



INTERNATIONAL REGULATORY INITIATIVES TO ENHANCE GLOBAL FINANCIAL STABILITY

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OUTLINE

1. FSB' s initiative for global standards
2. Standard Setting Bodies
3. Debatable Issues & Comparisons
4. Efforts for Convergence of **Financial Reporting issues relating to Islamic Finance** to IFRS
5. Conclusion
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Transparency –Financial Stability

Hans Hoogervorst – Chairman of the IASB

“Without transparency,
there can be no enduring stability”.

This not only holds for financial reporting,
but also more broadly for
securities markets supervision.

G-20 Leaders

G-20 Finance Ministers and Central Bank Governors

**Financial
Stability Board
(FSB)**

Group of Governors and
Heads of Supervision (GHOS)

Standard Setting Bodies
(IOSCO, IASB, IAASB, IAIS etc.)

Basel Committee on
Banking Supervision (BCBS)

International Organizations (IMF, WB)

Committee on Payment and
Settlement Systems (CPSS)

National Authorities



<u>Working Area</u> 12 Key Standards		<u>Issuing Body</u>
<i>Macroeconomic Policy and Data Transparency</i>		
Monetary and financial policy transparency		IMF
Fiscal policy transparency		IMF
Data dissemination		IMF
<i>Financial Regulation and Supervision</i>		
Banking supervision		BCBS
Securities regulation		IOSCO
Insurance supervision		IAIS
<i>Institutional and Market Infrastructure</i>		
Crisis resolution and deposit insurance		BCBS/IADI
Insolvency		World Bank
Corporate governance		OECD
Accounting and Auditing	International Financial Reporting Standards (IFRS)	IASB
	International Standards on Auditing (ISA)	IAASB
Payment, clearing and settlement		CPSS/IOSCO
Market integrity		FATF



Importance of Standards

Development, adoption, and
successful implementation of
international standards yields
both **national and international benefits**

Promote

international financial stability by facilitating
**better-informed lending and investment
decisions**, improving market integrity

Standard Setting Bodies

Conventional

- IOSCO,
- IASB,
- IAASB (auditing)
- IAIS (insurance)
- Asian Oceanian
Standard Setters
Group

Islamic

- IFSB
- AAOIFI
- MASB
- ICAP
- IAI

Asian Oceanian Standard Setters Group

AOSSG is a grouping of the accounting standard-setters
in the Asian-Oceanian region

The group has been formed to discuss issues and share
experiences

on the adoption of International Financial Reporting
Standards (IFRS) and

**to contribute to the development of a high-quality set
of global accounting standards**

**The AOSSG plans to play an important role in
encouraging the adoption of IFRSs in the
region.**

Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI)

An Islamic international
autonomous non-for-profit corporate body
that prepares accounting, auditing, governance,
ethics and Sharia'a standards for Islamic
financial institutions and the industry.

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AAOIFI

It was founded in 1991 and ,has so far issued a total of 80 standards covering the areas of accounting, auditing, ethics, and governance for Islamic financial institutions

- **26 accounting standards,**
- **5 auditing standards,**
- **7 governance standards (incl. on Shari'a supervision),**
- **2 codes of ethics, and**
- **40 Shari'a standards (rules for application of Shari'a).**

- **Statement of Principles – SOP**

SOP i-1 : Financial Reporting from an
Islamic Perspective

- **Technical Release – TR**

TR i-1 : Accounting For Zakat on Business

TR i-2 : Ijara

TR i-3 : Presentation of Financial Statements of
Islamic Financial Institutions

TR i-4 : Sharia Compliant Sale Contracts

Islamic Financial Accounting Standard (IFAS)

IFAS 1: Murabaha

IFAS 2: Ijarah

Indonesian Accounting Institute

IAI-Sharia Accounting Standards Board

- A framework for Preparation and Presentation of Shariah Financial Statemets
- PSAK- Pernyataan Standar Akuntansi Keuangan

