[Exposure Draft (F2/2024) of the]
AAOIFI Financial Accounting Standard __
Istisna-based Development Contracts

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AAOIFI Financial Accounting Standard (FAS) __ "Istisna-based Development Contracts" is set out in paragraphs 01-50. All the paragraphs have equal authority. This standard should be read in the context of its objective and the "AAOIFI Conceptual Framework for Financial Reporting".

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

Preface

PR1 Istisna-based development contracts are amongst the unique products of Islamic finance, having a significant proportion in the Islamic finance transactions in different markets. Due to multiple unique transaction structures based on Istisna, and certain Shari'ah compliance issues in their implementation, the financial reporting requirements for the same is always a challenge.

PR2 AAOIFI had earlier addressed these unique financial reporting requirements in the AAOIFI Financial Accounting Standard (FAS) 7 "Salam and Parallel Salam" and FAS 10 "Istisna'a and Parallel Istisna'a", which were identified for revision and improvement as a result of comprehensive FAS review and revision project initiated by AAOIFI Accounting Board (AAB / the board).

PR3 This standard aims at setting out the financial reporting principles for recognising, measuring, presenting and disclosing the transactions of Istisna-based development contracts that are carried out by both, the buyers and the sellers of such transactions.

PR4 This standard, along with the [ED of] FAS __ "Deferred Delivery Sales", supersedes the earlier FAS 7 "Salam and Parallel Salam" and FAS 10 "Istisna'a and Parallel Istisna'a".

Introduction

Overview

IN1 This standard prescribes the accounting and financial reporting principles for recognition, measurement, presentation and disclosures related to Istisna-based development contracts (which are generally medium- to long-term in nature), applicable to the developers and customers for such contracts.

Rationale for issuing this standard

IN2 In line with the financial accounting standards (FASs) development strategy, AAOIFI Accounting Board (AAB / the board) initiated a review and revision process for certain FASs, including FASs addressing the accounting and financial reporting issues of Salam and Istisna transactions. Such process and additional time-to-time feedback received from the market participants, revealed that certain aspects of the newer market practices and the changes and updates in the generally accepted accounting principles need to be incorporated in the relevant FASs. In addition, a need was felt to align certain requirements with the newer FASs and the revised AAOIFI Conceptual Framework for Financial Reporting (conceptual framework). Accordingly, it was considered imperative to revise the existing FASs dealing with Salam and Istisna transactions.

IN3 During the revision process, it was considered necessary by the board to separately address the financial reporting requirements related to development contracts based on Istisna (generally, medium- to long-term in nature, and involving significant element of efforts), differently from the more common forms of deferred delivery sales transactions (based on either, Salam or Istisna, and generally short-term in nature) which shall be covered in a separate standard to be issued simultaneously with this standard.

Significant changes from the previous standard

IN4 This standard brings significant changes from its predecessor standard (FAS 10 "Istisna'a and Parallel Istisna'a"), inter alia, in the following aspects:

a. the deferred delivery sales transactions based on Istisna (which are generally short-term in nature and do not meet the criteria for Istisna-based development contracts) are not included in the scope of this standard and are subject to the requirements of the FAS on "Deferred Delivery Sales[1]" (being simultaneously issued);

b. the financial reporting requirements prescribed by the revised standard are aligned with the requirements related to control, transfer of control and revenue recognition as prescribed by the conceptual framework, the relevant AAOIFI FASs and the generally accepted accounting principles, suitably incorporating the effect of the unique transaction structures and the business model of the Islamic financial institutions (IFIs / the institutions);

c. the predecessor standards included certain Shari'ah requirements which have not been included in the revised standard, and accordingly this standard shall be read in conjunction with the respective AAOIFI Shari'ah Standards (SSs);

[1] [ED of] FAS ___ "Deferred Delivery Sales"

d. the relevant definitions have been aligned with the definitions provided by the respective AAOIFI SSs;

e. the revised standard prescribes the financial reporting requirements from both the developer's and the customer's perspective, while the predecessor standards addressed the financial reporting for the developer only;

f. the revised standard aligns the requirements relating to the impairment, credit losses, net realisable value (NRV) and onerous contracts with the requirements of the respective AAOIFI FAS[2];

g. the treatments and financial reporting requirements for parallel Istisna-based development contracts have been simplified and are now based on the applicable treatments for the developer and the customer, respectively; and

h. accounting requirements with respect to subsequent changes in the terms of the contract have been simplified.

[2] FAS 30 "Impairment, Credit Losses and Onerous Commitments"

[Exposure Draft (F2/2024) of the]
AAOIFI Financial Accounting Standard __
Istisna-based Development Contracts

Objective of the standard

1. The objective of this standard is to prescribe the appropriate accounting and financial reporting principles for recognition, measurement, presentation and disclosures to apply in relation to Istisna-based development contracts for the developers / contractors and customers for such transactions.

