

TO BE PUBLISH IN PART II OF THE GAZETTE OF PAKISTAN

Statutory Notification (S.R.O.)

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Islamabad, the June 12, 2013

NOTIFICATION

S.R.O. ~~584~~ 2013. In exercise of the power conferred by sub-section(3) of section 234 of the Companies Ordinance, 1984 (XLVII of 1984), the Securities and Exchange Commission of Pakistan is pleased to direct that the Islamic Financial Accounting Standard 3 "Profit and Loss Sharing on Deposits" annexed to this notification, issued by the Institute of Chartered Accountants of Pakistan, shall be followed for the purpose of preparation of the financial statements by Companies and Modarabas while accounting for transactions relating to "Profit and Loss Sharing on Deposits" as defined by the said Standard.

Provided that the Commission may grant an exemption to any company or any modaraba, if it is in the public interest so to do, from compliance with all or any of the requirements of the aforesaid Standard.


(Nazir Ahmed Shaheen)
Executive Director

Islamic Financial Accounting Standard on Profit and Loss Sharing on Deposits

The Institute of Chartered Accountants
Of Pakistan



January 2013

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STANDARD ON PROFIT AND LOSS SHARING ON DEPOSITS

Preface

This Standard aims at setting out accounting principles to be followed by Institutions offering Islamic Financial Services (IIFS) for recognizing, measuring, presenting and disclosing the transactions relating to equity ('funds') of unrestricted investment / (Profit/Loss Sharing) PLS deposit account holders and their equivalents.

Statement of the Standard

1. Scope of the Standard

1.1 This Standard addresses two issues:

- (a) First the accounting principles relating to funds received by the IIFS for investment in its capacity as a mudarib at the IIFS's discretion, in whatever manner the IIFS deems appropriate (funds of unrestricted investment account holders / PLS deposit account holders); and
- (b) Second, the disclosure of bases for profit allocation between owners' equity and that of unrestricted investment / PLS deposit account holders as applicable to the financial statements published by IIFS to meet the common information needs of the users of such statements.

Explanation: This Standard is also applicable to *funds received on profit and loss sharing basis, such as export refinance from SBP* unrestricted investment accounts / PLS deposit accounts / funds obtained based on musharaka.

1.2 This Standard does not address the following:

- (a) The funds received by the IIFS on a basis other than the Mudaraba and / or Musharaka contract, for example:
 - Funds received for investment on the basis of agency for a specified fee;
 - Non remunerative cash margins and their equivalent;
 - Non remunerative security deposits and their equivalent; and
 - Current accounts and their equivalent based on qard.
- (b) Bases of calculation of Zakat on funds of unrestricted investment / PLS deposit account holders.

2. Definitions

2.1 Unrestricted investment accounts / PLS deposit accounts

- 2.1.1 Under this type of account, the investment account holder authorises the IIFS to invest the account holder's funds on the basis of Mudaraba or Musharaka contract in a manner which the IIFS deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested. Under this arrangement, the IIFS can commingle the investment account holder's funds with its own equity or with other funds the IIFS has the right to use with the permission of Investment account holders (e.g. current accounts or any other funds which the IIFS does not receive on the basis of Mudaraba or Musharaka contract).

