

**Financial Accounting Standard No. (14)**

# **Investment Funds**



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## Preface

This standard covers the form and content of financial statements of investment vehicles or investment funds,<sup>(1)</sup> which are established and managed according to Shari'a rules and principles. The Standard also covers the accounting rules for the recognition, measurement and presentation of the assets, liabilities, revenues and expenses of these Funds in their financial statements, and the related disclosures.

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(1) Referred to hereafter as Fund or Funds to represent the investment vehicles that are known as Funds or Portfolios.

## Statement of the Standard

### 1. Scope of the Standard

This standard shall apply to funds which are established and managed in accordance with Shari'a rules and principles, and are financially independent of the institutions that establish them. The Funds may or may not be managed by the institutions that establish them, and may or may not be separate legal entities. Various investors contribute to the capital of these funds in the form of shares or units of equal value, which represent ownership claims to the assets of the Funds and entitlement to profits or losses.

This standard shall not apply to:

- a) Funds that are accounted for in the statement of financial position of the establishing institution; and
- b) Funds of restricted investment accounts that are not in the form of shares or units.

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

### 2. General Provisions

#### 2/1 The complete set of financial statements

The complete set of financial statements to be prepared by Funds should consist of the following:

- a) Statement of Net Assets.
- b) Statement of Portfolio Investments, Receivables and Financing.
- c) Statement of Operations.
- d) Statement of Changes in Net Assets or Statement of Cash Flow.
- e) Statement of Selected Financial Highlights.
- f) Notes to the financial statements.

- g) Report of the Shari'a supervisory board as stated in the Governance Standard for Islamic Financial Institutions No. (1): Shari'a Supervisory Board: Appointment, Composition and Report.
- h) Any other statements, reports or schedules, which assist in providing information required by users of financial statements. (para. 2)

**2/2 Comparative amounts in the financial statements**

The Fund shall present comparative financial statements, which include the financial statements of the comparable prior period. The presentation methods and disclosures in the published comparative financial statements should enable the users to differentiate between actual changes and changes in accounting policies in the Fund's financial statements. (para. 3)

**2/3 The form and classifications of the financial statements and the terminology used therein**

The form and classification used in the financial statements shall ensure a clear presentation of their content. In addition, the terminology used to express the content of the financial statements shall enable their users to understand the information contained therein. (para. 4)

**2/4 Numbering of pages and notes**

Pages containing the financial statements and related notes shall be numbered consecutively. Notes to the financial statements shall be given clear titles and should be cross-referenced to the related items in the financial statements. (para. 5)

**2/5 Notes are an integral part of the financial statements**

Notes to the financial statements are considered an integral part thereof. The following statement shall appear on the bottom of every page containing the financial statements:

"The attached notes from number (x) to number (y) form an integral part of the financial statements".

In addition, notes shall be set forth immediately after the last page containing the financial statements. (para. 6)

### **3. Statement of Net Assets**

3/1 The statement of net assets shall comprise all assets and liabilities at the end of the financial period, segregated by main classifications. A section at the bottom of this statement shall be reserved for the presentation of the Fund's shares/units and the net asset value per share/unit at the end of the financial period. (para. 7)

3/2 Accounting policies used in valuing assets and liabilities shall be consistently applied. In case of a change in these policies, a disclosure to this effect shall be made including the reasons for and the effect of the change in the current financial period, if material. (para. 8)

3/3 Net asset value per share/unit is the amount of net assets attributable to each share/unit at end of the financial period. Net asset value per share/unit shall be calculated by dividing net assets by the number of outstanding shares/units. (para. 9)

3/4 The following categories shall be reported consecutively under assets:

- a) Cash and cash equivalents;
- b) Investments (for the purpose of income or trading);
- c) Receivables (for example, Murabaha receivables, Salam receivables, Istisna'a receivables);
- d) Financing;
- e) Any other assets. (para. 10)

3/5 Cash and cash equivalents shall include:

- a) Cash balances in hand and bank balances;
- b) Short-term investments, in both the Fund's reporting currency and foreign currencies.