Scope

2. This standard applies to accounting and financial reporting for Istisna-based development contracts (see paragraph 5) carried out under Shari'ah principles and rules[3] by the Islamic financial institutions (IFIs / the institutions) and other institutions following AAOIFI Financial Accounting Standards (FASs), except for those Istisna transactions that are excluded from the scope under paragraph 3.

3. This standard shall not apply to such Istisna transactions whereby:

   a. such Istisna transactions do not meet the criteria of an Istisna-based development contract (see paragraph 5), and hence are subject to accounting as a deferred delivery sales transaction according to the requirements of respective AAOIFI FAS[4];

   b. such Istisna transactions have a total development period[5] of less than 12 months, even otherwise meeting the criteria of Istisna-based development contract (see paragraph 5), which shall be subject to accounting as a deferred delivery sales transaction according to the requirements of respective AAOIFI FAS[6]; or

   c. the institution being a customer of an Istisna-based development contract, has intentions to either:

      i. lease out and eventually sell (or otherwise transfer) the subject-matter under Ijarah Muntahia Bittamleek arrangement, to be accounted for in line with the requirements of the respective standard[7]; or

      ii. use the subject-matter in its own operations (self-use or self-consumption).

[3] See paragraph 8(k) of FAS 1 "General Presentation and Disclosures in the Financial Statements"
[4] [ED of] FAS ___ "Deferred Delivery Sales"
[5] See paragraph 5(d) and explanation thereto
[6] [ED of] FAS ___ "Deferred Delivery Sales"
[7] FAS 32 "Ijarah"

Definitions

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

   a. Customer – in the specific context of this standard, is the buyer who acquires the subject-matter under an Istisna-based development contract;

   b. Deferred delivery sales[8] – are the sales transactions carried out in line with Shari'ah principles and rules, based on either Salam or Istisna contract, whereby the primary performance obligation under the respective contract is delivery of the subject-matter. Deferred delivery sales do not include such sales transactions that are promised to be carried out on a specific future date against a unilateral promise or undertaking to sell or purchase, which are consummated through an offer and acceptance on such future date, in line with Shari'ah principles and rules;

   c. Developer – in the specific context of this standard, is the manufacturer, constructor, producer, processor, fabricator or builder, etc., who develops (and sells) the subject-matter under an Istisna-based development contract;

   d. Istisna[9] – is a contract to sell a described asset with deferred delivery based on a manufacturing request. In practicality, it is a sale contract between the buyer and the seller whereby the seller, based on an order from the buyer, undertakes to manufacture, have it / get it manufactured or otherwise acquire the subject-matter of the contract according to the specifications and sell it to the buyer for an agreed upon price and method of settlement whether that be in advance, by instalments or deferred to a specific future time;

   e. Istisna-based development contract – is a contract of Istisna for development of an asset meeting the criteria defined in paragraph 5;

   f. Parallel Istisna[10] – is an arrangement whereby the seller / developer enters into another independent Istisna contract with a third party to acquire (through manufacturing / development) the subject-matter according to the specifications of the subject-matter specified in the first Istisna contract as to fulfil the obligation under the first Istisna contract. In contemporary custom, such second contract is called parallel Istisna. Parallel Istisna is executed only if so allowed by the buyer / customer under the first Istisna contract, without making the execution of the second Istisna contract dependent on the execution of the first one [Explanation: In practice, the sequence of the execution of the two independent Istisna transactions may vary according to the transaction structure]; and

   g. Stage of completion method – also, at times, referred to as percentage of completion method, is the recognition of revenue and expenses by reference to the stage of completion of a development contract. Under this method, development contract revenue is matched with the development contract project cost incurred in reaching the stage of completion,

[8] [ED of] FAS __ "Deferred Delivery Sales"
[9] [ED of] FAS __ "Deferred Delivery Sales"
[10] [ED of] FAS __ "Deferred Delivery Sales"

resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion / stage of work completed.

Assessment of Istisna-based development contracts subject to the requirements of this standard

5. Istisna-based development contract, within the scope of this standard, is a contract of Istisna for development of an asset (normally, an item of property, plant and equipment or investment property), duly meeting the following criteria:

    a. it involves a significant element of efforts on the part of the developer, including labour and services (which needs to be compensated for in the event of force majeure, in line with Shari’ah principles and rules and customary practices);

    b. it has either an element of partial control transfer through milestones-based delivery and / or construction / development on the customer’s owned property or, otherwise, defines multiple performance obligations as a part of the contract that may individually be assessed and used as criteria for determining stage of completion;

    c. the subject-matter is intended to address certain specific needs of an identified unique customer and hence, may generally not have a ready market or may not be in a condition, position or location suited for its sale to a third party; and

    d. it has a considerable original total development period (comprising of a single or multiple phases or tranches). [Explanation: Development period, in the specific context of this definition criteria, shall not be confused with, or considered interchangeable with, the deferred delivery period.]

