AAOIFI Financial Accounting Standard (FAS) 47

Transfer of Assets Between Investment Pools

Contents

AAOIFI Financial Accounting Standard (FAS) 47 "Transfer of Assets Between Investment Pools" is set out in paragraphs 01-12. All the paragraphs have equal authority. This standard should be read in the context of its objective and "AAOIFI Conceptual Framework for Financial Reporting".

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 Islamic financial institutions (the institutions) have specific types of stakeholders and operate under a unique business model. This includes investment pools that comprise distinct assets held under the ownership of and on behalf of the multiple stakeholders (e.g., owners' equity, quasi-equity and off-balance-sheet assets under management). At times, there is a transfer of assets between the respective investment pools. Such transfer necessitates a distinct set of financial reporting requirements in line with Shari'ah principles and rules, including adequate disclosures for the purpose of transparency.

PR2 It is expected that this revised standard will improve the practices of financial reporting in respect of transfer of assets between different sets of stakeholders.

PR3 This standard supersedes FAS 21 "Disclosure on Transfer of Assets".

Introduction

Overview

IN1 This standard prescribes the financial reporting principles and disclosure requirements applicable to all transfers of assets between investment pools related to (and where material, between significant categories of) owners' equity, quasi-equity and off-balance-sheet assets under management of an institution. It requires adoption and consistent application of accounting policies for such transfers in line with Shari'ah principles and rules and describes general disclosure requirements in this respect.

Rationale for issuing this standard

IN2 The AAOIFI Accounting Board (AAB / the board) initiated, in 2018, the "AAOIFI Financial Accounting Standards (FASs) review and revision project" encompassing all existing AAOIFI FASs. As an outcome of this project, as well as, during the revision process of FAS 27 "Investment Accounts", the board determined that FAS 21 "Disclosure on Transfer of Assets" requires a limited revision.

IN3 The board also determined that certain principles of financial reporting shall be addressed in addition to the disclosure requirements which were included in the predecessor standard. Accordingly, this revised standard has been developed to address these requirements, as well as, to align with "AAOIFI Conceptual Framework for Financial Reporting" (the conceptual framework) and FAS 1 "General Presentation and Disclosures in the Financial Statements".

Key changes from previous standard

IN4 This standard brings key changes from its predecessor standard (FAS 21 "Disclosure on Transfer of Assets"), inter alia, with respect to the following aspects:

a. the earlier standard was limited to the disclosure requirements of transfer of assets. The revised standard prescribes the financial reporting requirements, as well as, the general and specific disclosure requirements;

b. the revised standard requires accounting police(s) to be developed, consistently applied and disclosed for different classes of transactions comprising transfer of assets between investment pools;

c. the terminology and definitions in the standard are aligned with "AAOIFI Conceptual Framework for Financial Reporting";

d. the presentation and disclosure requirements have been improved in line with FAS 1 "General Presentation and Disclosures in the Financial Statements" and considering the information needs of various stakeholders; and

e. the financial reporting requirements are aligned with the Shari'ah requirements, e.g., disclosures of accounting policies and applicable restrictions to address and avoid the issue of buy-back and challenges relating to transfer of debt between investment pools and related tangibility requirements.

AAOIFI Financial Accounting Standard (FAS) 47
Transfer of Assets Between Investment Pools

Objective of the standard

1. The objective of this standard is to establish the financial reporting principles that apply in respect of transfer of assets between various investment pools of an Islamic financial institution (the institution).

Scope

2. This standard shall apply to all transfers of assets between investment pools related to (and where material, between significant categories of) owners' equity, quasi-equity and off-balance-sheet assets under management[1] of all the institutions, irrespective of their type or business model.

3. The assets transferred, for the purpose of application of this standard, include all monetary and non-monetary assets.

