[Exposure Draft (F2/2023) of the]
Financial Accounting Standard __
Participatory Ventures

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AAOIFI Financial Accounting Standard (FAS) __ “Participatory Ventures” is set out in paragraphs 1-76. All the paragraphs have equal authority. This standard should be read in the context of its objective and the Conceptual Framework for Financial Reporting as endorsed by AAOIFI.

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. This standard, in particular, shall be read in line with SS 12 “Sharikah (Musharaka) and Modern Corporations”, and SS 13 “Mudarabah”.

Preface

PR1 Mudaraba and Musharaka are perceived to be the most common forms of Shari'ah compliant participatory or profit and loss sharing (or taking) structures.

PR2 As the Islamic finance industry has grown in terms of size, products, structures and forms of Musharaka and Mudaraba, there was a need to review existing standards, FAS 3 "Mudaraba Financing" and FAS 4 "Musharaka Financing", and to align the same with the new "AAOIFI Conceptual Framework for Financial Reporting" and FAS 1 "General Presentation and Disclosures in the Financial Statements". This forms part of the comprehensive project undertaken by the AAOIFI Accounting Board (AAB, the board) for review and revision of financial accounting standards (FASs) issued earlier.

PR3 Furthermore, the previously issued standards did not address counterparty accounting for these structures.

PR4 This standard brings accounting and financial reporting for participatory structures in line with global best practices, particularly in relation to joint ventures. Participatory ventures, particularly, have unique characteristics and are distinguished from conventional joint ventures in terms of structures, classification and reporting requirements.

PR5 This standard supersedes the existing FAS 3 "Mudaraba Financing" and FAS 4 "Musharaka Financing".

Introduction

Overview

IN1 This standard prescribes accounting and financial reporting principles for recognition, measurement, presentation and disclosures to apply in relation to participatory ventures (including most of the common structures / products based on Mudaraba and Musharaka).

IN2 This standard shall be applied in respect of accounting and financial reporting by the investor(s), the working partner(s), as well as, the participatory ventures with regard to all such participatory ventures that fall within the scope of this standard, including those with fixed and variable equity / quasi-equity shares.

Rationale for issuing this standard

IN3 In line with the new strategy of the board, AAOIFI initiated the "AAOIFI Financial Accounting Standards (FASs) review and revision project" in 2018 to review and revise all existing FASs. As part of the process and in view of the feedback received from market participants, it was considered imperative to perform a comprehensive revision of the existing AAOIFI FASs on Mudaraba and Musharaka, in addition to the proposed revision of FAS 27 "Investment Accounts".

IN4 A revision of these standards was considered pertinent because the same had been issued quite a long time back, and since then there have been significant developments in the structure and application of the products based on Musharaka and Mudaraba, as well as, in the financial reporting standards applied to similar transactions and structures across the industry, globally. Furthermore, and as a result of the finalisation and issuance of the "AAOIFI Conceptual Framework for Financial Reporting" and the FAS 1 "General Presentation and Disclosures in the Financial Statements"[1], it was inevitable to ensure that all earlier issued FASs are also aligned with the new pronouncements. Particularly, certain accounting treatments prescribed by the earlier FASs were not considered aligned with the revised AAOIFI framework and the generally accepted accounting principles, and hence, their alignment with the same was considered necessary.

Significant changes from previous standards

IN5 This standard (FAS __ "Accounting and Financial Reporting for Participatory Ventures") introduces significant improvements to its predecessor standards (namely, FAS 3 "Mudaraba Financing" and FAS 4 "Musharaka Financing"), inter alia, in the following aspects:

a. the existing standards did not cover the cases of participatory ventures in the books of account of the working partner(s) and the participatory venture itself;

b. the existing standards were not aligned with the new conceptual framework and generally accepted accounting principles in many aspects including establishment of control, quasi-equity accounting, and off-balance sheet accounting;

[1] FAS 1 "General Presentation and Disclosures in the Financial Statements" was issued in December 2020.

c. the specific cases of participatory venture with gradual transfer of ownership / transfer of units such as variable equity ventures (e.g., running Musharaka), diminishing Musharaka and restricted Mudaraba were not covered under the existing standards; and

d. the existing standards, as similar to other certain earlier FASs issued by AAOIFI included certain Shariah related requirements in the body text, as well as, the respective appendices. In line with other newer AAOIFI FASs, such requirements have been removed and the new standard refers to, and shall be read in conjunction with, respective AAOIFI Shariah standards.

[Exposure Draft (F2/2023)]
AAOIFI Financial Accounting Standard ___
Participatory Ventures

Objective of the standard

1. The objective of this standard is to prescribe the principles of accounting and financial reporting for the participatory ventures.

Scope

2. This standard shall apply to all participatory ventures (see paragraph 4 (d)), except for the exclusions provided in paragraph 3, in respect of accounting and financial reporting by the investor(s), the working partner(s), as well as, the participatory ventures.

