

[Exposure Draft (F3/2022) v.3.0 of the  
AAOIFI Financial Accounting Standard \_\_\_\_  
**Off-balance-sheet Assets Under Management**

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AAOIFI Financial Accounting Standard (FAS) \_\_\_\_ “Off-balance-sheet Assets Under Management” is set out in paragraphs 01-29. All the paragraphs have equal authority. This standard should be read in the context of its objective, the Conceptual Framework for Financial Reporting as endorsed by AAOIFI, [ED of] FAS \_\_\_\_ “Quasi-equity (including Investment Accounts) and [ED of] FAS \_\_\_\_ “Control (of Assets and Business)”.

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

## Preface

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- 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 Islamic finance 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 investors and may or may not include restrictions regarding how such funds are invested. The relationship between the institution and such investors vary according to the terms of the respective contract and at times is limited to management of such investments without having control, as per AAOIFI's financial reporting framework, and hence qualify for off-balance-sheet accounting.
- PR3 This standard improves upon, and brings at one place, the requirements related to financial reporting of off-balance-sheet assets under management.
- PR4 This standard along with [ED of] FAS \_\_ "Quasi-equity (Including Investment Accounts)" supersedes earlier FAS 27 "Investment Accounts".

## Introduction

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### Overview

- IN1 This standard prescribes the criteria for characterisation of off-balance-sheet assets under management, and the related principles of financial reporting in line with the “AAOIFI Conceptual Framework for Financial Reporting” (the conceptual framework).
- IN2 The standard encompasses the aspects related to recognition, derecognition, measurement, selection and adoption of accounting policies etc., related to off-balance-sheet assets under management, as well as, certain specific aspects of financial reporting e.g., impairment and onerous commitments by the institution. The standard also includes the presentation and disclosure requirements, particularly aligning the same with the requirements of FAS 1 “General Presentation and Disclosures in the Financial Statement” in respect of the statement of changes in off-balance-sheet assets under management.
- IN3 This standard along with [ED of] FAS \_\_ “Quasi-equity (Including Investment Accounts)” supersedes earlier FAS 27 “Investment Accounts”.

### Rationale for issuing this standard

- IN4 In view of the recommendations of the comprehensive AAOIFI Financial Accounting Standard (FAS) review and 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”. 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 off-balance-sheet assets under management. The board particularly considered the need for alignment with certain changes brought in by FAS 1 “General Presentation and Disclosures in the Financial Statement” and recognised the increased significance of the subject with increasing use of Al-Wakala Bi Al-Istithmar by the institutions.
- IN5 In view of the same, the board concluded that there is a need for a separate standard for assets managed in a fiduciary capacity without establishing control, which are subject to off-balance-sheet accounting.

### Significant changes from previous standard

- IN6 This standard (FAS \_\_) brings significant changes from its predecessor standard (FAS 27 “Investment Accounts”), inter alia, in the following aspects:
- a. criteria for characterisation as off-balance-sheet assets under management (based on control) is defined and unlike the previous standard, structures other than those based on restricted Mudaraba have been included in the scope;
  - b. various definitions, such as, in respect of fiduciary capacity, off-balance-assets under management, as well as, off-balance-sheet investment accounts are aligned with [ED of] FAS on “Control (of Assets and Business)” and “AAOIFI Conceptual Framework for Financial Reporting”;

- c. the requirement are prescribed for selection and application of accounting policies for the purpose of off-balance-sheet assets under management to be consistent with an institutions overall accounting policies developed in line with the relevant AAOIFI FASs;
- d. presentation and disclosure requirements for the institutions are improved including requirement to prepare and present a statement of changes in off-balance-sheet assets under management as a primary financial statement in line with FAS 1 “General Presentation and Disclosures in the Financial Statement”; and
- e. certain specific aspects of financial reporting e.g., impairment and onerous commitment situations have been included.

# **[Exposure Draft (F3/2022) v3.0 of the]**

## **AAOIFI Financial Accounting Standard \_\_**

### **Off-balance-sheet Assets Under Management**

#### **Objective of the standard**

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1. The objective of this standard is to establish the principles of financial reporting related to off-balance-sheet assets under management in line with the “AAOIFI Conceptual Framework for Financial Reporting<sup>1</sup>” (the conceptual framework).