Indonesian Accounting Institute-PSAKs

PSAK 101: Presentation of Sharia Financial Statements

PSAK 102: Accounting For Murabaha

PSAK 103: Accounting For Salam

PSAK 104: Accounting For Istishna

PSAK 105: Accounting For Mudarabah

PSAK 106: Accounting For Musarakah

PSAK 107: Accounting For Ijarah

PSAK 108: Sharia Insurance Transactions

Accounting For Islamic Financial Transactions

View A

Such Transactions
can generally
be accounted for
using IFRS

View B

A separate set of
Islamic accounting
standards
would be required
to report
Islamic Financial
Transactions

AAOIFI

Review the standards
which have been developed by prevailing
accounting thought (ie,IFRS)
test them against Sharia and then
adopt those which are consistent with the
sharia and
exclude those which are not

AAOIFI

IFRS / IASB standards can be adopted by IFIs
AAOIFI standards issued because
IFRS / IASB standards cannot be adopted
in whole by Islamic financial institutions (IFIs)
AAOIFI standards are
issued for specific Islamic banking and finance
practices which are not covered by
IFRS / IASB standards.

MASB

Malaysian Accounting Standards Board

- The Financial Reporting principles in the IFRS **do not conflict with Sharia**
- Financial Reporting is a recording function that would **neither sanctify nor nullify** the Sharia validity of transaction
- The primary difference is **not that of recognition and measurement**, but the extent of information that needed to be provided to users

Two Main Debatable Issues

Time Value of Money

Is it appropriate
to reflect
a time value of money
in reporting an
Islamic Financial
Transaction ?

Substance Over Form

Is there any priority of
The Form of the
Contract
over its economic
substance?

Time Value of Money

View A

It is **inappropriate**
to reflect
a time value of money
in reporting
an islamic financial
transaction
when **no overt**
interest is chaged or
incurred in such
transactions

View B

Although
charging interest on a
loan is prohibited
Showing the financial
effect of a transaction
would not be so
would provide
information
that would benefit
users

Recognizing a Financing Effect

Conventional

In sale of good
with deferred payment,
IAS 18 requires
the difference between
the fair value and the
nominal amount
of consideration
is recognized as
interest revenue

Islamic

AAOIFI FAS 2 on Murabaha
refers to **profit** and
requires either;

“proportionate allocation
of profits over the
period of credit” or

“ as and when
instalments are
received”

Difference in the Definition

Conventional

Deferred Payment Fee
is “**interest**”

Islamic

Deferred Payment Fee
is “**profit**”

Malaysian Shariah Advisory Council of BNM

Time Value of Money

TVM is recognised in
Sharia

May be applied to
contracts of exchange

Economic value to time

Fuqaha had long
accepted that

there is an economic
value to time

permits an increase in
value due to lapse of
time

Substance Over Form

View A

The recognition and measurement of an Islamic Financial Transaction should give **prominence** to its **LEGAL FORM** to differentiate it from a perceived equivalent

View B

To show the economic substance of an Islamic Financial Transaction **Users** will benefit more information about legal form can be disclosed at footnotes

AAOIFI – Statement of Financial Accounting No 2 Concepts of Financial Accounting for Banks & Financial Institutions

(Superseded by “Conceptual Framework” as
Jan1,2011)

Reliability means that based on all the specific circumstances surrounding a particular transaction or event, the method chosen to measure and/or disclose its effects produces information **that reflects the substance of the event or transaction**. Estimates and judgments in applying accounting methods are not inconsistent with Shari’a principles which permit the use of persuasive evidence in the absence of conclusive evidence.
(para111)

Example for Substance over time contradiction

AAOIFI standards

**Both Operating *Ijarah*
and**

***IjarahMuntahia
Bittamleek***

**to be treated similar to
Operating Lease.**

In contrast, based on IFRS,

Ijarah

(especially if lease term is

for major part of economic life of
lease asset)

and ***IjarahMuntahia Bittamleek***

(due to the transfer of asset
ownership by the end of lease
term)

**would normally be classified
and treated as**

Finance Lease.



