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THE INFLUENCE OF IFRS 9 ON THE SUKUK ACCOUNTING STANDARD IN INDONESIA

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Abstract

This paper analyzes the influence of International Financial Reporting Standard (IFRS) 9 on Indonesia's *sukuk* accounting standard. The latter was revised to be more in harmony with the dominant global standard. The writer interviewed senior accountants of Islamic banks who were aware of the issue, as well as reviewing and comparing the *sukuk* accounting of Islamic banks after the revised standards were applied. IFRS adds market valuation and any changes recognized in other comprehensive income (OCI). Therefore, Indonesia's Statement of Financial Accounting Standard (SFAS) 110 was revised to accommodate IFRS, but a more complete adoption of IFRS 9 requires further review from Islamic scholars, especially in regard to the use of discount and interest rates for valuation. Islamic scholars in Indonesia prohibit this method for valuation.

Keywords: Sukuk accounting, IFRS, Islamic banking, bond

Not many countries adopt the accounting standards of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). As of this moment, only Bahrain and the United Arab Emirates refer to them. Indonesia has specific accounting standards for Islamic financial

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institutions (IFIs), but they still refer to AAOIFI (Azmi, 2010). Others use IFRS for their Islamic banking accounting standard (Siswantoro, 2015).

The focus of IFRS 9 accounting treatment in this research is on fair value treatment and financial statement presentation. These new treatments caused Indonesia to revise the accounting for *sukuk*. In the beginning, a distinct *sukuk* accounting standard was issued in Indonesia because IFRS was based on discount or interest rates for the valuation, which is not in line with Islamic teaching.

The problem of harmonization between Indonesia's *sukuk* accounting standard and IFRS 9 occurs here. Islamic scholars have a role in analyzing the suitability of IFRS 9 for Islamic teaching, given the differences between the IFRS and Islamic accounting principles (Siswantoro and Hameed, 2010). Yet financial statements should be recognized globally, so that accounting standards have a common template and financial statement presentation.

This paper tries to analyze how revising the accounting treatment of *sukuk* in Indonesia has affected fair value accounting and financial statement presentation. The process of revision included developing a consensus among Islamic bank accountants first, then asking for the opinion of Islamic scholars. The process is debatable, however, as there is no standard procedure for revising Indonesian accounting standards. The Shariah Accounting Standards Board (DSAS) of the Indonesian Institute of Accountants (IAI) must ensure that the standard has complied with Islamic teaching.

The Development of the Sukuk Accounting Standard

a. Issues in Sukuk Accounting

In 2004, before the accounting standard for *sukuk* was established, the Securities and Exchange Commission (SEC) evaluated the development of Islamic capital markets in Indonesia. Implicitly, it was assumed that the accounting treatment would have to differ from conventional standards in order to prepare reliable and suitable reports. In addition, the Asian-Oceanian Standard-Setters Group (AOSSG, 2010) researched Islamic accounting and identified two out of 15 outstanding issues concerning *sukuk* accounting.

AOSSG questioned the relevance of "sukuk valuation as many *sukuk* are "tradable," but they are usually not. Do they need to be measured at fair value? If so, how?" The response is that *sukuk* usually refer to market value, and that valuation should not be based on interest rates as it may contradict Islamic teaching. In general, a *sukuk* is asset backed and may not need valuation which is based on interest rates. Moreover, those that are not asset backed but merely asset-based are criticized by Islamic scholars because they may violate Islamic teaching for non-real asset transfers (Siswantoro, 2015). However, some asset-based *sukuk* may also be permissible due to complex and difficult factors (Hasan, 2013 on ISRA – Fatwa in Islamic Finance). Different structures can be seen in table 1. Generally, the *ijarah* structure is asset-backed while the *mudaraba* tends to be asset-based in Indonesia. In the *ijarah sukuk*, the rental fee of an underlying asset can be used as the source of payment to a *sukuk* holder.