Istisna-based development contracts in the books of the developer (seller)

Initial recognition

Development contract project cost

6. Development contract project cost (recognised as an asset) shall comprise:

    a. costs that are incurred directly on the subject-matter of the specific development contract;

    b. indirect overheads that are objectively attributable to the development process, hence, allocated to the development contract (excluding any idle capacity element of the fixed overheads); and

    c. such other costs as are specifically chargeable to the customer under the terms of the contract.

7. General and administrative expenses, selling expenses, research costs, etc., shall not be included in the development contract project cost.

8. The development contract project cost may be reduced by any incidental income that is not included in the development contract revenue, for example, income from the sale of surplus materials, income on the disposal of related plant and equipment or services provided to third parties using the resources allocated to the development contract.

9. Development contract project cost includes the costs attributable to a development contract for the period from the date of securing the contract to the final completion of the development contract / delivery of the subject-matter.

10. Costs directly relating to securing a development contract (such as legal fee, feasibility reports or engineering surveys / plans) are also included as part of the development contract project cost if, and only if, the same can be separately identified and measured reliably and it is virtually certain that the contract will be secured.

Development contract progress billings

11. Receivables from the customer and development contract progress billing (liability), as a corresponding liability, shall be recognised as and when contractually agreed progress billings (including mobilisation advance) are made to the customer.

Subsequent measurement

Development contract project cost

12. At the end of each financial reporting period, development contract project cost, in respect of each development contract, shall be carried at cumulative cost (see paragraph 14) less allowance for impairment, if any.

13. Allowance for impairment, if any, shall be accounted for in accordance with the respective AAOIFI FAS[11]. A delay in, or inability of, the customer to make contractually agreed progress payments against the development contract shall be considered as an objective evidence of impairment.

14. Development contract project cost, as subsequently measured, shall include the cumulative amount of periodically recognised development contract profit (i.e., the difference between the development contract revenue and the development contract cost of revenue).

Receivables from the customer

15. Receivables from the customer (net of recoveries and adjustments, if any) shall be subsequently measured at carrying value less expected credit losses, if any. In case of receivables from the customer after completion of the development contract and delivery of the subject-matter, involving a deferred payment, unamortised amount of deferred profit shall be shown as a deduction from the gross amount of receivables (see paragraph 22).

16. An allowance for expected credit losses, if any, shall be accounted for in accordance with the respective AAOIFI FAS[12].

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[11] FAS 30 “Impairment, Credit Losses and Onerous Commitments”
[12] FAS 30 “Impairment, Credit Losses and Onerous Commitments”

Development contract progress billing (liability)

17. Development contract progress billing (liability) at the end of each financial reporting period shall be reported at its cumulative amount less cumulative amount of accrued receivable / unbilled revenue against development contract progress, whereas:

    a. a net liability shall be shown as development contract progress billing (liability) – net; and

    b. a net asset shall be shown as accrued receivable / unbilled revenue against development contract progress – net.

Development contract revenue

18. Development contract revenue, at the end of each financial reporting period, shall be recognised on a stage of completion basis if, and only if:

    a. total development contract project cost can be measured reliably, and it does not exceed the total development contract revenue;

    b. the stage of completion of the subject-matter of the development contract can be reliably measured through pre-agreed project milestones or, in the absence of the same, through reasonable estimates (based on engineering surveys / estimates or costs incurred); and

    c. it is probable that future economic benefits shall flow to the institution.

19. Accrued receivable against development contract shall be recorded as a receivable against the development contract progress.

20. There is a rebuttable presumption that in all Istisna-based development contracts, the revenue may always be reliably measured as Istisna is generally a fixed price contract. However, in certain circumstances where variations in revenue are expected due to variations in delivery date, extra work or change in specifications, etc., a prudent estimate of the revenue shall be applied, for the purpose of application of stage of completion method unless, and till the time, a higher amount of revenue is virtually certain.

21. In case of mutually agreed changes in development contract price, hence total expected revenue, any such changes shall be incorporated in the total amount of expected revenue as and when contractually agreed.

22. In case of such transactions where full or part of the price is to be received on a deferred basis (i.e., after the delivery of the subject-matter), the revenue referred to in paragraphs 18-21, for the purpose of application of stage of completion method, shall exclude an appropriate proportion of the revenue (see paragraph 23) which shall be deferred and recognised over a period of time in line with the requirements of respective AAOIFI FAS[13].

