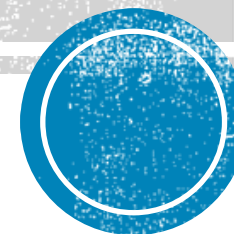


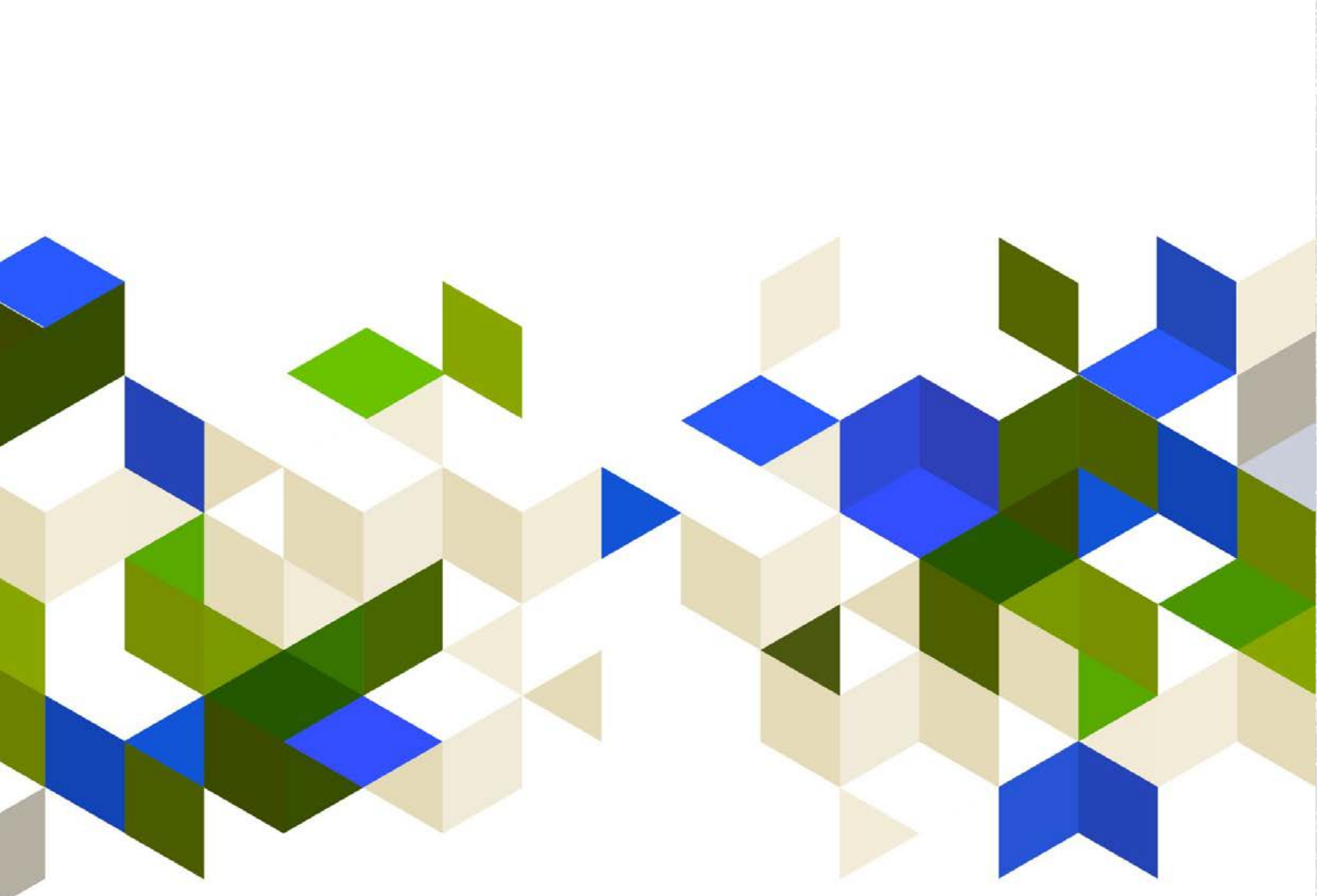
# Accounting in hyperinflationary economies under IAS 29: Islamic finance and Shari'ah considerations

Presentation for IASB Islamic Finance Consultative Group (IFCG)

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# Agenda: discussion points

- Broad categories of challenges for Islamic financial institutions (IFIs) in applying hyperinflation accounting
- Challenges in hyperinflation accounting due to business model and Shari'ah issues
- Way forward: possible solutions

# Broad categories of challenges for Islamic financial institutions (IFIs) in applying hyperinflation accounting

## Shari'ah issues: examples

- Certain assets and liabilities e.g., monetary assets and liabilities (receivables and payables, established as Dain / debt), are not allowed to be remeasured.
- Amounts are not allowed to be changed after constructive liquidation.

## Business model challenges: examples

- The business model differences result in attribution of profits, losses and comprehensive income to different sets of stakeholders.
- Attribution of underlying assets and determination of resultant profits and losses, have a corresponding effect on the amounts of URIA and QE.