Definitions

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

    a. Investment pool – in the specific context of this standard, comprises distinct assets whose risks and rewards (wholly or proportionately) are attributable to the funding provided by respective investors within owners' equity, quasi-equity and off-balance-sheet assets under management of an institution. It is generally a virtual entity and, at times, a separate reporting entity;

    b. Monetary assets – in the specific context of this standard, for the purpose of application of the tangibility requirements, in line with the Shari'ah principles and rules, are assets that are in the form of either:

        i. cash;

        ii. contractual right to receive cash or another monetary asset from another person, institution or entity; or

        iii. contractual right to exchange a monetary asset with another person, institution or entity.

    c. Non-monetary assets – in the specific context of this standard, for the purpose of application of the tangibility requirements, in line with the Shari'ah principles and rules, may include:

        i. tangible assets (i.e., assets that are physical such as property, plant, equipment and inventory);

[1] Such off-balance-sheet assets under management may have varying names and forms for different types of institutions, e.g., in case of a Takaful institution, these may be classified as participants' Takaful fund (PTF) and participants' investment fund (PIF).

ii. equity instruments;

iii. Sukuk or other instruments whereby the majority of underlying assets are tangible assets; and

iv. intangible assets (e.g., right-of-use assets).

d. Shari'ah principles and rules – is as defined in paragraph 11 of the "AAOIFI Conceptual Framework for Financial Reporting[2]";

e. Tangibility requirements[3] – in the specific context of this standard, are the requirements defined by an institution in line with Shari'ah principles and rules, acceptable for the purpose of transfer of an asset(s) (generally, not being or including debt) from an investment pool to another; and

f. Transfer of assets – in the specific context of this standard, is the transfer of assets from one investment pool to another (whether on-balance-sheet or off-balance-sheet) by way of either sale, exchange, investment, clearing or others (e.g., Hiba) in line with a contractual arrangement, or through reconstitution of multiple investment pools immediately following their constructive liquidation, in line with the requirements of Shari'ah principles and rules.

Adoption and consistent application of accounting policy(ies)

5. An institution shall adopt and consistently apply accounting policy(ies) in respect of transfer of assets between various investment pools, in line with the requirements of this standard and other relevant AAOIFI FASs and applicable Shari'ah principles and rules, duly considering the business model of the institution, as well as, the respective regulatory requirements and the contractual arrangements with the respective stakeholders.

[2] Shari'ah principles and rules comprise the Shari'ah principles and rules defined by the following hierarchy, as appropriate:

i. the Shari'ah standards issued by Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI);
ii. the regulations issued by the respective jurisdiction's regulator insofar as these entail the regulatory Shari'ah requirements;
iii. the rulings of the central Shari'ah board for the respective jurisdiction (if there is one);
iv. the requirements of the applicable Financial Accounting Standards as issued by AAOIFI insofar as these entail Shari'ah related requirements; and
v. the approvals and rulings given by the Shari'ah supervisory board of the institution.

[3] Tangibility requirements shall be developed in line with the requirements of relevant Shari'ah principles and rules, particularly, considering the requirements of AAOIFI Shari'ah Standard (SS) 59 "Sale of Debt", whereby a debt directly or through bundling with tangible assets, unless comprising a legal entity, may not be exchanged against cash / debt / monetary assets. Subject to the requirements of the said standard, certain transactions of exchange of debt with a commodity (with spot delivery) or usufruct or services are acceptable. (In particular, see paragraphs 8/1-8/4 read with paragraphs 5/1-5/2 of SS 59 "Sale of Debt"). In certain situations, a transfer of debt may take the form of an assignment (Hawala) rather than sale of debt, subject to a condition that such assignment may take place at par value only along with other requirements of SS 7 "Hawala".

Presentation and disclosure

General presentation and disclosure requirements

6. An institution shall follow the general presentation and disclosure requirements stated in FAS 1 "General Presentation and Disclosures in the Financial Statements" along with other applicable AAOIFI FASs[4] in respect of general presentation and disclosure for the specific types of institutions.