#### **Scope**

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2. This standard shall be applicable on all Islamic financial institutions (the institutions) preparing financial statements in line with the requirements of AAOIFI Financial Accounting Standards (FASs), with regard to the assets managed in a fiduciary capacity without establishing control, except for:
  - a. the participants’ Takaful fund and / or participants’ investment fund of a Takaful institution<sup>2</sup>; and
  - b. an investment fund managed by the institution, being a separate legal entity, which is subject to financial reporting in line with the requirement of the relevant AAOIFI FAS<sup>3</sup>.

#### **Definitions**

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3. For the purpose of interpreting and applying this standard, the following short definitions are relevant:
  - a. Fiduciary capacity – is the capacity to act, in good faith, on behalf, and for the benefit, of another party with a duty to preserve trust;
  - b. Off-balance-sheet assets under management – are assets managed on behalf of investors in a fiduciary capacity but not under control of the institution and include participatory investment instruments and off-balance-sheet investment accounts;
  - c. Off-balance-sheet investment accounts – are investment accounts that meet the definition of off-balance-sheet assets under management in line with the conceptual framework, including those offered and managed by an institution that are not under control of the institution; and
  - d. Participatory investment instrument (commonly referred to as an “account”) – is an instrument held by an investor under a profit or loss sharing (or taking) arrangement (e.g., Mudaraba, Musharaka or Al-Wakala Bi Al-Istithmar) representing funds received by an institution for investment on behalf of the investment accountholder with or without

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<sup>1</sup> “AAOIFI Conceptual Framework for Financial Reporting (Revised 2020)”

<sup>2</sup> The accounting and financial reporting for participants’ Takaful fund and a participants’ investment fund of a Takaful institution shall be in line with their requirements of relevant AAOIFI FASs on Takaful

<sup>3</sup> Presently, FAS 14 “Investment Funds”

conditions as regards to how the funds may be invested, whereby the holder of the instrument is entitled to the residual interest in the underlying assets.

## **Criteria for characterisation as off-balance-sheet assets under management**

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4. Participatory investment instruments may be divided in two main categories. First, whereby the institution controls the underlying assets, which are classified as quasi-equity instruments. Second, whereby the institution does not control the underlying assets, and manages the same only in a fiduciary capacity, which are classified as off-balance-sheet investment instruments.
5. In order to be characterised as off-balance-sheet assets under management, a participatory investment instrument shall be subject to the conditions specified below:
  - a. it manages participatory investment instrument (and related liabilities, and resulting income and expenses, including gains and losses) on behalf of investors only under a fiduciary capacity. The common structures used for these instruments are based on Al-Wakala Bi Al-Istithmar (investment agency), restricted Mudaraba and other Wakala arrangements;
  - b. in case of participatory investment instruments, it is entitled only to a fixed or variable fee (including incentives), share of profit or a combination thereof, according to the Shari'ah principles and rules, as remuneration against management of the underlying assets. However, the institution is not entitled to any residual interest in the underlying assets, except to the extent of such established remuneration;
  - c. it does not control participatory investment instruments, in line with the definition of control<sup>4</sup>, and hence, is not entitled to or exposed to the variable returns from its involvement with such underlying assets;
  - d. a Mudaraba shall be considered a restricted Mudaraba, if and only if, the Rab-ul-Maal has reasonably restricted the independent decision making powers of the Mudarib in respect of management of the Mudaraba investments. The condition specified in paragraph 5 shall be tested against the following common criteria:
    - i. specifying an asset pool separately from the common assets of the institution, without commingling with the institution's own funds or unrestricted Mudaraba investments etc.;
    - ii. defining an investment boundary e.g., through defining investment motive, market, platform, risk appetite, assets or asset classes, liquidity profiles, currency, geographical distributions, customer or customer classes; and
    - iii. restricting the replacement / transfer / reinvestment rights of the Mudaraba investments; and
  - e. the off-balance-sheet assets under management managed by the institution on behalf of investor(s) shall be considered as a separate virtual reporting entity<sup>5</sup> for recording, monitoring and reporting purposes.