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[13] See paragraphs 23-28 of FAS 28 “Murabaha and Other Deferred Payment Sales” [Explanation: According to such requirements, in case of deferred payment sales, the profit arising from the transaction i.e., the difference between revenue and cost of sales recognised, shall be deferred through a deferred profit account. However, in case where the equivalent cash sale price of the goods sold is higher than the cost of sales, the profit to the extent of difference between the cash sale price and the cost of sales shall not be deferred.]

23. An appropriate amount of revenue to be deferred in line with the requirements of paragraph 22 shall be equal to the difference between the total sale price of the subject-matter and the estimated equivalent cash sale price that would have been paid in case a full settlement of the same had taken place at the time of delivery of subject-matter.

Development contract cost of revenue

24. Development contract cost of revenue, at the end of each financial reporting period, shall be recognised on a stage of completion basis, corresponding to the development contract revenue, if the conditions prescribed in paragraph 18 are satisfied. The development contract cost of revenue may include an additional cost element in case of onerous situation (see paragraph 26).

Application of stage of completion method

25. Under the stage of completion method:

    a. development contract revenue is recognised in the statement of income of the relevant financial reporting period in proportion to the stage of completion of the subject-matter; and

    b. development contract project cost is recognised as an expense in the statement of income of the relevant financial reporting period in proportion to the stage of completion of the subject-matter (see paragraph 18(b)).

26. An onerous loss, whereby it is expected that the total development contract project cost would exceed the total development contract revenue, shall be immediately recognised, irrespective of stage of completion of the development contract.

27. A change in estimate with regard to the total development contract revenue and the total development contract project cost that results in an increase or reversal of a previously recognised onerous loss shall be immediately recognised in the statement of income. In case, such change in estimate results in a situation whereby the revised total development contract revenue (e.g., in case of contract re-negotiations) exceeds the revised estimate of total development contract project cost, profit recognition on the basis of stage of completion method, shall be resumed.

Derecognition

28. At the time of conclusion of the contract and complete handover / delivery of the subject-matter to the customer, the development contract project cost and the development contract progress billing shall be derecognised, whereas any differential amount shall be recognised in the statement of income. [Explanation: In most circumstances, at this point of time, both the accounts shall have equal value. However, in rare circumstances, these may have different values e.g., due to impairment.]

Inability to assess stage of completion of an Istisna-based development contract

29. In unusual circumstances where both the stage of completion and the total expected development contract project cost cannot be measured reliably at the end of the financial reporting period, the institution shall:

a. cease to follow the accounting prescribed by this standard and follow the requirements of respective AAOIFI FAS[14] applicable on deferred delivery sales, if such limitation is identified during the first financial reporting period; and

b. cease to recognise any development contract revenue (and reverse any already recognised development contract revenue) in the excess of already recognised development contract cost of revenue, if such limitation is identified subsequent to the preceding financial reporting period.

30. In case of application of paragraph 29(b), once a reasonable estimate of both, the stage of completion and the total expected development contract project cost, can be made, the remaining development contract revenue and profit shall be recognised on a stage of completion basis (including any cumulative effect of the same as of that date).

Onerous Istisna-based development contracts

31. Any onerous situation under an Istisna-based development contract shall be dealt with in line with the requirements of the respective AAOIFI FAS[15]. Situations such as those mentioned in paragraph 27 may be indicative objective evidence of overall impairment.

Presentation and disclosures

32. In addition to the disclosure requirements as stated in FAS 1 “General Presentation and Disclosures in the Financial Statements”, the following minimum disclosures shall be made in the financial statements of the developer:

    a. the accounting policies adopted for Istisna-based development transactions, including the aspects of recognition of development contract project cost, receivable from customers, development contract revenue, development contract cost of revenue and profit (including deferred profit, where applicable), etc.;

    b. the development contract project cost at the end of the financial reporting period;

    c. liability for the development contract progress billings and the receivables from the customer;

    d. the development contract revenue, development contract project cost of revenue and profit resulted from Istisna-based development contracts, respectively, during the financial reporting period;

    e. unamortised deferred profits providing a movement of the same during the period duly disclosed as a deduction from the outstanding amount of gross receivables; and

    f. allowance for impairment and credit losses and provision for onerous commitments / contracts, along with their respective movement, in line with the requirements of respective AAOIFI FAS[16].

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[14] [ED of] FAS __ “Deferred Delivery Sales”
[15] FAS 30 “Impairment, Credit Losses and Onerous Commitments”
[16] FAS 30 “Impairment, Credit Losses and Onerous Commitments”

33. The balance of the Istisna-based development project in-progress and outstanding progress billings shall be presented on the appropriate side of the statement of financial position, without netting off.