Specific presentation and disclosure requirements

7. An institution shall disclose, in reasonable detail, the accounting policy(ies) adopted in respect of transfer of assets between investment pools. Such disclosure of accounting policies shall include, as applicable, the following categories of transfers:

    a. transfers from owners' equity to a category or investment pool within quasi-equity, and vice versa;

    b. transfers from owners' equity to a category or investment pool within off-balance-sheet assets under management, and vice versa;

    c. transfer within categories of owners' equity;

    d. transfers from a category or investment pool within quasi-equity to a category or investment pool of off-balance-sheet assets under management, and vice versa;

    e. transfers from a category or investment pool within quasi-equity to another category or investment pool within quasi-equity; and

    f. transfers from a category or investment pool within off-balance-sheet assets under management to another category or investment pool within off-balance-sheet assets under management.

8. It is a presumption that the transfers referred to in paragraphs 7(b), 7(d) and 7(f) may not require development of specific accounting policies separately for the purpose of compliance with the requirements of this standard, as the same are already covered in the accounting policies applicable for recognition and derecognition developed in line with the respective AAOIFI FAS.

9. The disclosure in respect of accounting policy(ies) shall also include the following significant aspects:

    a. the bases and reasons that govern the transfer of assets between various investment pools;

    b. tangibility requirements and / or other restrictions applicable to transfer of assets between various investment pools, in line with the Shari'ah principles and rules;

    c. any restrictions, in line with the Shari'ah principles and rules, on short-term transfers of assets with expected reversion to the original investment pool, to avoid a buy-back transaction;

[4] For example, FAS 42 "Presentation and Disclosures in the Financial Statements of Takaful Institutions", presently FAS 14 "Investment Funds" and [ED of] FAS __ "Financial Reporting for Islamic Investment Institutions (Including Investment Funds)".

d. any restrictions, and any specific valuation approaches applied on transfers of any monetary assets, in line with the Shari'ah principles and rules;

e. treatment of changes in classification of investments in Sukuk, shares and other similar instruments in case of their transfer from one investment pool to another, as a result of such transfer or as a result of change in business model;

f. the bases applied by the institution in valuing the assets to be transferred, and the rationale in line with the relevant AAOIFI FASs and applicable Shari'ah principles and rules and the respective business model, in case such valuation is different from fair value; and

g. the commitments and restrictions applied by the mutual contractual relationship between investors of various investment pools.

10. An institution shall disclose, in reasonable detail, the cumulative quantitative information for the period, in respect of the following:

a. the cumulative amounts of transfers between (or, where material, between significant categories of) owners' equity, quasi-equity and / or off-balance-sheet assets under management at net transfer value, and respective gains or losses recognised in the respective categories, where applicable, as well as, the difference between the net transfer value and the fair value of such assets, if the net transfer value is different from the fair value;

b. the valuation differences resulting from the transfer of assets in foreign currencies and the financial effect of these transfers;

c. the nature and terms of the significant assets transferred and whether these assets are divisible / separable and any related Shari'ah principles and rules applied, as well as, the disclosure of significant assets proportionately divided between (or, where material, between significant categories of) owners' equity, quasi-equity or off-balance-sheet assets under management; and

d. transfer of assets transactions conducted with related parties[5], indicating the nature of the relationship, type of transactions, the total value of these transactions at beginning and end of the financial period and the financial effect, whether recognised or unrecognised, in line with the respective accounting policy(ies) and relevant Shari'ah principles and rules.

Effective date

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

Amendments to other standards

12. This standard, supersedes the earlier, FAS 21 "Disclosure on Transfer of Assets".

[5] See paragraphs 99-103 of FAS 1 "General Presentation and Disclosures in the Financial Statements"

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 to, 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. Mohamed 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. Dr. Mohamed Albeltagi – chairman
2. Mr. Ali Chreif
3. Ms. Amal Almasri
4. Dr. Anwar Misbah Soubra
5. Mr. Faizan Ahmed
6. Mr. Khalid Ibrahim
7. Mr. Muhammad Muzammil Kasbati
8. Mr. Saqib Mustafa