3. This standard shall not apply to the following:

   a. investment accounts and similar participatory instruments issued by Islamic banks and similar financial institutions which are subject to the requirements of relevant AAOIFI FASs[2];

   b. investment agency (Al-Wakala Bi Al-Istithmar) which is subject to requirements of respective AAOIFI FAS[3];

   c. co-owned assets (based on Shirkat-ul-Milk), as such assets do not constitute a participatory venture[4];

   d. participants' investment funds and other similar participatory instruments issued by Takaful institutions to the Takaful participants which are subject to the requirements of relevant AAOIFI FASs[5];

   e. investment structures in the form of a legal entity, e.g., those including:

      i. issuance of share capital by the working partner(s);

      ii. investments in Sukuk, shares and other similar instruments which are subject to accounting in line with the requirements of the relevant AAOIFI FASs[6], except for the Sukuk based on participatory ventures, to the extent of underlying product / asset accounting as referred back to this standard;

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[2] Presently FAS 14 "Investment Funds". Also see [ED of] FAS____ "Financial Reporting for Islamic Investment Institutions (including Investment Funds)"
[3] FAS 31 "Investment Agency (Al Wakala Bi Al-Istithmar)"
[4] If such assets with co-ownership are part of, or coupled with, an Ijarah contract, then see FAS 32 "Ijarah".
[5] FAS 42 "Presentation and Disclosures in the Financial Statements of Takaful Institutions" and FAS 43 "Accounting for Takaful: Recognition and Measurement"
[6] FAS 33 "Investment in Sukuk Shares and Similar Instruments" FAS 34 "Financial Reporting for Sukuk-holders" and [ED of] FAS 29 "Sukuk in the Books of the Originator"

iii. investment funds / entities having the status of a legal entity which are subject to financial reporting in line with the requirements of the respective AAOIFI FAS[7]; and

iv. investment in corporate entities having parent-subsidiary, associate or joint venture relationship, or investment through trusts, which shall be accounted for in line with the requirements of relevant AAOIFI FASs[8].

Definitions

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

   a. Control – is as defined in [ED of] FAS ___ "Control [of Assets and Business]";

   b. Mudaraba – is as defined in the "AAOIFI Conceptual Framework for Financial Reporting"[9];

   c. Musharaka – in the specific context of this standard, is a partnership based on Shirkat-ul-Aqd, whereby two or more parties agree to combine their assets, labour, entrepreneurship, financial commitments and / or goodwill for the purpose of making profit;

   d. Participatory structure – is as defined in [ED of] FAS____ "Control (of Assets and Business);

   e. Shari'ah compliant participatory venture (SCPV) – is a business venture constituted on the basis of a Shari'ah compliant participatory structure, being a virtual entity but not a legal entity, including Musharaka and Mudaraba (or any similar structure creating a Shari'ah compliant partnership, irrespective of the nomenclature);

   f. Variable-equity participatory venture – is a type of participatory venture in which the respective amount of quasi-equity contributed by the investor(s), as well as, the working partner remains variable through ongoing drawdowns and redemptions by the working partner on a very frequent basis, normally subject to a maximum limit of such quasi-equity contributed by the investor(s) [Explanation: The most common form of variable-equity participatory venture is running Musharaka, although certain other Musharaka-based and Mudaraba-based products and instruments may also classify as such]; and

   g. Working partner – is a partner in a participatory venture principally entitled to manage and / or operate such participatory venture and who receives equity contributions from the investor(s). Working partner, at times, may also commingle

[7] Presently FAS 14 "Investment Funds". Also see [ED of] FAS____ "Financial Reporting for Islamic Investment Institutions (including Investment Funds)"

[8] FAS 23 "Consolidation" and FAS 24 "Investments in Associates". Also see hierarchy for selection and application of accounting policies provided in paragraph 165 of FAS 1 "General Presentation and Disclosures in the Financial Statements".

[9] See paragraph 11(j) of "AAOIFI Conceptual Framework for Financial Reporting".

its own equity in the participatory venture. [Explanation: A working partner, depending on the nature of the underlying contract, may generally include a Mudarib or a Musharaka's working partner].

Assessment of extent of control by the investor(s) and the working partner

5. Accounting and financial reporting approach suitable for a participatory venture shall be assessed by determining the extent of control by the investor and the working partner on the participatory venture.

6. The extent of control over a participatory venture (and the assets underlying the participatory venture, where applicable) shall be assessed in line with the definition of control as per respective AAOIFI FAS[10].

7. An assessment of the extent of control, in line with the requirements of paragraph 5, shall result in one of the following conclusions:

   a. the participatory venture is controlled by the investor(s) (see paragraphs 8, 9(a) and 31(a));

   b. the participatory venture is controlled by the working partner(s) (see paragraphs 8, 9(b) and 31(b); and

   c. the participatory venture is under shared control of the investor(s) and the working partner(s) (see paragraphs 8, 9(b) and 31(c)).

Summary of accounting approaches applicable to the investor and the working partner

8. The following table summarises the accounting approaches applicable to the investor and the working partner in different situations related to the control of a participatory venture in line with requirements of paragraphs 9 and 31.

