**No problem with shariah compliance**

Streamlining Islamic finance under global accounting standards the right move after successes in several countries

**MFRS compliance**

To Malaysian Accounting Standards Board (MAB) chairman Mohd Raslan Abdul Rahman, the Malaysian Financial Reporting Standards (MFRS) applies to all Islamic financial institutions licensed by Bank Negara Malaysia as well as all issuers of Islamic capital market instruments, hence “compliance with MFRS is, effectively, compliance with IFRS.”

In the past, MAB would seek to issue guidance in the form of technical releases (TRs) before the adoption of IFRS. However, having adopted MFRS, MAB is no longer in a position to issue its own standards or interpretations, thus having withdrawn all TRs that may be in conflict with IFRS.

“Currently, with regard to additional guidance, it depends on whether the issue is a clarification or interpretation,” Raslan tells FocusM.

Since 2007, the Malaysian Institute of Accountants (MIA) has had a Financial Reporting Standards Implementation Committee (FRSIC). Any implementation issue including that related to Islamic finance will be addressed by the FRSIC. For example, 2013 saw FRSIC issue Guidance on Special Matter No 2 which centred on a Presentation of Financial Statements for Takeover Companies and Classification and Measurement of Qar’ah (Lease).

**Applying IFRS in practice**

GLOBALLY, Islamic financial institutions have demonstrated both a keen awareness and a strong acceptance of international Financial Reporting Standards (IFRS). Institutions in several of the Gulf Co-operation Council countries report under IFRS and there are further examples of IFRS being adopted in other territories, according to PriceWaterhouseCoopers (PwC) in its findings entitled Open to Comparison: Islamic Finance and IFRS.

In Malaysia, the accounting framework is based on IFRS and is adopted locally as the Malaysian Accounting Standards Board (MAB) standards. Rather than issuing specific Islamic standards, the MAB provides technical releases to explain how best to accommodate Islamic transactions.

“Further guidance comes from the central bank,” PwC points out in its study. “It is interesting to note that recent discussions between Malaysian regulators and local accounting standards setters have led to the conclusion that local financial reporting requirements do not generally conflict with shari’ah.”

Therefore, IFRS applies unless there is a clear or explicit shariah prohibition which, in the Malaysian experience, is very rare. In Britain, legislation requires all companies to prepare their financial statements in accordance with either IFRS or generally accepted accounting practice in the UK (UK GAAP).

There are no distinct accounting requirements for Islamic finance or the institutions which follow shariah principles. Nonetheless, a number of UK-based Islamic banks are able to meet their reporting obligations principally using IFRS.

**Addressing confusion**

Commenting on concerns that the IFRS framework does not cover all the needs of Islamic finance stakeholders, IASB’s Fais says that given the unique use of trade contracts instead of conventional agreements, stakeholders may require further clarification on how the IFRS applies to Islamic finance.

Hence, one of the functions of IASB’s Islamic Finance Consultative Group is to identify challenges in applying IFRS to Islamic finance and to suggest potential solutions. The issues are then discussed by the relevant IASB project team or the IASB’s interpretations committee in order to come up with changes or clarifications that can assist Islamic financial institutions to better apply IFRS.

Some of the issues relate to clarifications on how a specific IFRS requirement would apply to an Islamic transaction. For example, the consultative group has discussed the circumstances under which a profit element in an Islamic finance transaction may fall within the definition of existing IFRS requirements that may not have been originally written specially to cover our unique situation. This would help us in applying IFRS locally.

**Principle of substance over form**

According to Fais, the more important discussion would be on the principle of substance. Fais notes that the economic substance of a transaction should prevail over its legal form.

“Since an Islamic finance product usually comprises a combination of different Islamic contracts, there has been a fair degree of discussion on how to account for the overall effect of the combination of contracts, rather than accounting for each component contract in isolation,” he rationalises.

“Garah mutanabbi bitamamk” is a product that comprises a lease followed by a sale of the leased asset. The financial impact of the entire contract may affect the accounting for the lease and sale separately.

MAB’s Raslan feels that Malaysia has a significant Islamic finance component in its capital markets that the local standard set has to work hard with local Islamic financial institutions to help solve issues with the help of the IASB.

“It is important that our innovations are not hampered by confusion over the appropriate accounting or that we can continue to assert compliance with the IFRS,” he stresses. “With that in mind, we have a specialist Islamic technical unit at MAB, a powerful consultative committee which is made up of preparers, regulators and auditors to deal with Islamic finance matters.”

**Shariah-compliant stocks**

By adopting an internationally-accepted reporting regime like IFRS, Raslan reckons that the credibility of local markets, including the shariah-compliant counters on Bursa Malaysia, will see improvement through consistent and comparable reporting across political boundaries.

“This in turn eases cross-border listings, thus further encouraging such market mechanism that play a major role in developing capital markets,” he justifies. “Also, improved comparability enables investors to understand the potential returns, which can increase the shariah-compliant companies better.”

Currently, Raslan says the financial statements of shariah-compliant companies are included in the same report as the financial statements of shariah-compliant companies in other jurisdictions such as Saudi Arabia or the UAE.

**The World Islamic Banking Competitiveness Report 2015** published by Ernst & Young showed that 93% of international participants are based on nine core markets with Malaysia being ranked second with a 15.5% share of global population (behind Saudi Arabia’s 33% and slightly ahead of UAE’s 15.4%). These three top countries apply a global financial reporting language in the IFRS.