



AAOIFI
ACCOUNTING AND AUDITING ORGANIZATION
FOR ISLAMIC FINANCIAL INSTITUTIONS

IMPROVING ISLAMIC FINANCIAL ARCHITECTURE

AAOIFI'S PERSPECTIVE

AAOIFI, 20 October 2016

OUTLINE

- AAOIFI: Brief Overview
- Islamic Financial Architecture
- AAOIFI's Role
- Way Forward

AAOIFI: BRIEF OVERVIEW

HISTORY AND TRACK RECORD

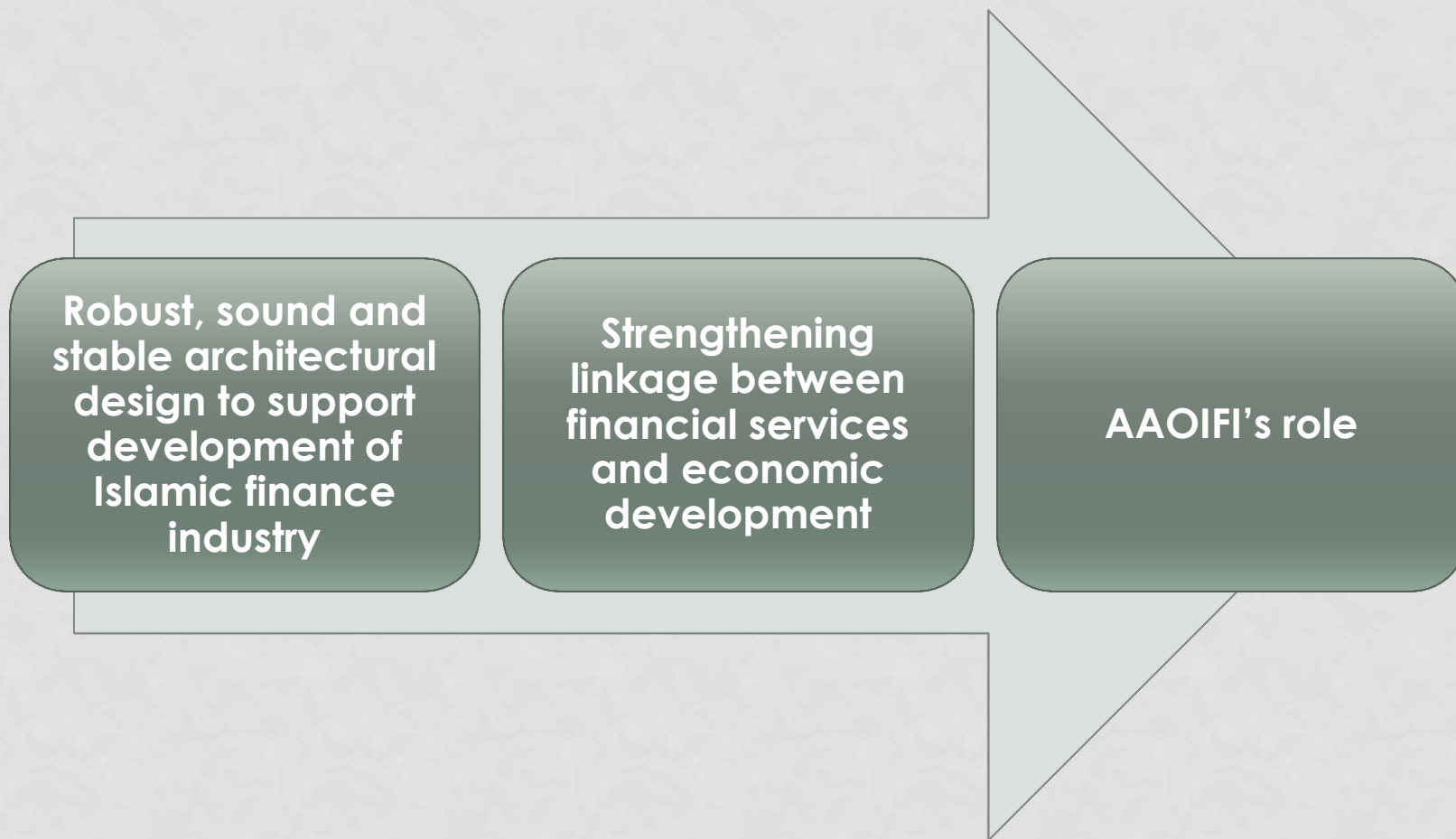
AAOIFI: BRIEF OVERVIEW

- Established in 1991 and is based in Bahrain.
- The leading international not-for-profit organization primarily responsible for development and issuance of standards for the global Islamic finance industry.
- It has issued a total of 95 standards in the areas of Shari'a, accounting, auditing, ethics and governance for international Islamic finance.
- It is supported by over 200 institutional members, including central banks and regulatory authorities, financial institutions, accounting and auditing firms, and legal firms, from over 45 countries.

AAOIFI: BRIEF OVERVIEW

- AAOIFI's standards are currently followed by all the leading Islamic financial institutions across the world and have introduced a progressive degree of harmonisation of international Islamic finance practices.
- Shari'ah standards provide guidance on Shari'ah rulings and Shari'ah basis with respect to permissibility and impermissibility in the area of Islamic banking and finance, and also for specific products and operations.
- Accounting, auditing and governance standards incorporate Shari'ah requirements and authentic with regard to Shari'ah compliance.
