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Dr. Hamed Merah
Secretary General
Accounting & Auditing Organization for
Islamic Financial Institutions (AAOIFI)
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Manama
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Dear Dr. Merah,

السلام عليكم ورحمة الله وبركاته،،،

CIBAFI Comments to the AAOIFI's Financial Accounting Standard No. 29: Sukuk Issuance

The General Council for Islamic Banks and Financial Institutions (CIBAFI) compliments the Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI) and takes this opportunity to express its appreciation of the work that the AAOIFI does to promote and enhance the Islamic financial services industry.

CIBAFI is the official umbrella for all Islamic financial institutions, whose services and products comply with the Shariah rules and principles. CIBAFI acts as the voice of the Islamic finance industry, where our members comprise banks and non-bank financial institutions, both large and small, and reach more than 120 members from 31 countries and jurisdictions.

We would like to express our thanks to the AAOIFI for its great effort and commitment with respect to developing standards that accommodate the interest of the global Islamic finance industry. We noted the request for comments on the AAOIFI's Financial Accounting Standard No. 29: Sukuk Issuance and welcome this opportunity to offer our comments and recommendations. However due to insufficient allocated time for public consultation, CIBAFI opted to only provide our high level comments from the Secretariat as we are not in the position to get feedback from our members in given time frame.

The comments contained in this letter represent the general and high-level views of CIBAFI Secretariat. We are also attaching as an Appendix 1 other comments for the AAOIFI's consideration.

Firstly, we would like to recommend establishing and further enhancing a close coordination between the AAOIFI, the Islamic Financial Services Board (IFSB) and the International Islamic Financial Market (IIFM), as we understand that both IFSB and IIFM have done or are doing some work on Sukuk related projects. It will therefore be important to ensure consistency of guidelines and recommendations to facilitate the implementation.

Secondly, we also note that clarification on recognition & de-recognition of assets in the books of the Sukuk originator and the Special Purpose Vehicle (SPV) are not detailed enough in the draft document. This issue often triggers discussions and inconsistent practices. We recommend that the standard shall provide more clarity and details on recognition & de-recognition of assets.

Thirdly, we would like to highlight that the proposed draft standard does not seem to cover in enough details all issues pertaining to Sukuk structures. For example, draft document prescribes criteria for Musharaka or Mudaraba Sukuk to be classified as either equity or quasi-equity, however draft document does not provide clarifications on how a Sukuk structured on one of those principles which does not meet the other criteria should

be treated. This situation is not helped by Appendix B and the sukuk covered by the table are not the same as those discussed in the notes.

We remain at your disposal should you need any further clarifications on the above or on the attached appendix.

Yours sincerely,



Abdelilah Belatik
Secretary General

Appendix

Comments on the Financial Accounting Standard No. 29: Sukuk Issuance

Section Definitions, Paragraph 6/E

Paragraph 6/E states that “*Participatory structure - is the type of contractual arrangement under which the parties to the contract share the profits, losses and residual interest in the net assets of the underlying assets or business.*”

We note that this definition may not be explicit enough. We recommend amending it to “**would exclude a Mudarabah structure from being treated as participatory**”, because it does not involve the sharing of losses (which fall entirely on the capital provider).

Section Definitions, Paragraph J & K

The paragraphs state that “*Tier 1 equity - represents the most subordinated claims on an institution’s asset (residual interest) and are perpetual in nature i.e are not callable by the issuer (except for discretionary buy backs allowed by relevant laws). Tier 2 equity-also represents a subordinated claim on institution’s asset after depositors [including investment account holders] and general creditors. These may be callable by the issuer for at least five years and only if they are replaced by tier 2 equity of same characteristics.*”

We believe that the definitions of Tier 1 and Tier 2 should be closely aligned with the Basel definition, or their Islamic counterparts the IFSB, since Tier 1 and Tier 2 are Basel concepts. In particular, **the two forms of Tier 1 capital (CET and AT1) should be distinguished, and the concept of loss absorbency should be explicitly defined.**

Section Sukuk Classified As Quasi-Equity, Paragraph 21

The paragraph states that “*Sukuk issuance shall be classified and accounted for as quasi-equity if these meet the definition of quasi-equity under this standard, have the characteristics similar to*

the equity of investment account holders and do not meet the criteria for classification as equity”.

We notice that the “**the equity of investment account holders**” is not related to the subject under discussion (both in paragraphs 21 and 24). We believe that accounting treatment for Sukuk should not depend on how similar they are to that equity, instead separate clear criteria should be set to help decide on their classification.

Section Sukuk Classified As Quasi-Equity, Paragraph 23

The paragraph states that *“There is a rebuttable presumption that Sukuk structured on Musharakah and Mudarabah basis shall be classified as quasi-equity if they are redeemable by Sukuk-holders and / or there is a separate purchase undertaking by the issuer, and / or if they do not meet the criteria for classification as equity”.*

We notice that there is **lack of clarity** on how Musharaka or Mudaraba sukuk, which fail one of the tests in para 23 should be treated.

Section Appendix C, Paragraph BCA 13

We believe that **the treatment here adopts a strong form-over-substance approach by decomposing the full structure of the Sukuk into a set of separate contracts and undertakings**. In practice, this would lead to a materially different accounting treatment from a form-over-substance standard like International Financial Reporting Standards (IFRS), which would treat the structure as a single bundle of rights and obligations. It is therefore unclear what real impact this would have on the accounting of Islamic banks. We notice that readers would have found it helpful to have one or two practical examples. This would help ensure consistency of accounting and reporting of such cases across jurisdictions.

Section Appendix C, Paragraph BCA 13/C

We note that in real Sukuk scenarios (e.g. Wakala), although a principal-agent relationship may exist contractually, the ability of the principals in practice to give direction to their agent is extremely limited. We believe that **in such situations it would be appropriate to say that the agent has constructive control, but the standard is rather unclear on this point.** We recommend that the statement could be elaborated more clearly.