	Controlling party	Accounting treatment by the investor	Accounting treatment by the working partner
a.	Investor(s) controls the participatory venture (see paragraphs 9(a) and 31(a))	• Pass-through accounting approach • Net investment in participatory venture accounting approach – if pass-through approach is impracticable	• Off-balance-sheet accounting approach
b.	Working partner controls the participatory venture (see paragraph 9(b) and 31(b))	• Net investment in participatory venture accounting approach	• Quasi-equity accounting approach

[10] See paragraph 5 of [ED of] FAS ___ "Control (of Assets and Business)"

c.	Investor(s) and working partner have shared control over the participatory venture (see paragraph 9(b) and 31(c))	• Net investment in participatory venture accounting approach	• Net investment in participatory venture accounting approach
d.	Perpetual participatory venture (see paragraph 47)	• Net investment in participatory venture accounting approach	• Accounting as equity, while following quasi-equity accounting approach as far as practicable
e.	Participatory ventures involving gradual transfer of ownership (see paragraph 58)	• Net investment in participatory venture accounting approach (if pass-through accounting approach is impracticable)	• Quasi-equity accounting approach
f.	Variable-equity participatory venture (see paragraph 59)	• Net investment in participatory venture accounting approach	• Quasi-equity accounting approach

Accounting and financial reporting in the books of account of the investor

Accounting and financial reporting approaches for the investor

9. An investor shall apply either of the following approaches for accounting and financial reporting of its investment interest in a participatory venture:

   a. in case the participatory venture is controlled by the investor(s) only – the pass-through accounting approach as prescribed in paragraphs 10-20, unless considered impracticable; and

   b. in all other cases (including the case where the participatory venture is controlled either by the working partner or is under shared control of the investor(s) and the working partner) – the net investment in participatory venture accounting approach as prescribed in paragraphs 21-30.

Accounting by the investor under pass-through accounting approach

Initial recognition

10. On initial recognition using the pass-through accounting approach, the investor shall recognise the assets (as well as, liabilities, if any) underlying the participatory venture in its books of account applying the initial recognition principles as applicable in line with relevant

AAOIFI FASs[11]. Proportionate assets (and liabilities) shall be recognised, applying the same principles, in cases where the arrangement has more than one investor.

Subsequent measurement

11. Subsequent to initial recognition, the underlying assets (and liabilities) shall be measured according to the requirements of relevant AAOIFI FASs[12]. Proportionate accounting shall apply, where applicable. [Explanation: These shall be recognised on a gross basis by the investor (i.e., assets to be included in assets, and liabilities, if any, to be included in liabilities].

12. An investor shall determine, at each period end, impairment in the value of investment under pass-through accounting approach in line with the requirements of respective AAOIFI FAS[13]. The settlement risk, as well as, existence of onerous commitments (e.g., a guarantee or a sale undertaking), shall also be considered for impairment purposes.

Revenues and expenses

13. Unless contrary to a specific requirement of this standard, the resulting revenues, expenses, gains and losses, arising from the participatory venture, shall be measured and accounted for, respectively, according to the nature of the contract(s) in line with the requirements of relevant AAOIFI FASs applicable to such transactions[14]. Normal accounting policies of the investor shall apply in respect of all such matters.

14. Revenues, expenses, gains and losses shall be recognised on a gross basis (i.e., the same shall be included in respective line items in the financial statements of the investor).

Working partner's share of profit

15. The working partner's share of profit payable, according to the contractual arrangements, shall be recognised as an expense at the end of each financial reporting period, based on the best estimate of amounts payable, as at the respective period end, based on contractual and constructive obligations.

16. Any contingent or conditional variable share of profit payable to the working partner as per contractual terms shall be recognised as an expense based on best estimates of the same, applying the following principles:

    a. variable share of profit related to past performance based on contractual arrangement shall be recognised as a liability when it becomes due – on an accrual basis;

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[11] See hierarchy for selection and application of accounting policies provided in paragraph 165 of FAS 1 "General Presentation and Disclosures in the Financial Statements".

[12] See hierarchy for selection and application of accounting policies provided in paragraph 165 of FAS 1 "General Presentation and Disclosures in the Financial Statements".

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

[14] See hierarchy for selection and application of accounting policies provided in paragraph 165 of FAS 1 "General Presentation and Disclosures in the Financial Statements".

b. variable share of profit related to past performance which is contingently reversible on a cumulative basis (e.g., reversible in case of a future loss) or is contingently dependent on a decision of a third party (e.g., a decision of the trustee at maturity of the transaction), shall be recognised as a liability when due, irrespective of probability of their reversal;

c. reversal of a liability earlier recorded (in line with (b) above) e.g., to recover a loss or against below par performance shall be recognised as a reduction of respective expense, in the period in which such reversals occur; and

d. variable share of profit related to, or fully dependent on, future performance of the working partner shall not be recognised.

17. In the event of a negligence by the working partner, determined in line with the Shari'ah principles and rules, the amount recoverable from the working partner shall be recognised as an income and recorded as a receivable from the working partner, at the time such negligence is established and the amount of compensation of loss is determined.

Presentation and disclosure

18. All assets, liabilities, revenues, expenses, gains and losses under pass-through approach shall be presented on a gross basis, rather than being presented on a net basis. Accordingly, these are to be clubbed on a line-by-line basis, with the respective assets, liabilities, revenues, expenses, gains and losses, in the financial statements of the investor. These shall, however, be presented and disclosed in a manner that the same can be identified as relating to the participatory venture through additional disclosures.

19. The working partner's share of profit determined in line with the requirements of paragraphs 15 - 17, shall be included in related expenses and disclosed appropriately.

20. In addition to the normal presentation and disclosure requirements applicable as per respective AAOIFI FAS[15], the minimum disclosure requirements shall be as follows:

a. summary of the contractual relationship(s) and significant terms and conditions;

b. ownership structure of the participatory venture (i.e., the proportion of participatory venture owned by the investor(s)), in the event of having more than one investor(s);

c. the nature of underlying assets and / or activity(ies) managed under the participatory venture; and

d. any contingent variable profit payable, not recognised as a liability.

[15] See hierarchy for selection and application of accounting policies provided in paragraph 165 of FAS 1 "General Presentation and Disclosures in the Financial Statements".