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<sup>4</sup> See paragraph 5 of [ED of] FAS \_\_ "Control (of Assets and Business)"

<sup>5</sup> See BC1 and BC2 of FAS 40 "Financial Reporting for Islamic Finance Windows" for discussion on virtual entity



## **Recognition, measurement and derecognition**

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6. In paragraphs 8-20, recognition, subsequent measurement and derecognition refers to the act of recording and measuring and removal of the assets and related transactions from the virtual reporting entity (distinct and separate from the institution's assets under control). It is clarified that off-balance-sheet assets under management are not recognised by the institution as its own (or under control) assets.

## **Selection and adoption of accounting policies**

7. The accounting policies applied by an institution for the purpose of off-balance-sheet assets under management shall be consistent with its overall accounting policies developed in line with the relevant AAOIFI FASs, unless use of such accounting policies results in an accounting mismatch or does not reflect the business model of the off-balance-sheet assets under management. In such case the accounting policies selected and adopted shall be in line with the relevant AAOIFI FASs.

## **Initial recognition**

### *Timing of initial recognition*

8. An institution shall initially recognise the investors' managed funds (of the off-balance-sheet assets under management) in a separate virtual reporting entity 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 off-balance-sheet assets under management; or
  - b. when the funds (or corresponding assets) received are transferred to the virtual reporting entity, on the effective date of the contract, as per contractual terms; and
  - c. the respective contract has no other precondition to come into effect.

### *Initial recognition of investors' managed funds*

9. The initial recognition of the investors' managed funds of off-balance-sheet assets under management shall be at the fair value of the consideration received when the contract comes into effect.

### *Initial recognition of underlying assets acquired*

10. An institution shall recognise acquisition of an underlying asset(s) according to the accounting policies adopted for the purpose of off-balance-sheet assets under management, in line with the respective AAOIFI FASs, when it acquires the asset(s).

## **Subsequent measurement**

### *Subsequent measurement of the investors' managed funds*

11. Subsequent measurement of the investors' managed funds of off-balance-sheet assets under management at the end of a reporting period shall reflect the residual interest in net underlying assets.

### *Subsequent measurement of underlying assets (and liabilities)*

12. An institution shall subsequently measure underlying asset(s) (and any related liabilities, if any) according to the accounting policies adopted for the purpose of off-balance-sheet assets under management, in line with the respective AAOIFI FASs).

### *Impairment and expected credit losses / write-offs attributable to underlying assets*

13. Impairment and expected credit losses / write-offs attributable to the underlying assets shall be recognised according to the accounting policies adopted for the purpose of off-balance-sheet assets under management, in line with the respective AAOIFI FASs, respective Shari'ah' principles and rules and contractual terms.

### *Reserves*

14. An institution may create a risk reserve(s) in the virtual entity in line with FAS 35 "Risk Reserves" to mitigate various risks faced by the investors of the participatory investment instruments.
15. Where a reserve is maintained for the off-balance-sheet assets under management, the impairment and expected credit losses / write-offs and fair value losses pertaining to the underlying assets may be set off against such reserves.

### *Provision for loss due to misconduct or negligence to be recognised by the institution*

16. 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 for the virtual reporting entity.

### *Reassessment by the institution*

17. In rare circumstances, the institution may need to inject its own funds in the participatory investment instrument, especially in the case of bridge financing or when the put option is exercised (partially) by the investor(s) before the maturity of the underlying asset. In such cases, the institution shall make a reassessment whether the funds are in the nature of:
  - a. receivable by the institution, and payable by the virtual entity and are not eligible for accrual of any return and proportionate ownership is acceptable and ascertained; or
  - b. investment in the institution is in the nature of, and at par with, the other equity investors of virtual entity; or
  - c. multi-level investment arrangement exhibiting the characteristics described in relevant AAOIFI FASs<sup>6</sup> are to be presented accordingly.

### **Institution's exposure to loss under onerous commitments**

18. In certain cases, the institution may be exposed to a risk of loss arising from the onerous commitment arising from underlying assets. This situation usually occurs when:
  - a. the life of the underlying asset is more than the contractual term of the participatory investment instrument; and
  - b. the underlying asset is expected to have a value lower than the current carrying value at the time the underlying asset reverts to the institution.
19. The loss referred to in paragraph 18 shall be recognised in a timely manner and charged to the statement of income of the institution.