34. Where the contract includes a parallel element, such transaction shall be separately disclosed, identifying that amount which pertains to the original Istisna-based development contract.

Istisna-based development contracts in the books of the customer (buyer)

Initial recognition

Advance against Istisna-based development project

35. Advance cash payments made by the customer to the developer (in the form of mobilisation advance or progress billing, etc.) shall be recognised as and when the advance payment(s) is made (in lump sum, or in instalments), if any, in line with the contractual arrangements, as advance against Istisna-based development project equivalent to the amount of cash paid.

Subsequent measurement

Advance against Istisna-based development project

36. Advance against Istisna-based development project, at the end of each financial reporting period, shall be reported at its carrying value less any transfers to the Istisna-based development project in-progress account, less allowance for expected credit losses, if any.

37. An allowance for impairment, if any, shall be accounted for in accordance with the requirements of the respective AAOIFI FAS[17]. A delay in, or inability of the developer to perform delivery of the subject-matter shall be considered as an objective evidence of impairment.

Istisna-based development project in-progress

38. Istisna-based development project in-progress, at the end of each financial reporting period, shall be recognised to the extent of the project's stage of completion as of that date (if such information is available), through transfer from advance against Istisna-based development project, or by way of recognising a liability (payable to the developer), in case such estimate is in excess of the advance already paid. [Explanation: A liability to be recorded in this respect shall not be confused with any progress billing(s) from the developer unless the same is strictly corresponding to the stage of completion of the Istisna-based development project. Any such progress billing(s) in the excess of stage of completion may constitute a firm commitment, but not a liability.]

39. Istisna-based development project in-progress shall be subject to impairment testing at the end of each financial reporting period. Allowance for impairment, if any, shall be accounted for in accordance with the requirements of the respective AAOIFI FAS[18]. A delay in, or inability of, the developer to perform delivery of the subject-matter may be considered as an objective evidence of impairment.

[17] FAS 30 "Impairment, Credit Losses and Onerous Commitments"
[18] FAS 30 "Impairment, Credit Losses and Onerous Commitments"

Acquisition of subject-matter

40. The project shall stand concluded once the subject-matter is delivered from the developer to the customer, i.e., the time when the customer essentially acquires the complete control, and hence substantially all risks and rewards incidental to ownership, of such subject-matter.

41. A delivery of the subject-matter not matching the contractual specifications may trigger a need for reassessment of impairment thereon, if any.

Presentation and disclosures

42. In addition to the disclosure requirements as stated in FAS 1 “General Presentation and Disclosures in the Financial Statements”, the following minimum disclosures shall be made in the financial statements of the customer:

    a. the accounting policies adopted for Istisna-based development transactions, including the aspects of recognition of advance against Istisna-based development projects, Istisna-based development projects in-progress, etc.;

    b. appropriate disclosures in respect of advance against Istisna-based development projects and Istisna-based development projects in-progress:

        i. advance payment (in full or in part) made to the developer and respective movement;

        ii. Istisna-based development project in-progress and the stage of completion of subject-matter (as provided by the developer) and respective movement; and

        iii. impairment, if any, on the advance or project in-progress, and the movement thereon;

    c. appropriate disclosure in respect of the progress billing against Istisna-based development projects, including:

        i. total progress billing to-date due for payment – gross and net (i.e., adjusted for payments made against the progress billing to-date or adjusted against advance payments), and their respective movement; and

        ii. commitment against progress billing expected against ongoing Istisna-based development contracts i.e., due in future periods (identifying as expected to be due within 12 months and after 12 months);

    d. appropriate disclosures in respect of sale of subject-matter, bifurcated according to sale based under agency or as direct sale:

        i. amounts receivable against the sale, bifurcating between receivable from the eventual buyer and the agent;

        ii. revenue and profit recognised under Istisna-based development contract;

iii. expected credit losses, if any, in respect of amounts receivable from the eventual buyer or agent (considering the requirements of respective AAOIFI FAS[19]); and

iv. onerous commitments / contracts (in case of a mutually agreed change order) in line with the requirements of respective AAOIFI FAS[20]; and

e. the amount waived / written-off, according to their respective nature, during the period.

43. The balance of the Istisna-based development project in-progress and outstanding progress billings shall be presented on the appropriate side of the statement of financial position, without netting off.

44. Where the contract includes a parallel element, such transaction shall be separately disclosed, identifying that amount which pertains to the original Istisna-based development contract.