Executive team

1. Mr. Omar Mustafa Ansari (AAOIFI)
2. Mr. Mohammad Majd Bakir (AAOIFI)
3. Ms. Farida Cassim (AAOIFI)

Appendix B: Basis for conclusions

Change in the objective and scope of the standard

BC1 The board noted, during the preliminary study, that the earlier standard, i.e., Financial Accounting Standard (FAS) 21 "Disclosure on Transfer of Assets" was primarily a disclosure standard, and did not touch upon the aspects of accounting and financial reporting, particularly, the accounting aspects of transfers of assets. Similarly, it required only disclosure of accounting policies.

BC2 The board considered the need and value addition for defining certain limited accounting and financial reporting requirements for such transfers. It became more relevant as the revision of standard on quasi-equity emphasised on the significance of investment pool accounting (mainly for the purpose of subsequent measurement of quasi-equity). The board also considered that certain Shari'ah principles and rules are relevant for the purpose of determining such accounting and financial reporting requirements, and hence the scope of the standard needs to be enhanced.

BC3 Certain aspects of accounting and financial reporting to be covered included determination of accounting policies for different types of transfer of assets between investment pools pertaining to different sets of stakeholders, which the board decided to include in the revised standard. These also included the issues relating to the valuation of assets relating to such transfers which the board concluded as not being primarily an accounting issue (see paragraphs BC5-BC7).

BC4 Accordingly, the new standard prescribes requirements for development of certain types of policies, as well as, the consistent application and disclosure of the same once developed, all in relation to different classes of transactions that are involved in the transfer of assets.

Valuation of transfer of assets

BC5 The issue of valuation of transfer of assets between investment pools was considered at length by the board. It was also raised at certain public hearings in the form of comments and feedback received, and was also discussed in the meeting of the Shari'ah committee. In this regard, a question arose as to whether the application of fair value for such transfers of assets shall be made mandatory.

BC6 The board, in line with the general views of the Shari'ah committee, considered that the fair value shall always be considered as the primary basis for valuation of internal transfers because in most of the cases, the institution acts on behalf of both parties (as principal (in case of owners' equity), Mudarib, working partner and / or agent). However, the board considered certain practical constrains and primarily the fact that determination of internal transfer pricing (being a business transaction, per se) is a Shari'ah, contractual and governance matter, rather than an accounting issue.

BC7 After due deliberations, the board decided the issue shall be addressed under the Shari'ah and governance standards, but not under FASs. However, in order to emphasise on the use of fair valuation and promoting fair treatment for the respective stakeholders, it was concluded that the basis for transfer shall be disclosed, and a disclosure shall be made if such transfer takes place at a basis other than fair value along with the impact of the same, where material. The board considered that such disclosures are intended to protect internal stakeholders who might be at a disadvantage due to the application of valuation basis.

Value addition by the detailed disclosures

BC8 The board considered the practicality and cost-benefit aspects of additionally prescribed detailed disclosures that may become, at times, much detailed and possibly cumbersome for the institutions, and potentially not having enough value addition in contrast to the effort involved.

BC9 After a due comparison with the requirements of the predecessor standard, judging them to be below expectations, and having regard to the general market practices in terms of these disclosures as of now, the board decided that there is a need to enhance the level of disclosures.

BC10 However, in order to consider the proportionality aspects for smaller institutions, as well as, the significance of these disclosures to different sets of stakeholders, the board decided to allow certain level of flexibility by making such disclosures mandatory in case of significance, and to mandate certain quantitative disclosures only to the extent of reasonable detail, with a margin of judgment being involved.

Significant Shari'ah issues

Tangibility requirements

BC11 The board considered the significance of certain Shari'ah principles and rules applicable with regard to the transfer of assets between investment pools. It evaluated the need to prescribe certain detailed requirements for the application of the tangibility requirements (including the tangibility ratio) in line with AAOIFI Shari'ah Standard (SS) 59 "Sale of Debt", as and to the extent, relevant to the accounting and financial reporting for such transfers.