Accounting by the investor under net investment in participatory venture accounting approach

Initial recognition

21. While applying the net investment in participatory venture accounting approach, an investor shall initially recognise the investment made as an investment in a participatory venture at cost, at the time when it is made available to the prospective working partner for investment.

22. In case of investment in-kind, the initial recognition shall be based on the fair value of the in-kind investment, as at the date of investment.

23. In case the investor has made investment available to the prospective working partner(s), but the contract is yet to be initiated, such amount shall be initially recognised as an advance against investment in the participatory venture, till the time such contract is initiated.

Subsequent measurement

24. The investment in a participatory venture shall be measured at the end of a financial reporting period at carrying amount (adjusted for additional capital contribution, capital withdrawals and payment of distributable profits) and shall be adjusted to include the net share of the profit or loss of the participatory venture as attributable to the investor under the contractual arrangements (as determined under the relevant AAOIFI FASs[16]), as at that date.

25. Net share of the profits and losses (duly comprising the net result of revenues, expenses, gains and losses) arising from investment in a participatory venture shall be determined after allocation of the working partner's share of profit (including variable profit).

26. Any share of losses reimbursable by the working partner as established in line with Shari'ah principles and rules, due to the working partner's negligence and misconduct shall be recognised as a reduction in losses (or as a profit, where applicable) when determined as such.

27. The investor shall determine, at each period end, impairment in the value of investment in a participatory venture in line with the requirements of respective AAOIFI FAS[17]. The settlement risk, as well as, existence of onerous commitments (e.g., a guarantee or a sale undertaking), shall also be considered for impairment purposes.

Presentation and disclosure

28. Share of profits (and / or losses) arising from investment in participatory venture shall be disclosed separately from other revenues of the investor, on a net basis.

[16] See hierarchy for selection and application of accounting policies provided in paragraph 165 of FAS 1 "General Presentation and Disclosures in the Financial Statements".
[17] FAS 30 "Impairment, Credit Losses and Onerous Commitments"

29. In addition, the investor shall disclose the following as minimum disclosure requirements:

a. a summary of the principal terms and conditions of the agreement(s) between the parties to the participatory venture;

b. the nature of underlying assets and / or activity(ies) managed under the participatory venture; and

c. any contingent profit payable to the working partner, not yet recognised.

30. In respect of any investment in participatory venture which is considered material to the financial statements of the investor, the investor shall preferably provide memorandum information in respect of assets, liabilities, revenues, expenses, gains and losses, as well as, the profits (and losses) attributable to the working partner.

Accounting and financial reporting in the books of account of the working partner

Accounting and financial reporting approaches for the working partner

31. The working partner shall apply any of the following approaches for accounting and financial reporting of its interest in a participatory venture:

a. in case the participatory venture is controlled by the investor(s) only – off-balance sheet accounting approach as prescribed in paragraphs 32-37;

b. in case the participatory venture is controlled by the working partner only – quasi-equity accounting approach as prescribed in paragraphs 38-46; or

c. in case the participatory venture is under shared control of the investor(s) and the working partner – the net investment in participatory venture accounting approach, similar to that of an investor (considering that the working partner's capacity of an investor is his primary capacity), as prescribed in paragraphs 21-30.

Accounting by the working partner under the off-balance-sheet accounting approach

32. Under the off-balance-sheet accounting approach, a working partner shall not recognise the assets and / or liabilities underlying the participatory venture controlled by the investor(s) in its books of account.

33. If the working partner previously owned such assets (and liabilities), through equity or quasi-equity, the working partner shall derecognise the assets (and liabilities) from its books of account, and any gain or loss on such disposal shall be recognised immediately (being the difference between the carrying value of such assets (and liabilities) and the value agreed upon contractually).

Investor's share of profits

34. Net share of the profits (duly comprising the net result of revenues, expenses, gains and losses) arising from investment in the participatory venture, after allocation of the investor's(s') share of profit (and losses, where applicable), shall be recognised periodically.

35. Any share of losses reimbursable to the investor(s) as established in line with Shari'ah principles and rules, due to the working partner's negligence and misconduct shall be recognised as an expense when determined as such.

36. Contingent or conditional share of profit, receivable by the working partner as per contractual terms, shall be recognised when there remains no material uncertainty with regard to its recoverability, duly applying the following principles:

    a. variable share of profit related to past performance based on contractual arrangement shall be recognised as and when it becomes receivable;

    b. variable share of profit related to past performance which is contingently reversible on a cumulative basis (e.g., reversible in case of a future loss) or is contingently dependent on a decision of a third party (e.g., a decision of the trustee at maturity of the transaction), shall not be recognised except to the extent of a best estimate of amounts recoverable with reasonable certainty, based on justifiable future projections and established customary practice, after allowing for a reasonable margin for uncertainties; and

    c. variable share of profit related to, or fully dependent on, future performance shall not be currently recognised irrespective of their probability of recoverability.

