



**Australian Government**

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**Australian Accounting Standards Board**

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# Islamic Finance

## Overview of selected issues

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AASB meeting February 2011



# Halal (permissible)

Most contracts that conform to the concepts of Islamic finance include one or more of the following:

- Profit sharing / Partnership
- Cost sharing
- Mutuality



# Haram (prohibited)

- Riba – interest – for example, on ‘conventional’ loans and leases
- Gharar – unacceptable level of uncertainty or ambiguity – for example, on some ‘conventional’ insurance contracts
- Maisir – gambling, gaming or speculation – for example, may affect some derivatives
- Significant element of judgement involved



# Halal structures

- Structures are devised that provide the services demanded by customers and avoid haram activities
- Can be a mistake to think of Islamic contracts as simply emulating ‘conventional’ transactions, but a link has to be made to comment to IASB



# Revenue issues

- Murabaha – purchase and resale/transfer to customer with (declared) mark-up on deferred payment terms
- IAS18 and Revenue ED = split into sale and financing, which may offend those wanting to reflect form
- Immediate recognition problematic for Islamic banks for Murabaha-based deposits
- AOSSG – Revenue ED emphasis on a single revenue recognition point magnifies issues



# Revenue issues

- Sale and repurchase (Wa'd) used for financing
- Revenue ED may require recognition on initial sale
- ED Appendix B – refers to:
  - unconditional obligation to repurchase (a forward)
  - unconditional right to repurchase (a call option)
- Wa'd may not legally be 'unconditional'
- AOSSG WG – 'unconditional' can be legal or constructive – need guidance on financings



# Insurance issues

- Is Takaful insurance for accounting purposes?
- Should the Takaful operator consolidate participants interests?
- Relevant considerations include:
  - Management / Performance fees
  - Claims handling costs
  - Qard



# Lease issues

- Ijarah – focus on lessor’s ownership of physical asset – so ED performance obligation approach is favoured over derecognition approach
- Ijarah – focus on lessee’s right of use – so ED approach generally well received
- AOSSG WG supports one model – Ijarah side agreements make operating-finance distinction difficult
- Lessor problem with interest remains – AOSSG WG suggests different characterisation of ‘interest’