to financial reporting aspects of such commingled funds. In order to address such inquiries, the board’s Technical Advisory and Interpretation Committee (TAIC) issued TR 01/2020 “Implementation guidance for AAOIFI FAS 31 “Investment Agency (Al-Wakala Bi Al-Istithmar)””, providing implementation guidance in respect of such commingled funds in the light of FAS 31 "Investment Agency (Al-Wakala Bi Al-Istithmar)”, besides certain other matters related to Al-Wakala Bi Al-Istithmar.

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[24] FAS 42 “Presentation and Disclosures in the Financial Statements of Takaful Institutions”. Particularly, see paragraph BC39.
[25] FAS 31 "Investment Agency (Al Wakala Bi Al-Istithmar)" and FAS 44 “Determining Control of Assets and Business”
[26] See paragraphs 37-38 of FAS 31 "Investment Agency (Al Wakala Bi Al-Istithmar)".

BC14 While developing this standard, the board decided to broadly include certain clarifications / guidance with regard to accounting for such commingled funds as contained in the earlier TR 01/2020 “Implementation guidance for AAOIFI FAS 31 "Investment Agency (Al-Wakala Bi Al-Istithmar)”” to eliminate potential ambiguity (see paragraphs 37-39). As a result, TR 01/2020 “Implementation guidance for AAOIFI FAS 31 “Investment Agency (Al-Wakala Bi Al-Istithmar)”" stands withdrawn.

Accounting requirements for investment pool

BC15 During the preliminary study, the board noted that the earlier FAS 27 "Investment Accounts" briefly discussed the approach towards the subsequent measurement of the investment accounts, without prescribing appropriate details with regard to the accounting for the respective investment pool (comprising of the underlying assets), which shall be the basis of determination of respective profits and losses attributed to such investment account, and hence impacting the subsequent measurement of the same.

BC16 The board further noted that while it is generally understood that the respective assets, liabilities, gain and losses, revenues and expenses related to different investment pools are to be kept separate, in an appropriate manner, and accounted for in line with the requirements of the Shari’ah principles and rules and the respective contractual arrangements, yet this matter was not explicitly prescribed in the earlier standard. The board, moreover, considered the significance of Shari’ah compliance aspects related to the appropriateness of such financial reporting.

BC17 As a result, the board decided to introduce a dedicated section to address the accounting for investment pools, whereby the subsequent measurement of the respective quasi-equity shall emanate from the performance and appropriate financial reporting of the respective investment pool, hence enhancing clarity, transparency and Shari’ah compliance in this critical aspect.

Appendix C: Brief history of the preparation of the standard

H1 The AAB held its 26th meeting on 28-29 Rabi' I 1443H, corresponding to 3-4 December 2021. In this meeting the board agreed on the initial output of revision FAS 27 "Investment Accounts". The initial output was agreed to be one standard on quasi-equity (including investment accounts) and one on off-balance-sheet assets under management.

H2 The working group in its 1st meeting held on 27 Rabi' I 1443H, corresponding to, 2 November 2021 discussed the revised scope, content and output of the standard.

H3 The working group in its 2nd meeting held on 8 Rajab 1443H, corresponding to, 9 February 2022 discussed the preliminary study and approved the revised scope of the standard. The working group also concluded that the output of FAS 27 "Investment Accounts" would comprise a standard on quasi-equity (including investment accounts) and a separate standard on off-balance-sheet assets under management.

H4 The working group in its 3rd meeting held on 6 Sha'ban 1443H, corresponding to, 9 March 2022 discussed the first version of the draft standard on quasi-equity (including investment accounts).

H5 The working group in its 4th meeting held on 20 Sha'ban 1443H, corresponding to, 23 March 2022 discussed the updated draft based on initial comments and observations. After making necessary changes the second draft was recommended to the board.

H6 The AAB held its 27th meeting on 27-28 Sha'ban 1443H, corresponding to, 30-31 March 2022. The board requested specific changes and approved, in principle, the exposure draft for issuance.

H7 After incorporation of the specified changes, the exposure draft was issued on 6 Jumada II 1444H, corresponding to 30 December 2022.

H8 A total of three public hearings (two in English language and one in Arabic language) for the exposure draft were held over the period between March 2023 and December 2023.

H9 The AAOIFI Public Interest Monitoring Consultative Committee (PIMCC) held its 5th meeting on 17 Dhul-Qa'dah 1444H, corresponding to 6 June 2023. No major comments were raised on the exposure draft from the public interest perspective.

H10 The committee of the Shari'ah board for review of accounting and governance standards held its 39th meeting on 16 Rabi' II 1445H, corresponding to 1 November 2023 where the exposure draft was discussed duly taking the views for conformity with AAOIFI Shari'ah standards.

H11 A Roundtable for the standard was held on 1 Jumada I 1445H, corresponding to, 15 November 2023.

H12 The working group in its 10th meeting held on 28 Jumada I 1445H, corresponding to, 12 December 2023 discussed all comments received from public hearings along with the views and comments from different industry participants on the exposure draft. After making necessary changes the standard was recommended to the board for final approval.

H13 The AAB held its 36th meeting on 12-13 Jumada II 1445H, corresponding to, 25-26 December 2023. The board deliberated on the changes suggested by the working group and the standard was approved for final issuance.

H14 After completion of the due process, the standard was issued on 18 Jumada II 1445H, corresponding to, 31 December 2023.