Presentation and disclosures

37. In case of applying the off-balance-sheet accounting approach, a working partner shall, at a minimum, make the following disclosures:

    a. a summary of the assets, liabilities and related movement including income on such assets and expenses thereon collectively for all off-balance-sheet participatory venture to be disclosed appropriately in the financial statements (either in form of a statement of off-balance-sheet assets under management, where applicable, or in the notes to the financial statements)[18];

    b. the total administrative and operational expenses charged to the participatory venture along with a brief description of its major components based on the materiality of the amounts;

    c. the amounts of profits (and losses) attributable to the investor(s) and the working partner respectively, identifying any variable, incentive and / or tiered profits;

[18] See the disclosure requirements contained in paragraphs 21-27 of the [ED of] FAS ___ "Off-balance-sheet Assets under Management".

d. the basis applied by the working partner for determining variable share of profits from the participatory venture if such profits are material;

e. the cumulative amount of contingent share of profits receivable, but not recognised due to conditions provided in paragraph 36(b); and

f. disclosure of transfers of assets from / to owned assets to / from the participatory venture shall be adequately made in line with the requirements of respective AAOIFI FAS[19].

Accounting by the working partner under the quasi-equity accounting approach

Initial recognition

38. Under the quasi-equity accounting approach, a working partner shall recognise the amount of quasi-equity of a participatory venture, in its books of account, equal to:

a. the amount cash received – in the event of investment in cash; or

b. the fair value of the underlying assets (net of liabilities, if any) as at the date of investment in the event of investment in kind.

39. At the time of initial recognition of quasi-equity of the participatory venture, in line with the requirement of paragraph 38, the underlying assets (and liabilities, if any), shall be recognised in the books of account of the working partner:

a. at the current carrying value of such underlying assets (and liabilities) (already owned by the working partner) as appearing in the books of account of the working partner – in case the investment is received in cash, and the value assigned to the underlying assets (and liabilities) is equal to their carrying value; or

b. at the contractually agreed value of such underlying assets (and liabilities) (already owned by the working partner) – in case the investment is received in cash, and the value assigned to the underlying assets (and liabilities) is different from their carrying value; or

c. at the contractually agreed value of the underlying assets (and liabilities) (previously owned by the investor) as at the date of investment – in the event of investment in-kind.

40. In case of application of paragraph 39(b), any difference between the contractually agreed value and the carrying value of the underlying assets (net of liabilities) shall be accounted for as follows:

a. any gain or loss (not being an impairment loss) shall be amortised by the working partner over the period of participatory venture – unless the participatory venture

[19] Presently, FAS 21 "Disclosure on Transfer of Assets". And also see [ED of] FAS ___ "Transfer of Assets between Investment Pools"

does not have a fixed period of maturity, or if it is not committed or reasonably expected that the working partner will acquire full ownership of underlying assets of the participatory venture (either through gradual transfer of ownership or at the end of the term of participatory venture), in which case such gain or loss shall be immediately recognised by the working partner; or

b. any loss, being an impairment loss, shall be immediately recognised by the working partner.

Subsequent measurement

41. Subsequent to the initial recognition, a working partner shall follow its normal accounting policies established in accordance with the relevant AAOIFI FASs[20], with regard to accounting for the underlying assets (and liabilities) and recognition of relevant revenues, expenses, gains and losses (including impairment losses on the underlying assets, if any) relating to a respective participatory venture.

42. The investor's share in profit (or loss) payable shall be recognised at the end of each financial reporting period, as an expense according to the contractual arrangements.

43. Any share of losses reimbursable to the investor(s) as established in line with Shari'ah principles and rules, due to the working partner's negligence and misconduct shall be recognised as an expense when determined as such.

44. A provision shall be maintained for any contingent or conditional share of profit, attributable to the working partner as per contractual terms, in respect of any variable share of profit related to past performance which is contingently reversible on a cumulative basis (e.g., reversible in case of a future loss) or is contingently dependent on a decision of a third party (e.g., a decision of the trustee at maturity of the transaction). Out of such provision, an amount may be taken to the income, if and only if, and only to the extent that, there remains no material uncertainty based on justifiable future projections and established customary practice, that such amount is no more payable.

Presentation and disclosures

45. In case of applying the quasi-equity accounting approach, a working partner shall, at a minimum, make the following disclosures:

    a. a summary of the underlying assets, liabilities and related movement including income on such assets and expenses thereon collectively for all participatory ventures to be disclosed appropriately in the notes to the financial statements, duly identifying the amounts attributable to quasi-equity and the commingled equity, respectively;

[20] See hierarchy for selection and application of accounting policies provided in paragraph 165 of FAS 1 "General Presentation and Disclosures in the Financial Statements".

b. the total administrative and operational expenses, as well as, impairment losses on the underlying assets, if any, charged to the participatory venture along with a brief description of its major components;

c. the amounts of profits (and losses) attributable to the investor(s) and the working partner respectively, identifying any variable, incentive and / or tiered profits, as well as, the amounts of profits attributable to the working partner on account of commingled equity;

d. the basis applied by the working partner for determining variable share of profits which it receives from the profits of the participatory venture;

e. the cumulative amount of (and movement in) the provision against contingent share of profits or consideration due to conditions provided in paragraph 44; and

f. disclosure of transfers of assets from / to owned assets to / from the participatory venture shall be adequately made in line with the requirements of respective AAOIFI FAS[21].

Additional considerations

46. In addition to the specific requirements of this standard, the requirements of respective AAOIFI FAS applicable to quasi-equity[22] shall by applied by the working partner, insofar as practicable.

Specific considerations

Perpetual participatory ventures

47. Certain participatory ventures, though in rare circumstances, may be perpetual in nature, i.e.:

a. these are not subject to liquidation at a fixed maturity date; or

b. these do not have a put-option of redemption in the hand of the investor.

