AAOIFI Financial Accounting Standard 27 (FAS 27) "Investment Accounts" and PSIFIs

FAS 27 issued in 2014 makes important changes in treatment of PSIAs that should be reflected in the *Compilation Guide*. The standard changes the accounting treatment of on-balance-sheet and off-balance sheet accounts, specifically PSIAs.

As stated in the Global Islamic Finance Report 2015:

> "The new standard introduces the concept of authority to make decisions in relation to use of and deployment of funds received from investment account holders in determining the treatment of such funds as on-balance sheet or off-balance sheet items.
>
> In contrast to the previous standards, the new standard stipulates that *accounting treatment for such funds is not dependent merely on whether the mudaraba contract is designated as restricted or unrestricted investment accounts.*
>
> Under the new standard, on-balance sheet accounting treatment is required for investment accounts that provide Islamic financial institutions with the authority for decision making and strategic policy, as well as day-to-day administration and operations in relation to where, when, and how the investment funds will be deployed.
>
> In cases where Islamic financial institutions have little authority or limited or no discretion in respect to the use of and deployment of the funds, they qualify for an off-balance sheet treatment. Notwithstanding, such off-balance sheet treatment needs to be accompanied with sufficient disclosures."

The new standard appears to bring the AAOIFI treatment closer to the IFRS concept of control to determine on-balance-sheet status introduced in 2013. The control concept requires that accounts be treated on-balance-sheet if the bank effectively controls the use of funding received and its income is affected by the use of the funds. By this standard, some RPSIAs could be required to be on-balance-sheet. As stated above, FAS 27 also can require some RPSIAs to be on-balance-sheet.

The change embodied in FAS 27 was anticipated in the draft *Compilation Guide* in its discussion of application of the IFRS 10 control concept to RPSIA, as shown in italics below….

> "Application of the control concept beginning in 2013 might have affected or could affect PSIFIs reporting in some countries. Significant changes in the composition of banking groups should be noted in metadata. *Treatment of RPSIAs could be affected under the control standard. The bank should exercise judgement whether it is principal or agent over funds placed in RPSIA. The terms of accounts will dictate the extent of decision-making power by the bank, the type of remuneration of the bank, and the variability of returns to the banks. The control concept might require inclusion of RPSIAs as on-balance-sheet assets within the group consolidation whenever an Islamic bank is judged to be a principal because it actively manages the funds placed in the RPSIA and has returns based on its*

management of those funds. Conversely, if the Islamic bank is judged to be an agent, the funds placed in the RPSIA are treated as off-balance-sheet and bank remuneration from the RPSIA is reported in a single line "IIFS share in income from restricted investment as Mudarib". Metadata should note whether national accounting standards require on- or off-balance-sheet treatment of RPSIA,

An implication of this change is that an Islamic bank's income statement and balance sheet probably should change the line "*IIFS share in income from restricted investment as Mudarib*" to something more like "*IIFS share as Mudarib in income from off-balance-sheet investment accounts.*

Appropriate changes should be made to the draft *PSIFI Compilation Guide* to reflect FAS 27.