BC12 The board particularly considered that an exchange of underlying debt against cash / monetary assets is tantamount to the sale of debt, under the provisions of the said SS. However, the effective application of related Shari'ah requirements cannot be ensured unless there are appropriate financial accounting requirements for the same. Hence, it was decided that this FAS shall include the financial reporting requirements in respect of the same. It was, however, decided that the standard shall not reproduce the tangibility requirements (or a specific tangibility ratio) which are within the scope of the relevant SSs.

BC13 The term used, and defined, in the exposure draft of the standard, was "tangibility ratio" and the definition of the same included the concept of bundling of assets, which is a common practice of certain institutions (who bundle debt with tangible / non-monetary assets, applying a specific tangibility ratio in line with their respective Shari'ah approvals). Additionally, the terms "monetary assets" and "non-monetary assets" were defined to explain the application of the tangibility ratio. However, the Shari'ah committee during its review of the exposure draft identified certain requirements of SS 59 "Sale of Debt", resulting in improvements in the respective definitions and use of the term "tangibility requirements", rather than "tangibility ratio". (See footnote 3, along with the definitions provided in paragraphs 4(b), 4(c) and 4(e)).

Transfer of assets involving buy-back

BC14 The board considered the challenges related to compliance with Shari'ah principles and rules in the possible event of buy-back between investment pools. The board noted that if an asset is transferred from one investment pool to another with an understanding (expressed, or implied) that such asset will revert back to the first investment pool within a short-term (e.g., due to expected liquidation of the other investment pool within a short period, or for any other reason), such situation may give rise to a potential buy-back of asset, which at times may not be in compliance with the Shari'ah principles and rules.

BC15 After due deliberations, the board concluded that although this is an incorrect practice and, hence, should not be allowed, yet the same is a governance and / or Shari'ah issue, and not an accounting issue. Nevertheless, the board decided that in order to discourage such practice from an accounting standpoint, a disclosure of any restrictions on the same shall be appropriately made.

Appendix C: Brief history of the preparation of the standard

H1 AAOIFI Accounting Board (AAB / the board) initiated the revision of this standard based on the recommendations of the "AAOIFI FASs review and revision project" in 2018. The revision of FAS 21 "Disclosure on Transfer of Assets" was initiated along with revision of FAS 27 "Investment Accounts" in 2021.

H2 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 limited scope revision of FAS 21 "Disclosure on Transfer of Assets".

H3 The working group in its 1st meeting held on 29 Rabi' II 1444H, corresponding to, 23 November 2022 discussed the first version of the draft standard on disclosure on transfer of assets. After making necessary changes the exposure draft was recommended to the board.

H4 The AAB held its 31st meeting on 1-2 Jumada I 1444H, corresponding to, 25-26 November 2022. In this meeting the board reviewed the draft and approved it for issuance as an exposure draft for public comments.

H5 After incorporation of recommended changes, the exposure draft of the standard was issued on 5 Jumada II 1444H, corresponding to, 29 December 2022.

H6 A total of four public hearings (three in English language and one in Arabic language) for the exposure draft were held over the period between March 2023 and December 2023.

H7 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.

H8 The committee of the Shari'ah board for review of accounting and governance standards held its 40th meeting on 26 Jumada I 1445H, corresponding to, 10 December 2023 where the exposure draft was discussed duly taking the views for conformity with AAOIFI Shari'ah standards.

H9 The working group in its 2nd meeting held on 1 Jumada II 1445H, corresponding to, 14 December 2023, discussed all comments received from the public hearings along with the views and comments raised by different industry participants on the exposure draft. After making necessary changes, the standard was recommended to the board for final approval.

H10 The board held its 36th meeting on 12-13 Jumada II 1445H, corresponding to, 25-26 December 2023, in which it deliberated on the changes suggested by the working group and the standard was approved for final issuance.

H11 After completion of the due process, the standard was issued on 18 Jumada II 1445H, corresponding to, 31 December 2023.