Table 1. Differences between Asset-Backed and Asset-Based Sukuk

Classification	Asset-Based Sukuk	Asset-Backed Sukuk
Accounting Treatment/ Concept	Usually designed as ON balance sheet (for obligor/originator) (treated like a debt)	Can either be ON or OFF balance sheet (for obligor/originator) (treated like a true-sale which has legal and off-balance sheet criteria)
Ownership	Sukuk investor only attains beneficial ownership	Full transfer of legal ownership of the underlying asset

Income source for the Sukuk-holder	Main source of payment usually comes from the issuer's/obligor's cash flow	Main source of payment is the revenue from the underlying sukuk assets
Funding Cost	Market driven, depending on originator/credit issuer	Capital driven, depending on the strength of the asset cash flow
Rating	Corporate rating of issuer	Strength of asset cash flow

Source: Hasan (2013).

AOSSG studied accounting practices for Islamic financial transactions and institutions. Some countries, such as the United Arab Emirates, Indonesia, South Africa, and Syria, have specific accounting standards for *sukuk*. The UAE, Indonesia, South Africa, and Pakistan evaluated *sukuk* at market prices, much like IFRS (AOSSG, 2011). However, in the case of Indonesia, SFAS 110 prohibits the use of interest rate valuation. This is the main reason why Indonesia has a different accounting treatment for *sukuk* valuation.

b. Relevant Issues in Revised SFAS No. 110

Differences in valuation between *sukuk* (SFAS No. 110) and conventional accounting standards in Indonesia (Siswanto, 2015):

1. *Sukuk* are based on a business model similar to IFRS 9. This assumes that *sukuk* transactions are held to maturity. *Sukuk* are not based on interest rate valuation.
2. The calculation of Present Value, which requires using interest rates, is prohibited.
3. Present Value, or discounted value, is ignored in impairment testing. Other methods that do not use interest rates are permitted.

The main issue is the use of interest rates, which may not be in line with Islamic teaching. On the other hand, IFRS 9 is heavily based on interest rates for valuation. Furthermore, it relates to Present Value and discount rates, which are generally used in impairment analysis (in the event of default). However, other methods for valuation are available: either earning asset quality as defined by the Financial Services Authority (OJK) or a real sector index method developed by the Bank of Indonesia. The index method is based on a real rate of return in some economic sector.

In the due process of establishing or revising an accounting standard in Indonesia, there is a public hearing forum in which other stakeholders are asked to give their opinion and to discuss the proposal of the revised standard. Concerning the original *sukuk* accounting standard, in the public hearing on 22 June 2011 in Jakarta, some practitioners made objections because they had been prepared to adopt the new conventional (IFRS-based) accounting standard (Siswanto, 2015).

Then in 2015 the revised standard gave a slightly different accounting treatment, as Table 2 indicates.

Table 2. Revision of SFAS 110 (2015)

Items	SFAS 110 (2015)	SFAS 110 (2011)
Classification	- Acquisition cost - FV OCI - FVTPL	- Acquisition cost - FV
Measurement in the beginning	FV OCI, change is to OCI FV OCI, change is to PL	n.a
Fair value	- Quoted price - Other (observable)	- Quoted price - Current price - Other fair value
Impairment	Decreasing value as loss	n.a

Source: Indonesian Institute of Accountants (IAI).

SFAS 110 does not fully adopt IFRS 9. The main difference is that SFAS 110 still does not permit the use of discount or interest rates for *sukuk* valuation. Even the coupon rate is understood to be a rental or leasing (*ijarah*) rate or a profit sharing (*mudaraba*) indicative return rather than a market interest rate. Malaysia, on the other hand, permits valuation and impairment based on discount rates (Suandi 2015). The Malaysian argument is that discount rates used in the valuation are only for calculation, not for charging the interest to a borrower, which is explicitly prohibited. Since they are not explicitly forbidden, the Malaysian Accounting Standard Board (MASB) accepts the IFRS methods of valuation. MASB withdrew current Islamic accounting standards and replaced them with IFRS standards. Indonesia is stricter in implementing Islamic teachings for Islamic banks than Malaysia. Another example is the *bay al innah* - permissible in Malaysia but not in Indonesia. This is because that scheme contains two transactions in one contract, which is prohibited in Indonesia. In practice, it is like a loan in a sale-and-buy-back that does not really occur. Other differences with IFRS are:

1. In the case of the time value of money, the issue here is not only charging interest on the loan but also valuation using discount or interest rates that would recognize loss or gain directly on the income statement or as OCI. This may be similar to *riba* (usury) as it is predetermined gain or loss activity. *Riba* concerns not only the person who is charging interest but also the one who records the interest rate transaction.¹ Therefore, Muslim scholars in Indonesia are cautious. It is safer to avoid *riba* in any related activities.
2. Indonesia's Islamic Accounting Standard was already established in 2003, while convergence with IFRS came later, in 2006. Islamic banks in Indonesia have effectively adopted the Islamic accounting standards, which were established bottom up, strongly supported by society. Some international standards, at least, can accommodate the Islamic scheme of financing, and "What cannot be completely attained, should not be completely left".² On the other hand, IFRS does not have an Islamic accounting treatment for Islamic financial transactions. So far, current SFAS 110 can accommodate the characteristics of Islamic financial transactions, enabling stakeholders to trust Islamic banks.

So far, the Indonesian Council of Ulama (MUI) only permits two *sukuk* structures, those of *mudaraba* and *ijarah*. In Malaysia, by contrast, other structures such as *murabahah*, *salam*,

¹ Jabir said that Allah's Messenger PBUH cursed the acceptor of interest and its payer, and one who records it, and the two witnesses, and he said: They are all equal (Narrated by Muslim No. 1598).

² This legal maxim was written by Abdul Hamid Hakim in Book of Mabadi Awaliyah.

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istisna'a, and *musharakah* are also permitted, whereas some Indonesian scholars consider that *sukuk* based on selling schemes may be *riba* if there is a change in price in the secondary market.

Table 3. Comparison between IFRS 9 and SFAS 110

	IFRS 9	SFAS 110
Valuation Basis	Discount rate	No discount rate
Structure	Interest rate	- Lease (ijarah) - Profit sharing (mudaraba)
Underlying assets	n.a	Available
Treatment as issuer (in balance sheet)	As liability	- Lease (ijarah) as liability - Profit sharing (mudaraba) as temporary shirkah funds account
Treatment as investor (in balance sheet)	- Amortized cost (based on interest rate) - Fair value OCI (based on interest rate) - Fair value PL (based on interest rate) (in the income statement)	- Acquisition cost - Fair value OCI - Fair value PL (in the income statement)
Impairment	Based on discount rate, 3 stages model	No discount rate

Source: SFAS 110, Connolly (2015) and Deloitte (2014).

Furthermore, *sukuk* in Indonesia are always based on an underlying asset which transfers ownership to the *sukuk* holder, so that it is not like a loan but more like an investment such as preferred stock. On the liability side the *mudaraba sukuk* issuer accounts for it in a temporary *shirkah* fund due to profit sharing risk. As for *ijarah*, it can be classified as a liability. And as for the investor, both IFRS 9 and SFAS 110 have analogous classifications, but IFRS 9 depends heavily on interest rate-based calculations, as noted earlier. Also for impairment, SFAS 110 does not permit the interest rate calculations connoted by discounting. Table 3 compares the accounting treatments prescribed by IFRS 9 with those of SFAS 110.

The use of discount or interest rates is unlawful for *sukuk* valuation because that valuation of *sukuk* can create gains or losses which directly affect the fair value of PL or OCI. The projected income is discounted in IFRS 9 by the expected market interest rate. The determination of this rate is based on interest rates. The behavior of fixing the projected income is analogous to *riba* (usury) in financing activity. The comparison of *sukuk* valuation between IFRS 9 and SFAS 110 can be seen in figure 1.