Related accounting treatments

Parallel Istisna: Accounting by the developer

The developer entering into parallel Istisna-based development contract with the parallel developer

45. In case of a parallel Istisna-based development contract whereby the developer enters into a parallel Istisna-based development contract with the parallel developer, the developer shall follow the accounting and financial reporting requirements as prescribed in paragraphs 6-34. In this case, the development contract project cost shall be based on information about the stage of completion provided by the parallel developer and any other direct costs attributable in line with the requirements of this standard.[21]

The customer entering into parallel Istisna-based development contract with a parallel customer

46. In case of a customer of a parallel Istisna-based development contract entering into parallel Istisna-based development contract with a parallel customer, the customer shall initiate accounting as a developer in line with the requirements of paragraph 45. Any profit arising as a difference between development contract revenue and corresponding development contract cost of revenue, depending on the stage of completion of the subject-matter as of that date, shall be immediately recognised.

Onerous Istisna-based development contracts

47. Any onerous situation under an Istisna-based development contract (including a parallel Istisna) shall be dealt with in line with the requirements of the respective AAOIFI FAS[22].

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[19] FAS 30 "Impairment, Credit Losses and Onerous Commitments"

[20] FAS 30 "Impairment, Credit Losses and Onerous Commitments"

[21] There is a rebuttable presumption that most common parallel Istisna transactions take place under a logical sequence whereby the developer, under the first Istisna-based development contract, enters into a parallel Istisna-based development contract with another developer (referred to as the parallel developer. However, in rare circumstances, the customer of an Istisna-based development contract may subsequently enter into a parallel Istisna-based development contract with another customer (referred to as the parallel customer), subject to requirements of Shari'ah principles and rules.

[22] FAS 30 "Impairment, Credit Losses and Onerous Commitments"

Subsequent change in price or cost estimate of the subject-matter

48. Any subsequent change in the price of the subject-matter of an Istisna-based development contract in line with the Shari'ah principles and rules (with mutual consent, or in certain cases, according to the pre-agreed mechanism defined under the contract[23]) or in the cost estimate shall be accounted for when it becomes virtually certain. Any change in the eventual profit or loss shall be adjusted according to the changes in estimates in respective computations, according to the stage of completion method. However, such a change event may, in certain situations, be considered as an objective evidence of impairment.

Effective date

49. This standard shall be effective on the financial statements of institutions for financial reporting periods beginning on or after 1 January 2027. Early adoption of the standard is encouraged.

Amendments to other standards

50. This standard, along with the ED of FAS __ "Deferred Delivery Sales", supersedes the earlier FAS 10 "Istisna'a and Parallel Istisna'a".

[23] A change in price of the subject-matter of an Istisna-based development contract may take place based on performance (e.g., meeting the delivery target or delaying from the initially agreed delivery date) if it is contractually defined. See paragraph 3/2/4 of SS 11 "Istisna'a and Parallel Istisna'a".

Appendices

Appendix A: Adoption of the standard

This standard was presented for approval in the ___ AAOIFI Accounting Board meeting held on _____, corresponding to ___________ and was duly approved.

Members of the board

1. Mr. Hamad Abdulla Al Oqab – chairman
2. Mr. Syed Najmul Hussain – deputy chairman
3. Mr. Abdulkadir Farah
4. Dr. Abdulrahman M. Alrazeen
5. Prof. Abdul Razzak Kasem
6. Dr. Bello Lawal Danbatta
7. Mr. Firas Hamdan
8. Mr. Irshad Mahmood
9. Mr. Kazim Merchant
10. Ms. Khawla Ahmed Ebrahim
11. Mr. M. Ali Latif
12. Dr. Muhammad Albeltagi
13. Mr. Saud Al Busaidi
14. Mr. Sezayi Toprak
15. Mr. Wael Merza

Reservation

The standard was approved unanimously.

Working group members

1. Mr. Syed Najmul Hussain – chairman
2. Mr. Achmad Iqbal
3. Mr. Ahmed Siddiqui
4. Dr. Anwar Misbah Soubra
5. Mr. Elmamoun Hamid
6. Mr. Kamal Hossain
7. Dr. M. Mahabbat Hossain
8. Dr. Muhammad Albeltagi
9. Mr. Wael Merza
10. Dr. Yosita Nur Wirdayanti
11. Mr. Yusuf Sayed

Executive team

1. Mr. Omar Mustafa Ansari (AAOIFI)
2. Mr. Mohammad Majd Bakir (AAOIFI)
3. Mr. Haroon Tabraze (Senior consultant-researcher)
4. Ms. Saira Shamsie (Senior consultant-researcher)
5. Ms. Merjan Abid (Consultant-researcher)

Appendix B: Illustrative of application of standard to Istisna-based development contracts

Example 1: Parallel Istisna does not exist (profitable contract)

Basic data

Development contract (DC) revenue: CU 500,000 (2-year Istisna-based development contract).

