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

- 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

- 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?

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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