Disclosure shall be made in the notes to the financial statements of any restrictions regarding the use of cash balances. (para. 11)

3/6 Investments shall be reported as a separate classification, and shall be measured at their cash equivalent values. If the cash equivalent value is not available, investments shall be measured at their net book value. Disclosure shall be made in the notes to the financial



statements of the gross book value of investments and their related valuation provisions. (para. 12)

3/7 Disclosure shall be made in the notes to the financial statements of the accounting policies used by the Fund to measure its investments. (para. 13)

3/8 Receivables shall be measured at their cash equivalent values, which is the historical cost less provision for doubtful debts and deferred income. (para. 14)

3/9 Receivables shall be reported as a separate classification, and a disclosure shall be made in the notes to the financial statements of their nature, terms, maturity, guarantees for collection, any valuation provisions in relation thereto, and any restrictions thereon (for example, for purposes of clearance or distraintment for liquidation). (para. 15)

3/10 Financing shall be reported as a separate classification, and shall be measured at its cash equivalent value. If the cash equivalent value is not available, financing shall be measured at its net book value. Disclosure shall be made in the notes to the financial statements of the gross book value of financing and the related valuation provisions. (para. 16)

3/11 Other assets shall be reported as a separate classification. If material, each item of other assets shall be disclosed separately in the notes to the financial statements (for example, prepaid expenses and taxes and pre-operating expenses). (para. 17)

3/12 Assets denominated in foreign currency shall be translated into the Fund's reporting currency at the prevailing exchange rates on the date of the financial statements. (para. 18)

3/13 Disclosure shall be made in the notes to the financial statements of the accounting policy for pre-operating expenses. (para. 19)

3/14 The following categories shall be reported separately in the order in which they are stated, under liabilities, if material:

- a) Accounts payable (for example, shares/units redeemed but not paid for, securities purchased on credit, and directors' or trustees' fees payable);
- b) Accrued liabilities (for example outstanding commitments); and
- c) Other liabilities (for example prepaid revenues, dividends and distributions payable).

Disclosure shall be made in the notes to the financial statements of the nature and terms of these liabilities. (para. 20)

3/15 Disclosure shall be made in the notes to the financial statements of information relating to the Fund's shares or units according to type. The disclosure shall include for each type of shares or units the following:

- a) Number of authorized shares/units;
- b) Number of issued shares/units
- c) Paid up shares/units;
- d) Par value; and
- e) Any privileges. (para. 21)

#### **4. Statement of Portfolio Investments, Receivables and Financing**

4/1 The Fund shall prepare a statement of portfolio investments, receivables and financing to report the amounts of each type of asset held. This statement shall disclose each asset type as a percentage of the total assets of the Fund at the date of the financial statements. This statement provides an indication of how closely the Fund is following its investment objectives at the date of the financial statements. (para. 22)

4/2 The statement of portfolio investments, receivables and financing shall include three main sections, namely investments, receivables and financing. Disclosures shall be made in the notes to the financial statements of the component parts of each section according to asset type, sector, any concentration on one customer, country or geographical region, and their respective periods to maturity or expected periods to cash conversion. (para. 23)

## **5. Statement of Operations**

- 5/1 The Fund shall prepare a statement of operations to report the increase or decrease in net assets resulting from the operations. (para. 24)
- 5/2 The statement of operations shall include the following main sections:
- a) Income from investments, sales and financing;
  - b) Expenses;
  - c) Net income or loss from investments, sales and financing;
  - d) Realized gains or losses and/or unrealized gains or losses from investments and financing;
  - e) Net gains or losses from investments and financing;
  - f) Net income (or loss) before the Mudarib share ( in case the Fund is managed on the basis of Mudaraba); and
  - g) Increase or decrease in net assets from operations after the Mudarib share. (para. 25)
- 5/3 The statement of operations shall report “income from investments, sales and financing activities” from which expenses shall be deducted to arrive at “net income or loss from investments, sales and financing”. (para. 26)
- 5/4 Expenses include:
- a) Management fees (in case the Fund is managed on the basis of agency);
  - b) Professional fees;
  - c) Administrative expenses;
  - d) Registration fees;
  - e) Marketing expenses (for example, prospectus expenses and other investors’ information) and
  - f) Any other expenses.
- Material expense items shall be reported separately. (para. 27)
- 5/5 The following items shall be reported under “realized and unrealized gains or losses from investments and financing”:
- a) Net realized gains or losses from investments and financing; and
  - b) Unrealized gains or losses from changes in the value of investments and financing.

These two items shall be added to arrive at “net gains or losses from investments and financing”. (para. 28)

5/6 “Net income or loss from investments, sales and financing” shall be added to “net gains or losses from investments and financing” to arrive at “net income or loss before the Mudarib share” (in case the Fund is managed on the basis of Mudaraba). (para. 29)

5/7 The Mudarib share shall be deducted from “net income or loss from operations before the Mudarib share” to arrive at “increase or decrease in net assets from operations after the Mudarib share”. (para. 30)

5/8 Income from cash dividends shall be recognized at their declared amount payable in cash on the date of declaration. (para. 31)

5/9 Stock dividends shall be added to the investment portfolio and measured as stated in 3/6. (para. 32)

5/10 Realized capital gains or losses shall be recognized at the date of sale, and shall be measured by the difference between:

- a) The sale price of the assets; and
- b) Their carrying amount plus any related expenses that are incurred to complete the sale transactions. (para. 33)

5/11 Gains or losses from foreign currency buying and selling transactions shall be recognized using the exchange rates prevailing at the date of the transaction. (para. 34)

5/12 Tax charges shall be presented as a separate classification in the statement of operations after “net income or loss from operations before the Mudarib share”. Disclosure shall be made, as part of the accounting policies in the notes to financial statements, of the general terms relating to taxes. (para. 35)

## **6. Statement of Changes in Net Assets or Statement of Cash Flows**

6/1 The Fund shall prepare a statement of changes in net assets or a statement of cash flows. (para. 36)

- 6/2 It is preferable that the Fund prepares a statement of changes in net assets if any of the following criteria are met:
- a) During the period, the majority of the Fund's investments were highly liquid;
  - b) Most of the investments are carried at market value;
  - c) The ratio of liabilities to total assets of the Fund is low. (para. 37)
- 6/3 The Fund shall prepare a statement of changes in net assets to provide the users of financial statements with sufficient financial information to help them:
- a) Account for changes in assets and liabilities resulting from investments, receivables and financing activities, and share/unit transactions and other transactions;
  - b) Summarize the amounts in the statement of operations for net income or loss from investments, sales and financing, realized gains or losses from investments and financing, and the unrealized gains or losses from changes in the value of investments and financing.
  - c) Compare dividends and distributions to shareholders/unitholders with related income. (para. 38)
- 6/4 The statement of changes in net assets shall comprise the following categories:
- a) Increase/decrease in net assets from operations,
  - b) Distributions to shareholders/unitholders,
  - c) Shares/units transactions,
  - d) Capital contributions, and
  - e) Changes in the net assets. (para. 39)
- 6/5 Increase/decrease in net assets from operations shall be presented as a separate category in the statement of changes in net assets. (para. 40)
- 6/6 Capital contributions for the period shall be presented as a separate category, and disclosure shall be made in the notes to the financial statements of their nature and their purpose. (para. 41)
- 6/7 The statement of changes in net assets shall present:
- a) The changes in net assets for the financial period.
  - b) Net assets at the beginning of financial period.
  - c) Net assets at end of financial period. (para. 42)

- 6/8 The beginning and ending balances of net assets in the statement of changes in net assets shall agree with the comparable balances shown in the statement of net assets. The difference between beginning and ending balances shall reflect the aggregate change (increase or decrease) in net assets for the period. (para. 43)

**7. Statement of Financial Highlights**

- 7/1 The Fund shall prepare a statement of financial highlights, which is a separate report that precedes the notes to the financial statements. This statement presents important financial information about the Fund's shares/units at the end of the financial period. (para. 44)
- 7/2 The statement of financial highlights shall present, for each share/unit for the most recent three financial periods, the following:
- a) Net asset value at the beginning of the financial period;
  - b) Net income or loss from investments, sales and financing (based on the weighted number of shares/units outstanding);
  - c) Net realized and/or unrealized gains or losses from investments and financing;
  - d) Total income from investments, sales and financing before the Mudarib share;
  - e) Mudarib share
  - f) Total income from investments, sales and financing after the Mudarib share
  - g) Dividends/distributions of net income from investments, sales and financing, distributions (including declared dividends payable) from net realized gains from investments and financing, and return of capital;
  - h) Capital contributions; and
  - i) Net asset value at the end of the financial period. (para. 45)
- 7/3 The statement of financial highlights shall disclose the following additional information:
- a) Total net assets at the end of financial period;
  - b) Weighted average net assets;
  - c) Ratio of expenses to weighted average net assets;



- d) Portfolio investments, receivables and financing turnover rate; and
- e) Annual rate of return. (para. 46)

7/4 Disclosure shall be made in the notes to the financial statements of the methods used to calculated each of the following:

- a) Ratio of expenses to weighted average net assets;
- b) Portfolio investments, receivables and financing turnover rate; and
- c) Annual rate of return. (para. 47)