48. There is a rebuttable presumption that such participatory ventures may qualify for accounting as equity under the requirements of relevant AAOIFI FASs[23], and presented as a separate class within equity. In such case:

a. the working partner shall follow the accounting requirements applicable to the underlying assets (and liabilities) etc., under the quasi-equity accounting approach as prescribed in paragraphs 38-46, insofar as practicable, while following other requirements of the relevant AAOIFI FASs; and

[21] Presently, FAS 21 “Disclosure on Transfer of Assets”. See also [ED of] FAS___ “Transfer of Assets between Investment Pools”

[22] Presently, FAS 27 “Investment Accounts”. See also [ED of] FAS___ “Quasi-equity (including Investment Accounts)”

[23] See FAS 1 “General Presentation and Disclosures in the Financial Statements” along with the “AAOIFI Conceptual Framework for Financial Reporting”.

b. the investor shall follow the net investment in participatory venture accounting approach, as prescribed in paragraphs 21-30.

Transfer of control – from investor(s) to working partner

Forms of transfer of control

49. Transfer of ownership (and corresponding control) from investor(s) to working partner in case of most participatory ventures, takes place through transfer of control (entailing risks and rewards incidental to ownership of such underlying assets) under a separate arrangement, taking form of either of the following:

a. sale undertaking by the investor(s) or purchase undertaking by the working partner – executable after the end of the participatory venture term (or at times when a specific event triggers early liquidation of participatory venture); or

b. gradual sale of proportionate ownership (generally in form of ownership units) through a promised mechanism – over the term of participatory venture; or

c. partial redemption of investor's equity through partial sale of proportionate ownership (generally in form of ownership units) based on mutual agreement – before intended maturity of participatory venture.

Timing of transfer of control

50. Transfer of underlying assets' ownership (or proportionate ownership) shall be accounted for by both parties at the time of transfer of control of the underlying asset (or proportion thereof) to the working partner. The timing of transfer of corresponding control of the underlying asset (or proportion thereof) to the working partner shall coincide with the timing of consummation of the relevant contract, through:

a. documentation of offer and acceptance of the transfer of ownership (or proportionate ownership) of the underlying assets; or

b. payment against purchase of such units as a continuing arrangement (and acceptance of such payment) if already documented through a purchase undertaking, in line with Shari'ah principles and rules and contractual arrangements.

Recognition of transfer of control – complete or partial

51. Under all forms of intended or mutually agreed transfer of control (or proportion thereof) from the investor(s) to working partner, the transaction of transfer of control of underlying assets (and liabilities) (or proportion thereof) shall be recorded separately from the transaction of investment in participatory venture, and recognising returns thereon, in line with the requirements of paragraph 50.

52. The investor(s), irrespective of the accounting approach followed, shall derecognise the underlying assets (and liabilities), or proportion thereof, from their books of account while recognising a gain or loss on such transfer being a difference between the carrying value and the fair value of the consideration received (or receivable).

53. The working partner, at the time of partial acquisition of control, shall apply the respective accounting treatment from the following, corresponding to the accounting approach being applied:

a. in case of applying the quasi-equity accounting approach – shall record a reduction from the amount of quasi-equity reflected in its financial statements attributable to the investor(s), while recognising a gain or loss (if any) on such transfer being the difference between the carrying value of such proportion of quasi-equity and the fair value of the consideration paid (or payable); or

b. in case of applying the net investment in participatory venture approach – shall increase the amount reflected as net investment in respective participatory venture, at cost (of such additionally acquired units).

54. There is a rebuttable presumption that a working partner applying the off-balance sheet accounting approach may not experience partial transfers of control from the investor, except for extraordinary circumstances. In such an event, the working partner shall re-assess the suitability of accounting approach, and shall preferably change the same to, either of the following, as considered appropriate:

a. quasi-equity accounting approach (which may become more suitable when it is considered that the working partner controls the participatory venture); or

b. net investment in participatory venture accounting approach (which may become more suitable when it is considered that a shared control exists).

55. The working partner, at the time of complete acquisition of control, shall apply the respective accounting treatment from the following, corresponding to the accounting approach being applied:

a. in case of applying the off-balance sheet accounting approach – shall recognise all underlying assets (and liabilities) of the participatory venture in its books of account, while recognising a gain or loss (if any) on such transaction, being the difference between:

   i. the fair value of the underlying assets (and liabilities) recognised in its books of account as a result of such transfer of control; and

   ii. the consideration paid (or payable) in respect of transfer of complete control of participatory venture;

b. in case of applying the quasi-equity accounting approach – shall de-recognise the amount of quasi-equity reflected in its financial statements attributable to the investor(s), while recognising a gain or loss (if any) on such derecognition being the difference between the carrying value of such quasi-equity and the consideration paid (or payable); or

c. in case of applying the net investment in participatory venture approach – shall derecognise net investment in participatory venture and recognise all underlying assets (and liabilities) of the participatory venture in its books of account, while recognising a gain or loss (if any) on such transaction, being the difference between:

i. the fair value of the underlying assets (and liabilities) recognised in its books of account as a result of such transfer of control; and

ii. the carrying value of net investment in participatory venture plus the consideration paid (or payable) in respect of transfer of complete control of participatory venture.