- These standards are developed based on the Islamic finance principles and practices.

ISLAMIC FINANCE ARCHITECTURE: FOCUS AREAS



ISLAMIC FINANCE ARCHITECTURE

- Architectural Design
 - Key elements:
 - Standards setting infrastructure.
 - Legal framework and customer protection infrastructure.
 - System liquidity infrastructure (payment settlement, monetary operations, foreign exchange, liquidity management, etc.).
 - Standard setting infrastructure
 - This includes accounting standards and governance regime for Islamic financial institutions, among others.
 - Infrastructure institutions, as building blocks, play a key role in promoting the Islamic finance industry, nationally and internationally.
 - A more focused approach is vital: removal of overlaps and increased coordination and cooperation between building blocks.

ISLAMIC FINANCE ARCHITECTURE

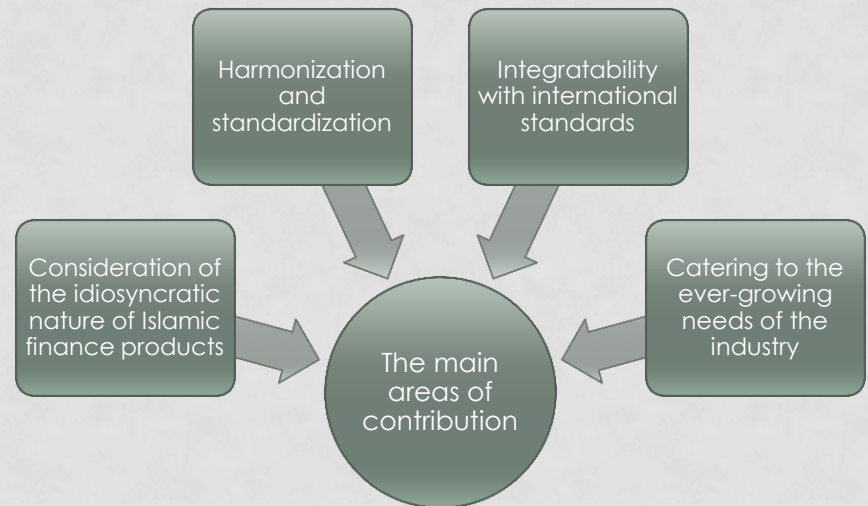
- Architectural Design
 - The shape and design of supporting infrastructure institutions are affected by:
 - The challenges posed by the industry (evolving requirements).
 - Tighter regulatory environments (prudential measures and risk focused approach).
 - Intensifying competition by other segments of the economy (conventional institutions).
 - Relentless globalization forces.
 - Necessity to integrate with the broader financial system.
 - Idiosyncratic nature of Islamic finance and Islamic financial intermediation.