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<sup>6</sup> See paragraph 36 of [ED of] FAS\_\_\_ "Quasi-equity (including Investment Accounts)"

## **Derecognition**

20. The investors' managed funds of off-balance-sheet assets under management and the underlying assets are derecognised from the virtual reporting entity when they satisfy the following criteria:
- a. the control of the asset is transferred to another party through sale or otherwise (e.g., through gift or settlement); or
  - b. there are no future economic benefits expected from use or disposal of such asset (e.g., if the asset is expired or surrendered or the asset is destroyed or fully impaired); or
  - c. the underlying contract is terminated, and there are no further legally enforceable obligations in the virtual entity.

## **Presentation and disclosures**

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### **Disclosure of accounting policies**

21. The accounting policies applied to the off-balance-sheets assets under management, if different from the accounting policies applied by the institution, shall be identified and disclosed in the notes.

### **Statement of changes in off-balance-sheet assets under management**

#### *Presentation in the primary financial statements of the institution*

22. An institution shall prepare and present a statement of changes in off-balance-sheet assets under management as part of its primary statements at each period end. The statement shall include the requirements of paragraphs 136 -139 of FAS 1 "General Presentation and Disclosures in the Financial Statements". The off-balance-sheet participatory instruments shall be presented on a combined basis in the statement.
23. The statement of off-balance-sheet assets under management shall provide adequate disclosures by asset-type (and related liabilities) in a suitable manner.
24. The disclosures of the following are generally relevant for the purpose of the statement of off-balance-sheet assets under management<sup>7</sup>:
- a. balance at the beginning of the period
  - b. investors' additional capital received during the period
  - c. withdrawals / divestments and maturities of investors' managed funds during the period
  - d. net profits / (losses) during the period, including:
    - i. revenues;
    - ii. expenses;
    - iii. fair value gains / (losses);

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<sup>7</sup> Another approach towards measurement and presentation is acceptable, insofar as, the same is in line with the relevant accounting policies developed according to the respective AAOIFI FASs and the requirements of this standard

- iv. impairments and expected credit losses<sup>8</sup> or write-offs (net of reversals), if any; and
- v. institution's agency fee / Mudarib's share
- e. transfers (to) / from the technical reserves during the period
- f. distributions of profit during the period
- g. balance at the end of the period

### *Disclosures of changes in off-balance-sheet assets under management for significant virtual reporting entities*

- 25. An institution shall disclose appropriately (in form of individual statements or detailed disclosures), as part of the notes to the financial statements, the information required in paragraph 22-24 for each material virtual entity. [Explanation: Material virtual entity for the purpose of this paragraph shall be any virtual entity having net assets in excess of 10% of total equity of off-balance-sheet assets under management or in excess of 5% of the total equity of the institution.]
- 26. In case a financial statement for a virtual entity is required then the same shall be presented in line with the requirements of relevant AAOIFI FASs<sup>9</sup> depending on the nature of underlying assets.

### **Additional disclosures**

- 27. The institutions shall disclose the following additional information in the notes of the financial statements:
  - a. provision for onerous commitment in case of expected losses in the value of the underlying assets in case of a probable reversion of the underlying asset(s) to the institution;
  - b. any recourse available to any of the investors against a potential loss;
  - c. the details of the any ring-fencing arrangement, if any; and
  - d. details of any Hiba, gift, or waiver of fee by the institution to the virtual entity.

### **Effective date**

- 28. This standard shall be effective for the financial periods beginning on or after 1 January 2025. Early adoption is encouraged. This standard shall be adopted at the same time as of adoption of [ED of] FAS \_\_\_\_ "Quasi-equity (including Investment Accounts)".

### **Amendments to other standards**

- 29. This standard along with [ED of] FAS \_\_\_\_ "Quasi-equity (including Investment Accounts)" will supersede FAS 27 "Investment Accounts".