Onerous commitments for redemption / gradual transfer of ownership

56. A commitment to transfer ownership or proportion thereof from an investor(s) to the working partner at a promised value or at fair value (which at times may be different from the carrying value) of the underlying net assets of a participatory venture, may turn onerous on either party, if it results in an expected loss on such redemption / gradual transfer of ownership. Such onerous commitment may exist in the form of purchase undertaking by the working partner or a sale undertaking by the investor or a gradual transfer arrangement between the parties.

57. An investor(s) or working partner, being subject to an onerous commitment shall record a provision against such onerous commitment, in line with the requirements of respective AAOIFI FAS[24].

Gradual transfer of ownership

58. There is a rebuttable presumption that a participatory venture with gradual transfer of ownership (e.g., in case of diminishing Musharaka (with Shirkat-ul-Aqd)), may not be eligible for any other accounting approach, except for:

a. in case of investor – the net investment in participatory venture accounting approach (see paragraphs 21-30); and

b. in case of working partner – the quasi-equity accounting approach (see paragraphs 38-46).

Variable-equity participatory venture

59. In case of a variable-equity participatory venture, only the following accounting approach shall be applied:

a. in case of investor – the net investment in participatory venture accounting approach (see paragraphs 21-30); and

b. in case of working partner – the quasi-equity accounting approach (see paragraphs 38-46).

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

60. The drawdowns and redemptions of the quasi-equity of the of the investor(s), under a variable-equity participatory venture takes place at cost (in line with relevant Shari'ah principles and rules and the contractual arrangement), and hence are accounted for at cost (equal to the amount of cash invested or redeemed), without recognition of a gain / loss against the carrying value.

61. Attribution of profit (and loss) to the respective parties shall be made, at the end of each financial reporting period, according to the weighted average balances, as remained outstanding during the period, and the profit sharing ratios as contractually agreed, in line with Shari'ah principles and rules.

62. In addition to the specific requirements of this standard, the requirements of respective AAOIFI FAS applicable to quasi-equity[25] shall by applied by the working partner, insofar as practicable.

Risk reserves

63. Accounting for risk reserves, if any, shall take place in line with the contractual arrangements considering the requirements of respective AAOIFI FAS[26]. Adequate disclosures shall be made in respect of balances of, and movements in respect of, risk reserves in line with the disclosure requirements contained in the respective AAOIFI FAS[27].

Accounting and financial reporting by the participatory venture

Objective of accounting and financial reporting for participatory venture

64. The objective of financial reporting for the participatory venture is to provide timely and faithful information about the financial position and results of operation of the participatory venture to, both to the working partner and the investor(s), in order to enable them to incorporate such financial information in their respective financial statements, on a periodic basis, in line with the requirements of this standard, and as contractually agreed or as required by the regulations.

65. Summarised financial information of the participatory venture, as a virtual entity, shall be prepared[28] in line with the requirements of this standard on a periodic basis, commensurate with the financial reporting requirements of the working partner, as well as, the investor(s).

Summarised financial information

Set of summarised financial information of participatory venture

66. The set of summarised financial information for a participatory venture shall comprise of a summarised form of the following:

[25] Presently, FAS 27 "Investment Accounts". See also [ED of] FAS___ "Quasi-equity (including Investment Accounts)"
[26] FAS 35 "Risk Reserves"
[27] FAS 35 "Risk Reserves"
[28] The working partner shall prepare or cause to prepare these summarised financial reports and shall share these with the investor(s) along with the financial information related to the working partner, where necessary.

a. a summarised report of financial position;

b. a summarised report of income and expense; and

c. explanatory material to the financial information.

Selection and adoption of accounting policies for participatory venture

67. Financial reporting and characteristics of summarised financial information of a participatory venture shall be commensurate with the nature of business carried out by the working partner (particularly, those relevant to the participatory venture itself). The accounting policies selected and adopted for the purpose of financial reporting by the participatory venture shall generally by aligned with the accounting policies adopted and applied by the working partner, insofar as these are in line with the requirements of relevant AAOIFI FASs[29].

68. Accounting policies applied for the purpose of financial reporting of the participatory venture may be different from those applied by the working partner, if either of the following conditions is met:

a. such accounting policies better reflect the financial information in light of the contractual requirements between the parties, and the business model of the participatory venture; or

b. the accounting policies generally applied by the working partner are not in line with the requirements of relevant AAOIFI FASs[30], or their application for the purpose of financial reporting of the participatory venture may result in a non-compliance with the Shari'ah principles and rules.

69. Determination of accounting policies and application of significant judgments and estimates (e.g., depreciation and amortisation) for a participatory venture shall take into consideration, both, the business model and the term to maturity of the participatory venture. [Explanation: Considering the business model and the expected maturity of the participatory venture, it is expected that the accounting policies selected shall take a simplified form and complex accounting treatments, and involvement of additional financial statements e.g., statement of other comprehensive income shall not be necessary].

General accounting considerations for participatory venture

70. Accounting (including initial recognition and subsequent measurement for assets, liabilities, quasi-equity and equity (where applicable) and recognition of revenues, expenses, gains and losses) shall be performed by the participatory venture in line with the accounting policies, selected and consistently applied, and the significant judgments and estimates applied, in line with the requirements of this standard and relevant AAOIFI FASs.

[29] See hierarchy for selection and application of accounting policies provide in paragraph 165 of FAS 1 "General Presentation and Disclosures in the Financial Statements".
[30] See hierarchy for selection and application of accounting policies provide in paragraph 165 of FAS 1 "General Presentation and Disclosures in the Financial Statements".