#### **8. Disclosure in the Notes to the Financial Statements**

- 8/1 Disclosure shall be made of the type of Fund, its main activity, and the significant investment policies that govern the Fund's investment activities and the investment objectives it seeks to achieve. (para. 48)
- 8/2 Disclosure shall be made of the accounting policies adopted to value investments, receivables, financing and other assets. (para. 49)
- 8/3 Disclosure shall be made of the accounting policy adopted to recognize income. (para. 50)
- 8/4 Disclosure shall be made of the accounting policy adopted to amortize the Fund's pre-operating expenses. (para. 51)
- 8/5 Disclosure shall be made of the bases that govern the redemption by shareholders/unitholders of all or part of their shares/units. (para. 52)
- 8/6 Disclosure shall be made of the contractual relationship between the Fund and the party/parties that manage(s) it and the contractual relationship between the Fund and the investment custodian. (para. 53)
- 8/7 Disclosure shall be made of the bases that govern the Fund's sale of assets owned by the Mudarib or the agent. (para. 54)
- 8/8 Disclosure shall be made of the bases that govern the transactions that are jointly financed, wholly or partly, by the Fund's manager (Mudarib/agent) and the Fund. Disclosure shall also be made of the terms of such transactions, if any. (para. 55)
- 8/9 Disclosure shall be made of the bases that govern the rules relating to investments by the Fund's Mudarib/agent in the Fund. (para. 56)

8/10 Disclosure shall be made of transactions with related parties according to Financial Accounting Standard No. (1): General Presentation and Disclosure in the Financial Statements of Islamic Banks and Financial Institutions. (para. 57)

8/11 Disclosure shall be made of the Mudarib share or the agent's fee. (para. 58)

8/12 Disclosure shall be made of the bases that govern the Fund's investments in another fund managed by the same Mudarib or agent. (para. 59)

8/13 Disclosure shall be made of the value of capital contributions not accompanied by issuance of additional shares/units, and the parties that made those contributions and the reasons for them. (para. 60)

8/14 Disclosure shall be made of earnings prohibited by Shari'a, if any, and how those amounts are disposed of. Disclosure shall also be made of any amounts paid for purposes not permitted by Shari'a. (para. 61)

8/15 Disclosure shall be made of whether the Zakah payment is the responsibility of the Fund or the responsibility of shareholders/unitholders. The Fund shall also disclose the Zakah due for each share/unit. (para. 62)

8/16 Disclosure shall be made of whether or not the Fund makes provisions to meet its tax obligations. (para. 63)

8/17 Disclosure shall be made of the Fund's duration and the conditions applicable to its liquidation, if any. (para. 64)

#### **9. Real Estate Funds or Real Estate Assets in Other Funds**

9/1 Real estate assets shall be measured, at the time of acquisition, at historical cost plus any direct expenses related to the ownership of real estates. (para. 65)

9/2 Real estate assets shall subsequently be revalued to their cash equivalent values, using the latest valuation by real estate valuers. In case the cash equivalent values are not available, real estate



assets shall be measured at their historical cost. Disclosure shall be made of the period in which the valuation was made. (para. 66)

9/3 The Fund shall disclose in the notes to the financial statements the types of real estate assets it owns, the countries in which they are located, purchase prices, valuation method used and dates of valuations. (para. 67)

#### **10. Effective Date**

This Standard shall be effective for financial statements for fiscal periods beginning 1 Muharram, 1423 A.H. or 1 January, 2002 A.D. (para. 68)

## Adoption of the Standard

The Investment Funds standard was adopted by the Accounting and Auditing Standards Board in its meeting No. (19) held on 17 Safar, 1421 A.H., corresponding to 21 May, 2000 A.D.

### Members of the Board

- |  |                 |
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| 13. Dr. Yousif Mohammed Mahmood Qassim |                 |

## **Appendix (A)**

### **Brief History of the Preparation of the Standard**

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

On 29 Ramadan, 1419 A.H., corresponding to 16 January, 1999 A.D., two consultants were commissioned to prepare a preliminary study on the accounting aspects of the standard. Another consultant was commissioned to study the juristic aspects of the standard.

In its meeting No. (19) held in Bahrain on 18 and 19 Muharram, 1420 A.H., corresponding to 4 and 5 May, 1999 A.D., the Accounting Standards Committee discussed the accounting study and made amendments thereto. The Committee took note of the summary of the juristic aspects of the standard. The Committee also discussed the revised accounting study and the exposure draft of the standard in its meeting No. (20) held in Bahrain on 21 Rabi' I, 1420 A.H., corresponding to 4 July, 1999 A.D., and asked the consultants 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 Committee in its meeting No. (21) held in Bahrain on 25-26 Jumada I, 1420 A.H., corresponding to 5-6 September, 1999 A.D., and the amendments which were considered necessary were made. The Committee also discussed the amended exposure draft of the standard in its meeting No. (22) held in Bahrain on 25-26 Jumada II, 1420 A.H., corresponding to 5-6 October, 1999 A.D., and further amendments were made.

The exposure draft of the standard was discussed by the Shari'a Committee for Standards in its meeting No. (2) held in Bahrain on 16-17 Rajab, 1420 A.H., corresponding to 25-26 October, 1999 A.D., and some further amendments were made.