Total estimated (and actual) development contract project cost: CU 400,000 (including pre-contract costs of CU 15,000) (paragraph 10).

	Year 1	**Year 2**
Cumulative development costs incurred	300,000	400,000
Progress billings	280,000	220,000
Received from customer	230,000	270,000

Accounting treatment by the developer (seller)

Paragraph	Description	Year 1		Year 2	
		Dr.	Cr.	Dr.	Cr.
6	DC project cost (in-progress) (SFP[24])	300,000		100,000	
	Cash (SFP)		300,000		100,000
	[To record asset against cost incurred during the period (assuming that all cost is paid in cash)]				
11	Receivable from customer (SFP)	280,000		220,000	
	DC progress billing (SFP)		280,000		220,000
	[To record progress billing (and advance billing) from time to time]				
15	Cash (SFP)	230,000		270,000	
	Receivable from customer (SFP)		230,000		270,000
	[To record receipt of payments from customers (assuming that all progress billings are received)]				
	Revenue and expense				
24	DC cost of revenue (SI[25])	300,000		100,000	
	DC project cost (in-progress) (SFP)	75,000		25,000	
18(a)	DC revenue (SI)		375,000		125,000
	[To record expense and revenue on a stage of completion basis – see working below]				
28	DC progress billing (SFP)			500,000	
28	DC project cost (in-progress) (SFP)				500,000
	[To derecognise the subject-matter at the time of delivery / conclusion of the project]				

Assumption: Stage of completion can be measured reliably

Paragraph		Year 1	Year 2
18	Stage of completion	(300,000 / 400,000) * 100 = 75%	25%
18	DC revenue (SI)	500,000 * 75% = 375,000	125,000
15	DC project cost (in-progress) (SFP) [to be added at the end of the period to the DC project cost in-progress in nature of deferred profit]	(500,000 - 400,000) * 75% = 75,000	25,000

[24] Statement of financial position (SFP)
[25] Statement of income (SI)

Excerpt from statement of financial position at the end of the financial reporting period

	Year 1	**Year 2**
DC project cost (in-progress) (SFP)	375,000	125,000
Receivable (280,000 – 230,000)	50,000	-
Progress billing	280,000	-

Excerpt from statement of income at the end of the financial reporting period

	Year 1	**Year 2**
DC revenue	375,000	125,000
DC cost of revenue	300,000	100,000

Example 2: Parallel Istisna does not exist (profitable contract with deferred payment element)

Basic data

Development contract revenue: CU 525,000 (2-year Istisna-based development contract with an additional year for payment), where cash equivalent revenue is CU 500,000 and CU 25,000 is the profit for the period after construction is complete.

Total estimated (and actual) development contract project cost: CU 400,000 (including pre-contract costs of CU 15,000) (paragraph 10).

	Year 1	Year 2	Year 3
Cumulative development costs incurred	300,000	400,000	-
Progress billings	175,000	175,000	175,000
Received from customer	175,000	175,000	175,000

Accounting treatment by the developer (seller)

Para.	Description	Year 1		Year 2		Year 3	
		Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
6	DC project cost (in-progress) (SFP)	300,000		100,000			
	Cash (SFP)		300,000		100,000		
	[To record asset against cost incurred during the period (assuming that all cost is paid in cash)]						
11	Receivable from customer (SFP)	175,000		175,000		175,000	
	DC progress billing (SFP)		175,000		175,000		175,000
	[To record progress billing (and advance billing) from time to time]						
15	Cash (SFP)	175,000		175,000		175,000	
	Receivable from customer (SFP)		175,000		175,000		175,000
	[To record receipt of payments from customers (assuming that all progress billings are received by end of year 3)]						
	Revenue and expense						
24	DC cost of revenue (SI)	300,000		100,000			
	DC project cost (in-progress) (SFP)	75,000		25,000		25,000	
18(a)	DC revenue (SI)		375,000		125,000		25,000
	[To record expense and revenue on a stage of completion basis – see working below]						
28	DC progress billing (SFP)					525,000	
28	DC project cost (in-progress) (SFP)						525,000
	[To derecognise the subject-matter at the time of delivery / conclusion of the project]						

Assumption: Stage of completion (at the cash equivalent value) can be measured reliably

Paragraph		**Year 1**	**Year 2**	**Year 3**
18	Stage of completion	(300,000/400,000)*100 = 75%	25%	N/A
18	DC revenue (SI)	500,000*75% = 375,000	125,000	N/A[26]
15	DC project cost (in-progress) (SFP)	(500,000-400,000)*75% = 75,000	25,000	N/A

Excerpt from statement of financial position at the end of the financial reporting period

	Year 1	**Year 2**	**Year 3**
DC project cost (in-progress) (SFP)	375,000	500,000	525,000
Receivable	-	-	-
Progress billing	175,000	350,000	525,000

Excerpt from statement of income at the end of the financial reporting period

	Year 1	**Year 2**	**Year 3**
DC revenue	375,000	125,000	25,000
DC cost of revenue	300,000	100,000	-

[26] Stage of completion for year 3 is not relevant, due to the completion of construction within 2 years. The revenue for year 3 comprises of the deferred profit allocated for the period.