71. Any gains and losses, as applicable to the investor(s) and the working partner prior to, or at the time of, commencement of participatory venture shall not be considered as an income, expense, gain or loss of the participatory venture.

72. Any redemption of quasi-equity, as well as, drawdowns of additional quasi-equity that results in transfer of assets to/ from participatory venture to either party shall be accounted for at carrying value.

Presentation and disclosures

73. In addition to the relevant significant presentation and disclosure requirements stated in respective AAOIFI FAS[31], the following are the minimum disclosure requirements for the summarised financial information of a participatory venture:

   a. disclosure of the nature of the participatory venture, its underlying assets, main activities (including nature of products), etc.;

   b. the underlying contract and salient features of the contractual requirements applicable to the investment and any changes thereto, as well as, the governance structure of the participatory venture as may be applicable;

   c. information about any ring-fencing or other form of segregation of assets from other assets of the working partner, as applicable;

   d. disclosure of fair valuation of the participatory venture and the significant underlying assets (as well as, any potential impairment or credit losses) along with necessary disclosures of valuation techniques used to determine the fair value along with the level of observable inputs used [Note: Fair value shall be determined with suitable frequency ensuring that the decision making of the investor(s) might not be affected by the obsolescence of information];

   e. information about the tangibility of underlying assets, where applicable, in line with the Shari'ah principles and rules;

   f. at the time of liquidation of participatory venture, the details of the transaction execution and its financial effects on the respective parties;

   g. balances of, and movements in, risk reserves, if any;

   h. disclosure of any charity and its movement, including any income taken to charity, if any, and its disposal; and

   i. disclosures about Zakah related to participatory venture, in line with the requirements of respective AAOIFI FAS[32].

[31] FAS 1 "General Presentation and Disclosure in the Financial Statements"
[32] FAS 39 "Financial Reporting for Zakah"

Effective date

74. This standard shall be effective on the financial statements of the institutions beginning on or after 1 January 2026. Early adoption of the standard is encouraged.

Transitional provisions

75. An institution may opt to apply this standard on a prospective basis for transactions executed on or after the effective date. If an institution applies this transitional provision, it shall disclose the impact of the same.

Amendments to other standards

76. This standard supersedes the earlier FAS 3 “Mudaraba Financing” and FAS 4 “Musharaka Financing”.

Appendices

Appendix A: Adoption of the standard

This standard was presented for the approval in the____ AAOIFI Accounting Board meeting held on___ 1444H, corresponding to __ 2023 and was duly approved.

Members of the board

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

Reservation

The standard was approved unanimously.

Working group members

1. Mr. Firas Hamdan – chairman
2. Dr. Abdulrahman Alrazeen
3. Mr. Abdulmalik Alsuwayni
4. Mr. Ali Abdellatif Abubaker Amar
5. Mr. Bazari Azhar Azizi
6. Mr. Bilal Jakhura
7. Dr. Eltegani Abdelgadir Ahmed
8. Mr. Jamil Ahmed Shaikh
9. Mr. Kamal Hossain
10. Dr. M. Mahabbat Hossain
11. Dr. Muhammad Albeltagi
12. Mr. Mohammad Bouya
13. Mr. Pravin Manik
14. Mr. Saed Abdallah
15. Mr. Samet Arslan
16. Mr. Sohail Sikandar
17. Mr. Sulaiman Al Harthy

Executive team

1. Mr. Omar Mustafa Ansari (AAOIFI)
2. Mr. Mohammad Majd Bakir (AAOIFI)
3. Mr. Haroon Tabraze (Senior Consultant-Researcher)

Appendix B: Basis for conclusions

Appendix C: Brief history of the preparation of the standard

H1 The AAB held its 9th meeting on 7-8 Rajab 1439H, corresponding to 24-25 March 2018 and decided to initiate the "AAOIFI Financial Accounting Standards (FAS) review and revision project", aiming to review all existing AAOIFI FASs or to revise certain existing FASs as necessary.

H2 The AAB held its 13th meeting on 15 and 16 Rajab 1440H, corresponding to 22 and 23 March 2019. In this meeting the board agreed to commence work on revision of FAS 3 "Mudaraba Financing" and FAS 4 "Musharaka Financing".

H3 The working group, at its 1st meeting held on 24 Rajab 1442H corresponding to 8 March 2021, discussed the preliminary study on the revision project.

H4 The AAB held its 23rd meeting on 3 Sha'ban 1442H, corresponding to 16 March 2021, where the preliminary study was presented to the board. At this meeting, the board addressed and agreed the content and structure of the new standard. The board decided to develop one standard that covers the various types of participatory ventures falling within its scope.

H5 The working group, at its 2nd meeting held on 15 Sha'ban 1444H, corresponding to 7 March 2023, discussed the first draft of the exposure draft on the new standard titled "Participatory Ventures".

H6 The working group, at its 3rd meeting held on 17 Safar 1444H, corresponding to 23 August 2023, discussed the updated draft based on initial comments and observations provided by its members.

H7 The working group, at its 4th meeting held on 26 Safar 1444H, corresponding to 11 September 2023, continued discussion on the updated draft.

H8 The working group, at its 5th meeting held on 2 Rabi' I 1444H, corresponding to 17 September 2023, continued discussion on the updated draft. After making necessary changes, the second draft was recommended for submission to the board.

H9 The AAB held its 34th meeting on 3-4 Rabi' I 1444H, corresponding to 18-19 September 2023. It requested changes and principally approved the exposure draft for issuance.