The amended exposure draft was discussed in the Accounting and Auditing Standards Board meeting No. (18) held in Bahrain on 14-15 Sha'ban, 1420 A.H., corresponding to 22-23 November, 1999 A.D. The Standards Board made further 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.

A listening session was held in Bahrain on 27-28 Dhul-Hajjah, 1420 A.H., corresponding to 2-3 April, 2000 A.D. The listening session was attended by more than 46 participants representing central banks, Islamic banks, accounting firms, Shari'a scholars, academics and others who are interested in this field. Members of the Accounting Standards Committee responded in the listening session to the written comments as well as to the oral comments that were expressed in the listening session.

The Accounting Standards Committee held a meeting on 6-7 Muharram, 1421 A.H., corresponding to 11-12 April, 2000 A.D, in Jordan 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.

The revised exposure draft was reviewed and approved by the Shari'a Committee for Standards in its meeting No. (3) held on 19-20 Muharram, 1421 A.H., corresponding to 24-25 April, 2000 A.D., after making some changes to the draft.

The Accounting and Auditing Standards Board adopted the proposed standard in its meeting No. (19) held on 17 Safar, 1421 A.H., corresponding to 21 May, 2000 A.D.

## **Appendix (B)**

### **Juristic Rules for Investment Funds**

#### **Definition of Investment Funds and Shari'a Rulings Governing Them**

Funds are investment vehicles, which are financially independent of the institutions that establish them. Funds take the form of equal participating shares/units, which represent the shareholders'/unitholders' share of the assets, and entitlement to profits or losses. The Funds are managed on the basis of either Mudaraba or agency contracts.

**Shari'a Ruling:** Investment funds are permissible by Shari'a. Because Funds are a form of collective investment that continue throughout their term, the rights and duties of participants are defined and restricted by the common interest, since they relate to third parties' rights. Hence, in case the Fund is managed on the basis of agency the shareholders'/unitholders' waive their right to management, redemption or liquidation except in accordance with the limitations and conditions set out in the statutes and by-laws.

#### **Management of Funds**

There are two methods used for the management of Funds, and both are allowed by Shari'a:

- a) Management on a Mudaraba basis, according to which the management fee of the Mudarib is specified as a share (i.e., a percentage) of the profit made by the Fund.
- b) Management on an agency basis, in which the management fee is specified for the agent as a fixed amount (lump sum) or as a percentage of the amount underwritten, which eventually becomes a lump sum, or a percentage of the net asset value. This form is considered permissible

by some Fuqaha<sup>(2)</sup> on the basis that it is analogous to a sale agency fee which is based on a percentage of the price.

There is another form that combines the two methods, where the manager receives a basic fee plus a specified performance fee based on certain hurdle rates of return being achieved.

### **Regulation of the Funds**

Regulation of the Funds requires the drawing up of a considerable amount of documents, some of which regulate the relationship between the management and the participants, or the relationship among the participants themselves, such as statutes, by-laws and prospectus. Some documents also regulate the relationship between the parties managing the Fund, such as the Fund manager, custodian, investment advisor, external auditor and the Shari'a supervisory board through numerous agreements that are drawn up among them. The regulation process is a service that may be rendered in return for some consideration, because it is a form of employment to perform specified work, or an agency function in return for consideration. These services include the legal services, conducting transactions, marketing, agency to accept underwriting or execute payment, etc.

However, some of the tasks that require a guarantee by means of a prior underwriting commitment should be undertaken without consideration, such as a commitment to underwrite the premium contribution amounts, because it is not permissible to pay consideration for such a commitment. Rather, a commitment may be entered into at the nominal value, but if there are assets in kind, the commitment may be by way of buying them as a whole at one price, and selling them for a higher price.

As regards the redemption of shares/units, any agreement by the Fund's management to repurchase the shares/units should be at the market value at the date of repurchase or at such other value as may be agreed at that time. Any agreement by the Fund's management to repurchase or redeem at the nominal value or a pre-determined higher value is not permitted. However, a third party may enter into such an agreement according to Shari'a

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(2) "Hashiyat Ibn Abidin" [7: 350], "Sharh Muntaha Al-Iradat" [2: 217].

guidelines,<sup>(3)</sup> provided no commission is charged for such a transaction. The management of the Fund may, however, determine a repurchase or redemption price that is less than the market value at the date of redemption.

### **Shari'a Governance of the Activities of Funds**

Like other forms of investments, activities of Funds should be undertaken in accordance with the Shari'a rules and principles. These include the following:

- a) Regulation of the relationship between shareholder/unitholders, management, and other concerned parties,
- b) Selection of the assets represented by the shares/units
- c) Preclusion of the guarantee of principal or of profit by any participant or by management, except in cases of misconduct or negligence.
- d) Establishment of profits and sustaining of losses,
- e) Transfer, redemption and liquidation, and such other matters.