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<sup>8</sup> Accounting policies to be developed according to FAS 30 "Impairment, Credit Losses and Onerous Commitments"

<sup>9</sup> Either FAS 14 "Investment Funds" or FAS 34 "Financial Reporting for Sukuk-holders"

## **Appendices**

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### **Appendix A: Adoption of the standard**

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This standard was presented for approval in the \_\_\_ AAOIFI Accounting Board meeting held on \_\_\_\_, corresponding \_\_\_\_\_ 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. Samet Arslan
14. Mr. Saud Al Busaidi
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. Mufti 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)

## Appendix B: Illustrative statement of changes in off-balance-sheet assets under management

[Name of IFI]

### Statement Of Changes In Off-Balance-Sheet Assets Under Management For The Period 31 December 20xx

Bank balances	Receivables – Ijarah trade-based modes	Muntahia Bittamleek	Participatory Investments investments in real estate	Investments in Others Sukuk, shares and other securities	Current account with the institution – net	Liabilities (if any)	Total
-----CU in '000-----							

#### Current period

Balance as at beginning of the period	A	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	(xxxxx)	(xxxxx)	xxxxx
Additions	B	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx
Recoveries / disposals / maturities	C	(xxxxx)	(xxxxx)	(xxxxx)	(xxxxx)	(xxxxx)	(xxxxx)	(xxxxx)	(xxxxx)	(xxxxx)
Net increase / (decrease)	D=B-C	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx
Net income	E		xxxxx	xxxxx	xxxxx	xxxxx	xxxxx			xxxxx
Mudarib's share	F						(xxxxx)			(xxxxx)
Fixed agency fee	G						(xxxxx)			(xxxxx)
Variable agency fee	H						(xxxxx)			(xxxxx)
Total institution's management share	I=F+G+H						(xxxxx)			(xxxxx)
Distributions / withdrawals	J	(xxxxx)					(xxxxx)			(xxxxx)
Balance as at end of the period	K=A+D+E-I-J	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	(xxxxx)	(xxxxx)	xxxxx

#### Prior period

Balance as at beginning of the period	A	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	(xxxxx)	(xxxxx)	xxxxx
Additions	B	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx
Recoveries / disposals / maturities	C	(xxxxx)	(xxxxx)	(xxxxx)	(xxxxx)	(xxxxx)	(xxxxx)	(xxxxx)	(xxxxx)	(xxxxx)
Net increase / (decrease)	D=B-C	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx
Net income	E		xxxxx	xxxxx	xxxxx	xxxxx	xxxxx			xxxxx
Mudarib's share	F						(xxxxx)			(xxxxx)
Fixed agency fee	G						(xxxxx)			(xxxxx)
Variable agency fee	H						(xxxxx)			(xxxxx)
Total institution's management share	I=F+G+H						(xxxxx)			(xxxxx)
Distributions / withdrawals	J	(xxxxx)					(xxxxx)			(xxxxx)
Balance as at end of the period	K=A+D+E-I-J	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx	(xxxxx)	(xxxxx)	xxxxx

[Note 1: This format is an example of how the statement may be presented. Alternative modes of presentation that are consistent with the disclosure objective may be considered. Distributions could be item-wise or total. A simplified statement can also be made with total assets, total liabilities, less distributions, agency fee, etc. Similarly, liabilities may include funding costs. In such a situation, the amount may be presented in column E of liabilities. Any direct expenses may be shown in column E of cash with adequate disclosures in the notes.]

[Note 2: This is a consolidated statement of all off-balance-sheet assets under management.]

[Note 3: Net income shall include income from investments, fair value gains / losses and attributable expenses. The institution may expand this presentation if such information is considered material for the users of the financial statements.]

[Note 4: Break-up of material items to be disclosed.]



## **Appendix C: Basis for conclusions**

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[to be updated]

## **Appendix D: Brief history of the preparation of the standard**

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- H1 The AAB held its 26<sup>th</sup> 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 and one on off-balance-sheet assets under management.
- H2 The working group in its 7<sup>th</sup> meeting held on 4 Safar 1444H, corresponding to 31 August 2022 discussed the first draft of the exposure draft on off-balance-sheet assets under management.
- H3 The working group in its 8<sup>th</sup> meeting held on 15 Safar 1444H, corresponding to 11 September 2022 discussed the updated draft based on initial comments and observations. After making necessary changes the exposure draft on off-balance-sheet assets under management was recommended to the board.
- H4 The AAB held its 29<sup>th</sup> meeting on 29 Safar 1444H, corresponding to 25-26 September 2022. In this meeting the board requested specific changes and approved, in principle, the exposure draft for issuance.
- H5 After incorporation of the specified changes, the exposure draft was issued on 6 Jumada II 1444H, corresponding to 30 December 2022.