# Remeasurement of receivables and payables

- Shari'ah considerations in remeasurement: receivables and payables cannot be reported at a value different from their par value. How to address such an issue?

## Current balance sheet

- As monetary assets and liabilities are not required to be adjusted, hence no significant issue.

## Adjustments during the current period

- Adjustments on periodic basis become an issue, as reporting of receivables and payables at other than par value is considered impermissible.
- Such remeasurements may affect the profits and losses for URIA and QE, hence considered questionable.

## Corresponding figures

- Changes in receivables and payables values is a question.



# Corresponding figures and opening balances

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- What are the challenges for remeasurement of corresponding figures, and adjustments of opening balances?
- Can corresponding figures be changed as per Shari'ah? Considering these are reflecting the rights and obligations of the respective parties?
  - Monetary assets and liabilities
  - Other assets and liabilities
  - URIA and QE – and their underlying assets
- Can opening balances be changed by adjustments to actual corresponding figures? How it will impact the profit and loss computations etc.



# Remeasurement of URIA and QE, if considered monetary liability – current period accounting

- Unrestricted investment accounts (URIA) and other quasi-equity (QE) e.g., certain Sukuk have a put option: As per IFRS it is classified as monetary liability, but as per Shari'ah it is not a liability, particularly monetary liability?
- If classified as monetary liability, what are the challenges?

## Current balance sheet

- As monetary assets and liabilities are not required to be adjusted, hence not to be remeasured.
- If it is not remeasured, how to treat the remeasurement effect of underlying assets?
- How to deal with the difference, if URIA and QE, and their underlying assets are remeasured differently?

## Adjustments during the current period

- Adjustments on periodic basis become a challenge, as periodic remeasurement of underlying assets is to be adjusted and accounted for.
- Such adjustments may be questionable from Shari'ah perspective, if these are result of remeasurement of monetary assets and liabilities.



## Remeasurement of URIA and QE, if considered monetary liability – corresponding figures

- Remeasurement of URIA and QE in corresponding figures: what are the additional challenges?
- After constructive liquidation, the distributable profit is determined. Revaluing the corresponding figures will mean either:
  - creating a liability / or a reserve in the investment pool – for URIA and QE; or
  - creating a liability / or a reserve for shareholders (will have Shari’ah implications).
- However, if we do not create a liability / or a reserve, it will create an accounting mismatch. And additionally, the rights and obligations of parties may not be reflected fairly.



# Remeasurement of URIA and QE, if considered monetary liability – opening balances

- Remeasurement of URIA and QE in corresponding figures and changing opening balances: what are the additional challenges?
- Once the figures are adjusted, the next challenge is about adjusting the opening balances – for financial reporting purposes, as well as, for computation of profits and losses. Will it be Shari’ah compliant to use adjusted figures?
- The determination of equity proportion in the investment pools become the next imminent challenge.
- During the year inflation adjustment is not possible as the amount paid will be different from the amount presented as expense - creating a loss in profit to the URIA and QE holders and the shareholders. There may be Shari'ah implications of any such loss is credited to the investment account holder.





# Constructive liquidation

- Investment pools are constructively liquidated at period end.
- Once constructive liquidation takes place the investment account holders lose their claim on future returns arising due to any other adjustment in the current balances.
- Same applies to shareholders' rights on the underlying assets of the respective investment pools.

## Current remeasurements

- Will the computation of distributable profits / losses consider all current revaluations? The revaluation of non-monetary assets may not be distributable, due to lack of liquidity.

## Fairness and equity

- Is it just and fair to have these adjustments, or not to have such adjustments?
- Whether or not to distribute or attribute the gains / losses to URIA and QE and whether to create reserves, if distribution is not possible.



# Constructive liquidation: reserve maintenance

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- Once constructive liquidation takes place the URIA and QE lose their claim on future returns arising due to any other adjustment in the current balances.
- What about the reserves of profits (mainly on non-monetary assets) which are not distributed?
- Can we take the revaluation of non-monetary assets to any of the reserves? i.e., Profit Equalization Reserve (PER), Investment Risk Reserve (IRR) or a special reserve created for this purpose?
- Who will be the beneficiary of the reserve, and when?
- What about long-term undistributed reserves? Their reversal and realisation plans?
- What would be the disclosure requirements to ensure fairness and transparency?
- What would be an accounting issue, and what would become a business issue?





# The way forward: possible solutions

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## Change functional currency

Purchase price stability is not present in hyperinflationary economy. Paragraph 17 of IAS 29 suggests using a “relatively stable foreign currency”. Paragraphs 3(a), (b) refer to stable foreign currency reference as condition for determination of hyperinflation.

## Exempt QE and underlying asset of QE

URIA and QE, may be considered monetary liabilities. And for matching principle exempt the underlying assets.

## Out-of-the-box thinking

Use of fair value accounting, where possible

Restate comparatives: a three-columnar approach