There are activities that are unlawful in Shari'a, which the Fund cannot invest in. These include, among others:

- a) Activities related to the objectives of the Fund such as investment in interest-based transactions, conventional insurance transactions, intoxicants, gambling, pornography, unlawful meat; and
- b) Activities related to the management of Funds such as taking interest-bearing deposits or raising interest-bearing loans.

Many rulings have been issued in some Shari'a seminars and by Shari'a supervisory authorities or boards that provide for setting ceilings to limit investment in companies that invest funds in unlawful deposits and/or raise unlawful loans. These rulings allow dealings in Funds which do not exceed such ceilings since their objectives and main activities are lawful, although interest-bearing deposits and loans are unlawful.

Resolutions issued by Fiqh academies<sup>(4)</sup> and other Fatwas<sup>(5)</sup> prohibit investment in Funds that invest in interest-bearing loans or in Funds whose investments include securitized debt instruments arising out of lawful

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(3) See the International Islamic Fiqh Academy, Resolution No. (5), Session No. (4), relating to the Mudaraba bonds.

(4) International Islamic Fiqh Academy Resolutions No. 10 (10/2) and No. 60 (11/6).

(5) Dar Al-Ifta Al-Missriyyah (The Egyptian Fatwa House) No. (1252).



dealings, such as Murabaha sales. However, the latter case is permissible if there is a pool of assets in kind and benefits together with cash and Murabaha receivables provided the amounts of assets in kind and benefits are greater.

According to the resolution issued by the International Islamic Fiqh Academy<sup>(6)</sup>, it is permissible to invest in Funds whose shares/units represent assets in kind and benefits (which should constitute the preponderant percentage of the Fund's assets) in addition to cash and debts. Dealings in this kind of investment is permissible depending on the price agreed upon, and it is also permissible to defer the price at which the shares/units will be sold. The investment mechanism in such Funds is based on the principle of purchasing assets and then selling them for the purpose of making profit in the form of returns on the shares/units (operating profit) or benefiting from the increase in their prices (capital gain). However, the profit may be restricted to the capital gain, if there is a provision that no profits should be allocated (i.e. they are to be accumulated). All shareholders/unitholders shall be entitled to profit and incur loss as well as to receive any proceeds from liquidation.

### **Zakah on Funds**

The management of Funds does not pay Zakah on the assets of the Fund, except in the cases stated in Financial Accounting Standard No. (9): Zakah, namely, if the law requires the Fund to satisfy the Zakah obligation, if the Fund is required by its charter or by-laws to satisfy the Zakah obligation, or if the shareholders/unitholders of the Fund either in their periodical meetings or by proxy have passed a resolution requiring the Fund to satisfy the Zakah obligation. Otherwise, the payment of Zakah shall be the responsibility of shareholders/unitholders.

### **Shari'a Supervision of Funds**

Governance Standard for Islamic Financial Institutions No. (1) stipulates that a Shari'a supervisory board should be appointed for a Fund. This means that all documentation such as statutes, prospectus and the agreements should

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(6) International Islamic Fiqh Academy Resolution No. 30 (5/4).



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be examined by the Fund's Shari'a supervisory board to ensure compliance with Shari'a, Rules and Principles. The resolutions of the Shari'a supervisory board shall be binding upon both the management and those who invest in the Fund. The Shari'a supervisory board shall provide a periodical report on the Fund.

## Appendix (C)

### Reasons for the Standard

Islamic financial institutions have introduced investment funds as part of their financial services to investors. These funds have increased both in number and in size and have become an attractive vehicle for mobilizing substantial amounts of funds by Islamic financial institutions.

This standard has benefited from a survey of Islamic Funds conducted by Islamic financial institutions and other finance companies specializing in the management of investment funds. The study of the financial statements of the 16 Funds that have been surveyed revealed noticeable qualitative and quantitative variations in the recognition, measurement, and presentation of assets, liabilities, income, expenses, gains, losses and the disclosures in the notes to the financial statements, thereby rendering the financial statements of these Funds non-comparable.

Such variations may be grouped as follows:

**First:** A group of Funds prepare their financial statements using either the same or different accounting policies, as compared with those used by the institutions that manage these funds.

**Second:** A group of Funds does not prepare separate financial statements, but incorporate their financial data into the financial statements of the institutions that manage these Funds.

These variations do not help users of financial statements in making economic decisions. This may deter investors from investing in the Funds.