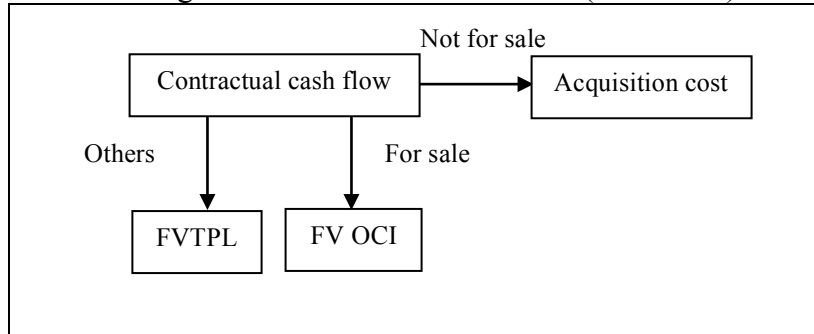
Figure 1. Comparison of Method between IFRS 9 and SFAS 110

For example, A bank buys <i>ijarah sukuk</i> (5 years maturity), US\$5 million with <i>ijarah</i> rental coupon 5% per year on 1 January 2015. The question is how to report on 31 December 2015 if the expected market interest rate is 7% on that day?			
IFRS 9			
Year	Expected Cash Flows	7% discount factor	PV (m USD)
31 December 2016	5m USD x 5% = 0.25m USD	0.935	0.233
31 December 2017	0.25m USD	0.873	0.218
31 December 2018	0.25m USD	0.816	0.204
31 December 2019	0.25m USD + 5m USD	0.763	4.005
4.661			
Under IFRS 9 the bank would create a loss of 0.339m USD on their OCI or PL. If the expected market interest rate is 4%, it would create a gain.			
SFAS 110			
The bank would refer to the Financial Services Authority (OJK) earnings asset quality regulation to determine the Allowance for <i>Earning Assets (PPAP)</i> . Another method could be to refer to a real sector index based on real economic returns by the Bank of Indonesia.			

Source: IFRS 9, Bank Indonesia, Islamic banks

The classification of *sukuk* in SFAS 110 is quite simple (see figure 2). If the *sukuk* is not for sale, it is classified at acquisition cost. If it is for sale, it can be classified as fair value through other comprehensive income (FVOCI) or through profit and loss (FVTPL).

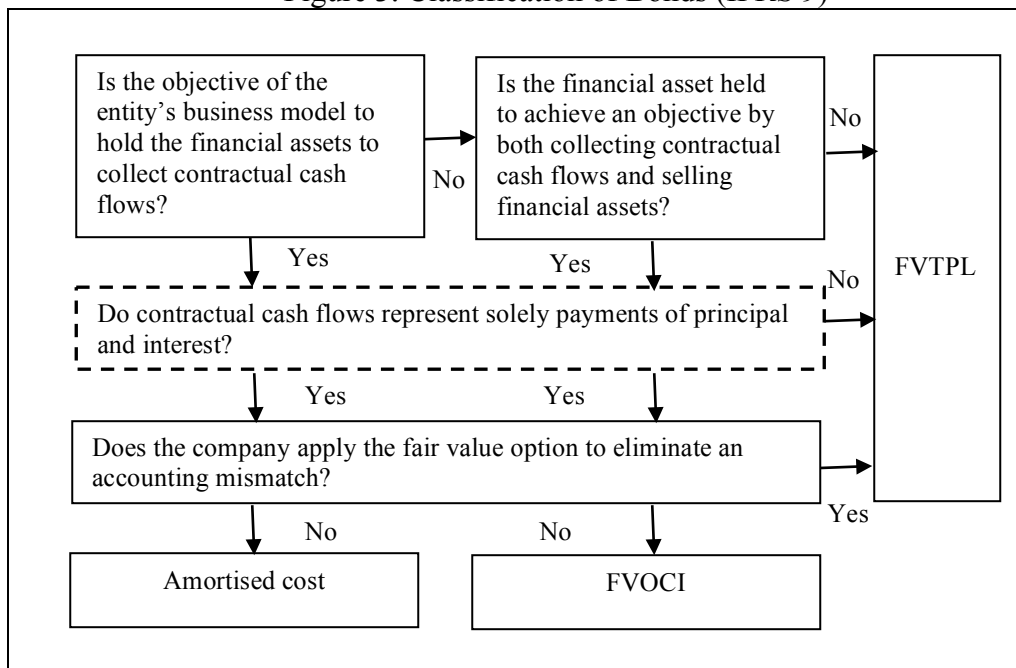
Figure 2. Classification of Sukuk (SFAS 110)



Source: SFAS 110 (interpretation).