Example 3: Parallel Istisna does not exist (onerous contract)

Basic data

Development contract revenue: CU 400,000 (2-year Istisna-based development contract).

Total estimated development contract project cost commencement of contract: CU 300,000 (including pre-contract costs of CU 15,000) (paragraph 10).

At the end of year 1, due to inflation, the total estimated development contract project cost increased to CU 440,000.

	Year 1	**Year 2**
Cumulative development costs incurred	264,000	440,000
Progress billings	280,000	120,000
Received from customer	230,000	170,000

Accounting treatment by the developer (seller)

Paragraph	Description	Year 1		Year 2	
		Dr.	Cr.	Dr.	Cr.
6	DC project cost (in-progress) (SFP)	264,000		176,000	
	Cash (SFP)		264,000		176,000
	[To record asset against cost incurred during the period (assuming that all cost is paid in cash)]				
11	Receivable from customer (SFP)	280,000		120,000	
	DC progress billing (SFP)		280,000		120,000
	[To record progress billing (and advance billing) from time to time]				
15	Cash (SFP)	230,000		170,000	
	Receivable from customer (SFP)		230,000		170,000
	[To record receipt of payments from customers (assuming that all progress billings are received)]				
	Revenue and expense				
24	DC cost of revenue (SI)	240,000		160,000	
26	DC cost of revenue (onerous loss element) (SI)	40,000		-	
18(a)	DC revenue (SI)		240,000		160,000
26	Provision for onerous loss (SFP)		40,000		-
	[To record expense and revenue on a stage of completion basis – see working below] [To record onerous loss and provision for onerous contract]				
28	DC progress billing (SFP)			400,000	
	Provision for onerous loss (SFP)			40,000	
28	DC project cost (in-progress) (SFP)				440,000
	[To derecognise the subject-matter at the time of delivery / conclusion of the project]				

Assumption: Stage of completion can be measured reliably

Paragraph		Year 1	Year 2
18	Stage of completion	(264,000 / 440,000) * 100 = 60%	40%
18	DC revenue (SI)	400,000 * 60% = 240,000	160,000
26	Loss (total loss immediately recognised)	400,000 - 440,000 = (40,000)	

Excerpt from statement of financial position at the end of the financial reporting period

	Year 1	**Year 2**
DC project cost (in-progress)	264,000	440,000
Receivable (280,000 – 230,000)	50,000	-
Progress billing	(280,000)	-
Provision for onerous loss	(40,000)	-

Excerpt from statement of income at the end of the financial reporting period

	Year 1	**Year 2**
DC revenue	240,000	160,000
DC cost of revenue	240,000	160,000
DC cost of revenue (onerous loss element)	40,000	-

Appendix C: Basis for conclusions

BC1 [to be inserted]

Appendix D: Brief history of the preparation of the standard

H1 The working group on revision of FAS 7 and FAS 10 in its 1st meeting, held on 23 Shawwal 1445H, corresponding to 2 May 2024, discussed the need for revision of the existing standards. The members agreed that the revision of both standards would be done simultaneously, with a separate standard addressing short-term deferred delivery sales and another standard on long-term construction contracts.

H2 AAB, in its 38th meeting held on 2-3 Dhul-Qa'dah 1445H, corresponding to 10-11 May 2024, discussed the preliminary study of the revision project and agreed on the structure and content of the standards. The board also agreed to the development of the core concepts of the two standards.

H3 The initial draft of the standard was presented in the 4th and 5th working group meetings held on 13 Rabi I 1446H and 27 Rabi I 1446H, corresponding to 16 September 2024 and 30 September 2024, respectively. The members of the working group deliberated on the draft standard and requested conclusions to be presented to the board with its recommendations.

H4 The draft standard was presented to AAB in its 40th meeting, held on 4 Rabi II 1446H, corresponding to 7 October 2024. In this meeting, the board reviewed the draft and recommendations made by the working group. After due deliberations, the exposure draft was approved for issuance.

H5 The exposure draft of the standard was issued, after incorporation of the board and working group comments, on 21 Jumada II 1446H, corresponding to 22 December 2024.