Users of financial statements need adequate financial information to evaluate the performance, management, liquidity, and investment risks of a Fund. Financial information is also needed to compare Funds and to ascertain their compliance with Shari'a Rules and Principles. These objectives

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can be achieved only by the provision of transparent and consistent financial information that is prepared by the Funds according to an acceptable accounting standard governing the recognition, measurement, presentation and disclosure of the assets, liabilities, income, expenses, gains and losses.

## **Appendix (D)**

### **Basis for Conclusions**

This appendix discusses the alternatives considered by the Accounting Standards Committee when choosing the accounting treatment for the Funds, and the justification and the basis for the treatment adopted.

#### **Set of Financial Statements for the Funds**

The Committee discussed the types of financial statements that could be appropriate for the Funds. The Committee discussed whether the financial statements should comprise the following:

- a) Statement of Financial Position;
- b) Income Statement;
- c) Cash Flow Statement and
- d) Statement of Changes in Owners' Equity

or the following:

- a) Statement of Net Assets;
- b) Statement of Portfolio Investments, Receivables and Financing;
- c) Statement of Operations;
- d) Statement of Changes in Net Assets or Statement of Cash Flows
- e) Statement of Financial Highlights.

After discussing each of these statements, the Committee decided to adopt the latter set of financial statements. The Committee based its decision on the following:

- a) The Funds do not have owners' equity like other business corporations. Rather, in Funds, net assets represent owners' equity. Hence, both the statement of financial position and the statement of changes in owners' equity would not be relevant for the Funds.
- b) The Funds have investment objectives that are published in the prospectus for the attention of investors. Therefore, the Funds should

prepare financial statements that reflect their compliance with these objectives. This can be achieved more effectively by the preparation of a statement of portfolio investments, receivables and financing.

- c) The preparation of the statement of changes in net assets as an alternative to the cash flow statement is more relevant to the Funds because the ratio of liability to total assets in these Funds is very low.

**Statement of Portfolio Investments, Receivables and Financing**

The Committee discussed the title and contents of this statement and whether it should be called statement of portfolio investments or statement of portfolio investments, receivables and financing. The Committee decided to adopt the latter alternative because in the case of Funds, the portfolio may not be confined to investments, but may comprise all three types of assets.

## **Appendix (E)**

### **Definitions**

#### **Investments (for the Purpose of Income And/Or Trading)**

- a) The allocation of resources to acquire shares, Islamic bonds or units in investment funds for the purpose of receiving income. This includes investment in any assets that are acquired for the purposes of developing the asset with a view to sell it as well as the acquisition of assets for leasing.
- b) The purchase and sale of shares for the purpose of trading.

#### **Sales**

A sale is an exchange transaction using any of the Islamic instruments such as Murabaha, Salam or Istisna'a.

#### **Financing**

Financing is a transaction in which Mudaraba and/or Musharaka are used.

#### **Net Assets**

Net assets of a Fund represent shareholders'/unitholders' equity and this includes shareholders'/unitholders' contributions, undistributed net income from investments (or investment losses), undistributed net realized and unrealized gains (or net realized losses), and net increase/decrease in the value of investments and other assets.

#### **Capital Contributions**

Capital contributions are additional funds collected from the investors in the Fund or others to finance liabilities that may arise in the future as the Fund manager considers appropriate. New shares/units are not issued in exchange for these capital contributions.

**Distributions to Shareholders/Unitholders**

Distributions to shareholders/unitholders include distributions from net income from investments, sales and financing, distributions from realized gains from investments and financing, and return of capital.

**Capital Transactions**

Capital transactions include the sale of shares/units, and the number of shares/units issued on reinvestment of distributions/dividends less the value of shares/units redeemed.

## **Appendix (F)**

### **Example of the Financial Statements and Disclosures Therein**

**Note:**

The purpose of this example is to illustrate the application of some of the provisions of the standard. The example is not intended to illustrate the only acceptable method(s) for the presentation of or the disclosure in the financial statements. Furthermore, the example does not reflect all the requirements of the standard.



**Investment Fund No. (1)**  
**Statement of Net Assets**  
**As at xxx\*\*\* (year) and xxx\*\*\* (last year)**

	xxx (year) Monetary Unit	xxx (last year) Monetary Unit
<b>Assets</b>		
Cash & cash equivalents		
Investments		
Securities for trading		
Securities for investment		
Leased assets		
Receivables		
Sales receivables (Murabaha, Istisna'a, Salam...etc.)		
Other receivables		
Financing (Mudaraba & Musharaka)		
Other assets		
<b>Total assets</b>	<b>xx</b>	<b>xxx</b>
<b>Liabilities</b>		
Payables		
Shares/units purchased		
Securities portfolios purchased		
Accrued charges		
Other liabilities		
<b>Total liabilities</b>	<b>xx</b>	<b>xxx</b>
<b>Net assets</b>	<b>xx</b>	<b>xxx</b>
<b>Number of shares/units outstanding</b>		
<b>Net assets per unit</b>		

(\*) The attached notes from No. ( ) to No. ( ) form an integral part of the financial statements.