TÜRKİYE CUMHURİYETİ
MERKEZ BANKASI

AAOIFI-Statement of Financial Accounting No.1

CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING BY ISLAMIC FINANCIAL INSTITUTIONS

**In effect by Jan.1 2011
Supersedes SFA 1 and SFA2**



AAOIFI-Statement of Financial Accounting No.1

A paragraph is available for “Substance over Form” : 8 / 3 / 3

8.3.3 Substance and form

If information is to represent faithfully the transactions and other events that it purports to represent, **it is necessary that they are accounted for and presented in accordance with its substance and economic reality as well as the legal form.** Financial reporting involves consideration of the substance of an economic phenomenon as well as its legal form.

Substance vs. Form

Substance > Form.....IFRS

Substance < Form.....XXX

Substance = Form.....Islamic(*)

(*) AAOIFI Revised Framework

AOSSG working Group on Financial Reporting Relating to Islamic Finance

The Working Group was set up
to provide input and feedback on
the adequacy and appropriateness of
proposed and existing IFRS to Islamic financial
transactions and events.

The Working Group comprises staff from
**the standard-setters of Australia, China, Dubai,
Indonesia, Korea, Malaysia, Pakistan, and
Saudi Arabia.**

AOSSG working Group on Financial Reporting Relating to Islamic Finance

Publications

- [AOSSG Survey – Accounting for Islamic Financial Transactions and Entities](#)
Dec 2011
- [Financial Reporting Issues relating to Islamic Finance](#) Oct 2010

Submissions to IASB

- [Comments on IASB ED/2011/6 Revenue from Contracts with Customers](#)
[AOSSG20](#) Mar 2012
- [Comments on IASB Exposure Draft ED/2011/1 Offsetting Financial Assets and Financial Liabilities](#)
28 Apr 2011
- [Comments on IASB Supplement to Exposure Draft ED/2009/12 Financial Instruments: Impairment](#)
1 Apr 2011
- [Comments on ED/2010/13 Hedge Accounting](#) 9 Mar 2011
- [Comments on IASB ED/2010/9 Leases](#) 14 Dec 2010

Source: Deloitte-IAS Plus-Mar 26, 2012

The Islamic Finance Working Group of
the Asian-Oceanic Standard-Setters Group
(AOSSG)

has submitted a comment letter to the IASB on
ED/2011/6

'Revenue from Contracts with Customers',
noting

"gaps in guidance for Islamic finance
transactions".

The Working Group comment letter,
which is in addition to the main AOSSG
submission on the exposure draft,
notes a number of issues.

Some of these issues were previously raised in
response to the earlier revenue recognition
exposure draft (ED/2010/6).

The issues raised in the comment letter include

- The ED could result in a sale that is a financing transaction being reported differently from other financings under IAS 39
- The application of ‘enforceable’ and ‘unconditional’ in relation to promises to repurchase must be clear
- Contracts with multiple unrelated parties can still be ‘a single contract’. Also, what constitutes ‘a contract’ may be interpreted differently in Islamic finance
- The description of a customer appears to exclude commercial customers
- It would be useful to include an example of a deferred payment sale in the Illustrative Examples

CONCLUSION 1

1. **After Global Financial Crisis G 20-FSB took initiative for global standards**
 2. “Rapid growth of Islamic [finance](#) is increasing pressure for the industry to enter [the accounting mainstream](#), by seeking guidance from the International Accounting Standards Board (IASB), the global body which sets the tone for book-keeping in conventional finance” (Reuters Apr 5, 2012)

CONCLUSION 2

3. Asean – Ocean standard setters group lead by Malaysian Accounting Standards Board making efforts for convergence
4. Contradictory issues may be resolved by integrating several standards relevant to Islamic Finance to IFRS

References

1. **AAOIFI, Statement of Financial Accounting No1. Conceptual Framework for Financial Reporting by Islamic Financial Institutions**
2. **Asian-Oceanian Standard Setters Group, Research Paper, Financial Reportinissues relating to Islamic Finance**
3. **www.iasplus.com/en/resources/resource64**
4. **www.coffis.fr/coffis/index/.php?option..file...islamic_finance**

THANK YOU

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