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- 2.1.2 Funds of unrestricted investment / PLS deposit account holders and their equivalent refer to the balance, at the date of the statement of financial position / balance sheet, from the funds originally received by the IIFS from the account holders plus (minus) their share in the profits (losses) and decreased by withdrawals or transfers to other types of accounts.
- 2.1.3 Certificates of investment, term deposit receipts, redeemable capital and other accounts of similar nature are equivalent to unrestricted investment / PLS deposit accounts. These are issued by the IIFS in the names of those who subscribe to them on the basis that the IIFS will use those funds to finance its investment activities.
- 2.1.4 Profits are allocated between holders of such instruments and the IIFS, based on the relative amount of funds invested by each in the respective pool and preagreed profit distribution weightages / ratios, after the IIFS has received its share of profits as a Mudarib. Losses are allocated between the IIFS and holders of these instruments based on the relative amount of funds invested by each.
- 2.1.5 Funds of unrestricted investment / PLS deposit account holders and their equivalent are to be considered as redeemable capital for the purpose of financial accounting and reporting. This is because the IIFS is not obligated in case of loss to return the original amount of funds received from the account holders unless the loss is due to negligence, misconduct or breach of contract. Current accounts and other non-investment accounts are guaranteed by owners' equity and not by the funds of unrestricted investment / PLS deposit account holders or their equivalent.
- 2.2 Agency based contract for investments**
- 2.2.1 Holders of investment accounts appoint IIFS to invest their funds on the basis of an agency contract in return for a specified fee or a specified fee and share of the profit if the realised profit exceeds a certain level, the latter being an incentive for the IIFS to achieve a return higher than expected.
- 2.3 Mudaraba**
- 2.3.1 Mudaraba is a partnership in profit whereby one party provides capital (rab al maal) and the other party provides labour (mudarib).
- Explanation: Mudarib may also contribute capital with the consent of the rab al maal.
- 2.4 Musharaka**
- 2.4.1 Relationship established under a contract by the mutual consent of the parties for sharing of profits and losses arising from a joint enterprise or venture.
- 2.5 Return on unrestricted investment accounts / PLS deposit accounts and their equivalent**
- 2.5.1 Return on unrestricted investment accounts / PLS deposit accounts and their equivalent is the share allocated to the holders of those accounts out of investment profits and losses as a result of their participation jointly with the IIFS, in the financing of investment transactions during the period covered by the income statement.

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2.6 Profit / loss sharing period (the period)

2.6.1 Profit / loss sharing period (the period) of IIFS shall be the period for which an IIFS computes, distributes / allocates profits / losses to its unrestricted investment / PLS deposit account holders and the IIFS.

2.7. Redeemable Capital

2.7.1 The expression 'redeemable capital' for the purposes of this Standard means funds or deposits received from unrestricted investment account holders / PLS deposit account holders by IIFS on profit / loss sharing basis and subject to such terms and conditions as may mutually be agreed between the IIFS and such account / deposit holders.

3. Accounting treatment in respect of unrestricted investment account holders / PLS deposit account holders

3.1 Funds of unrestricted investment / PLS deposit account holders and their equivalent

3.1.1 Funds of unrestricted investment / PLS deposit account holders shall be recognised when received by the IIFS. IIFS may maintain more than one pool to finance its investments activities. In case the IIFS makes it a condition that the funds will not be invested before a certain date, then the funds received shall be recorded in a current account until their date of investment is due.

3.1.2 Funds of unrestricted investment / PLS deposit account holders shall be measured by the amount received by the IIFS at the time of contracting.

3.1.3 At the end of the period, funds of unrestricted investment / PLS deposit account holders shall be computed as follows:

Balance of investment account at the beginning of the period
Add: Any further deposits
Less: Any withdrawals
Add: Any share of profits allocated and reinvested
Less: Any share of losses allocated
Add / less: Any other necessary adjustment.

3.2 Allocation and accounting treatment of profit / loss

3.2.1 Profits of investment(s) jointly financed by the IIFS and unrestricted investment / PLS deposit account holders shall be allocated between them according to the mutually agreed terms.

3.2.2 Allocated but unpaid profits which are not reinvested as per mutual agreement shall be recognised and disclosed as a liability by the IIFS.

3.2.3 Loss resulting from transactions in a jointly financed investment should, in the first instance, be deducted from any unallocated profits / ¹Profit Equalization Reserve on the investment. Any loss remaining should be deducted from

¹ Islamic Financial Services Board (IFSB) I Guiding Principles of Risk Management for Institutions (Other than Insurance Institutions) offering only Islamic Financial Services

Profit equalisation reserve (PER) is the amount appropriated by the IIFS out of the *Muḍārabā* income, before allocating the *Muḍārib*'s share, in order to maintain a certain level of return on investment for IAH and to increase owners' equity.

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- 4.5.2 The rights, conditions and obligations of each class of unrestricted investment accounts / PLS deposit accounts and their equivalent and other deposit accounts shown in the statement of financial position / balance sheet should be disclosed.
- 4.5.3 Separate disclosures shall be made of all material items of revenues, expenses, gains and losses classified under the headings appropriate to the IIFS distinguishing those attributable to:
- a.) unrestricted investments / PLS deposit accounts ;
 - b.) IIFS; and
 - c.) IIFS and unrestricted investments / PLS deposit account holders jointly.

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