**Investment Fund No. (1)**  
**Statement of Portfolio Investments,**  
**Receivables & Financing**  
**As at xxx\*\*\* (year) and xxx\*\*\* (last year)**

	xxx (year) Monetary Unit	% of Portfolio Monetary Unit	xxx (last year) Monetary Unit	% of Portfolio Monetary Unit
<b>Investments</b>				
Equity				
Sukuk (Islamic bonds)				
Leased assets				
-----				
-----				
<b>Receivables</b>				
Murabaha				
Istisna'a				
Salam				
-----				
-----				
<b>Financing</b>				
Mudaraba				
Musharaka				
<b>Total investments, receivables &amp; financing</b>		<b>100%</b>		<b>100%</b>

(\*) The attached notes from No. ( ) to No. ( ) form an integral part of the financial statements.

**Investment Fund No. (1)**  
**Statement of Operations**  
**for the year ended xxx\*\*\* (year) and xxx\*\*\* (last year)**

	xxx (year) Monetary Unit	xxx (last year) Monetary Unit
<b>Income from investments, sales &amp; financing</b>		
Investments		
Receivables		
Financing		
Other Income		
<b>Total income from investments, sales &amp; financing</b>	<b>xx</b>	<b>xxx</b>
<b>Expenses</b>		
Management commission (in case the Fund is managed on the basis of agency)		
Professional fees		
Administrative expenses		
Registration fees		
Marketing expenses		
Other expenses		
<b>Total expenses</b>	<b>xx</b>	<b>xxx</b>
<b>Net income/loss from investments, sales &amp; financing</b>	<b>xx</b>	<b>xxx</b>
<b>Realized gains/losses and/or unrealized gains/ losses from investments &amp; financing</b>		
Net realized gains/losses from investments & financing		
Increase/decrease from changes in value of investment & financing		
<b>Net gains/losses from investments &amp; financing</b>	<b>xx</b>	<b>xxx</b>

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<b>Net income/loss before Mudarib share</b>	<b>xx</b>	<b>xxx</b>
Less: Mudarib share	(xx)	(xxx)
<b>Increase/decrease in net assets from operations after the Mudarib share</b>	<b>xx</b>	<b>xxx</b>

(\*) The attached notes from No. ( ) to No. ( ) form an integral part of the financial statements.

**Investment Fund No. (1)**  
**Statement of Changes in Net Assets**  
**for the year ended xxx\*\*\* (year) and xxx\*\*\* (last year)**

	xxx (year) Monetary Unit	xxx (last year) Monetary Unit
<b>(Less) Distributions to shareholders/ unitholders</b>		
<b>Increase/decrease in net assets from operations</b>		
From net income from investment, receivables & financing		
From net realized gains from investments & financing		
Return of capital		
Total distributions	xx	xxx
<b>Capital transactions</b>		
Sale of shares/units		
Shares/units issued on re-investment of distributions		
Less: shares/units redeemed		
<b>Net shares/units transactions</b>	xx	xxx
<b>Capital contributions</b>	xx	xxx
<b>Changes in net assets for the period</b>	xx	xxx
<b>Net assets – beginning of period</b>	xx	xxx
<b>Net assets – end of period</b>	xx	xxx

(\*) The attached notes from No. ( ) to No. ( ) form an integral part of the financial statements.

**Investment Fund No. (1)**  
**Statement of Financial Highlights**  
**for the three years ended xxx\*\*\* (year)**

**Data per share/unit**

	<b>Current year</b>	<b>Second year</b>	<b>First year</b>
<b>Net assets value – beginning of period</b>			
<b>Income from investments, sales &amp; financing</b>			
Net income from investments, sales & financing			
Net realized and/or unrealized gains or losses from investments and financing			
Total income from investments, sales & financing before Mudarib share			
less Mudarib share			
Total income from investments, sales & financing after Mudarib share			
<b>Distributions to shareholders/unitholders</b>			
From net profits on investments, sales & financing			
From net realized gains on investments & financing			
Return of capital			
Total distributions			
<b>Capital contributions</b>			
<b>Net assets value – end of period</b>			
<b>Financial Ratios/Supplemental Data</b>			
Total net assets – end of period (millions)			
Weighted average net assets (millions)			
Ratio of expenses to weighted average net assets	%		

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Turnover rate of portfolio investments, receivables and financing	%		
Annual rate of return	%		



(\*) The attached notes from No. ( ) to No. ( ) form an integral part of the financial statements.