FINANCIAL DEVELOPMENT SUPPORTS ECONOMIC DEVELOPMENT

- Flourishing of the real sector of an economy largely depends on financial development, including existence of a robust financial infrastructure.
- Additionally, the existence of a robust financial system infrastructure greatly attributes to financial market development and stability of the financial system.
- The fast growing industry, horizontally and vertically, reflects the increasing appeal of Shari'ah-compliant products and services to clients and investors, both locally and globally.
- This creates pressure on infrastructure entities in terms of the support they do- and must- provide to the industry.

AAOIFI'S ROLE

- AAOIFI's standards largely contributes towards achievement of the objectives of IFIs and their customers, investors, and users of their financial statements.
- This positively impacts the broader Islamic financial sector and economy.



CONSIDERING THE IDIOSYNCRATIC NATURE OF ISLAMIC FINANCE

- The accounting international standards (IASB) covers a wide array of products and transactions, but are unable to address the idiosyncratic nature of Islamic finance products such as Sukuk, Salam, Istisna'a, Murabahah, Ijarah, as well as specific nature calculations such as profit and loss distribution, Zakah, etc.
- Certain accounting requirements of Islamic banking operations are not covered by the international accounting standards.
- Certain contractual requirements arising from Shari'ah compliance are not handled by international standards.

HARMONIZATION AND STANDARDIZATION

- Adoption of different sets of standards certainly lead to different treatments, particularly in terms of recognition, measurement and disclosure.
- Example: *Murabahah*, from the perspective of Shari'ah, belongs to the broader category of trading contracts (sales), while under conventional accounting regimes, it is categorized as interest-bearing loan, and this profoundly impacts its accounting treatment.

INTEGRATION WITH INTERNATIONAL STANDARDS

- International standards may be applied by IFIs where no compromise on Shari'ah rulings and requirements occurs. AAOIFI standards and international standards may complement each other by removal of overlapping, redundancy, and Shari'ah-incompatible treatments and practices.

CATERING TO THE EVER-GROWING NEEDS OF THE INDUSTRY

- AAOIFI exerts unwavering efforts to address the expanding needs of the Islamic finance industry, both in terms of continuous development and improvement of the standards. The industry has been on an ascending trajectory, geographically, and sector-wise.
- AAOIFI has crafted an ambitious plan to develop new standards and to review existing ones to keep up with market expectations and also to cope with a rapidly changing environment.

PROJECTS PIPELINE

Shari'ah standards:

- Repurchase Agreement.
- Sale of Debt (Ba'i al-Dain).
- Gold.
- Muzara'ah.
- Mughararah.
- Commissions and Fees.
- Forward Ijarah.
- Purification of Impermissible Gains

PROJECTS PIPELINE

Accounting standards:

- Murabahah and Deferred Payment Sales.
- Sukuk
- Wa'ad and Khayar (Islamic Derivatives)
- Wakalah.
- Ijarah.
- Impairment, Expected Losses, Provisions and Reserves.
- Zakah.

PROJECTS PIPELINE

Governance standards:

- Centralized Shari'ah Boards (CSB)
- External Shari'ah Audit.
- Internal Shari'ah Audit.
- Shari'ah Compliance Function.
- Shari'ah Compliance and Fiduciary Ratings for IFIs.

Ethical standards:

- Comprehensive Ethics and Code of Conduct

WAY FORWARD

- Wider adoption of AAOIFI's standards by countries and jurisdictions.
- Improved involvement of regulators with AAOIFI's standard setting process.
- More integration with the broader financial system.
- Promotion of real-economy activities, in line with Shari'ah objectives including promotion of IFIs for involvement in asset administration rather than focusing solely on financial intermediation.
- Increased standardization of products and practices.