IFRS 9, on the other hand, specifies whether a bond’s fair value is to be derived from comprehensive income (FVOCI), from profit and loss (FVTPL), or from amortized cost based solely on payments of principal and interest. Figure 3 presents the guidelines for classification and implies that the fair value option for a *sukuk* should be based on FVTPL rather than FVOCI. The contractual cash flows may indeed be different from principal and interest, especially for a *mudaraba* structure in which the coupon fee may not be fixed. In fact, SFAS 110 does not specify any requirements for FVTPL. SFAS 110 does not even state any requirements for FVTPL classification.

Figure 3. Classification of Bonds (IFRS 9)



Source: PwC (2014).

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The revised SFAS 110 only introduces slight changes to transition accounting treatment for FVOCI (but none for FVTPL), as Table 4 indicates. The FVTPL classification may have been accommodated in SFAS 110 (2011) implicitly as “Fair value” since in the previous standard (2011) FV referred to FVTPL. Naturally, a *sukuk* is an investment which is held until maturity. Some Islamic banks actually utilize short-term *sukuk* as an Islamic money market but their liquidity may be a problem: it may ignore the purpose of a *sukuk* investment that requires being held until the maturity date.

Table 4. Transition Implications of SFAS 110

Revision 2011		
Before	After	Implication
Fair value to profit and loss and available for sale	Acquisition cost	Change is amortized
Available for sale	Fair value	OCI reclassified to R/E
Held to maturity	Fair value	Retained Earnings (R/E)
Revision 2015 (addition)		
Fair value to profit and loss	Fair value OCI	Record as the beginning
Acquisition cost	Fair value OCI	OCI

Source: Indonesian Institute of Accountants (IAI).

Table 5 displays the differences in accounting treatment for investors between IFRS 9 and SFAS 110. To determine fair value from comprehensive income (FVOCI), SFAS 110 requires amortization during the period if there has been a change, whereas IFRS 9 does not. IFRS 9 states that any change would directly impact its classification. SFAS 110 is more flexible as the change after acquisition would be allocated proportionately during the period.

Table 5. Accounting Treatment for Investors

Accounting Treatment	IFRS 9	SFAS 110
Subsequent:		
- Acquisition cost	Change is to PL	Change after acquisition is amortized to PL during period.
- FVOCI	Change is to OCI	Change after acquisition is amortized to PL during period. Change is to OCI
- FVTPL	Change is to PL	Change is to PL
Impairment:		
- Acquisition cost	Model (general, simplified, special provision), 3 stages to determine loss (12-month expected credit loss, lifetime expected credit losses, lifetime expected credit losses-net)	Loss if less than nominal value
- FVOCI	Model (general, simplified, special provision), 3 stages to determine loss (12-month expected credit loss, lifetime expected credit losses, lifetime expected credit losses-net)	Loss if less than nominal value + OCI
- FVTPL	Model (general, simplified, special provision), 3 stages to determine loss (12-month expected credit loss, lifetime expected credit losses, lifetime expected credit losses-net)	n.a

Source: SFAS 110 and Deloitte (2014).

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In impairment, SFAS 110 does not specify any requirements for predicting losses. By contrast, IFRS 9 develops models of expected losses, all of which are based on discount rate valuation.

1. Practices of Islamic Banks

How in practice were the revisions in accounting standards being applied? Three senior managers from major Islamic banks in Indonesia were interviewed about the issues related to the revision of SFAS 110.³ Additionally, secondary data were gathered from financial statements of companies issuing *sukuk*. Other Islamic banks' financial statements were analyzed to see how they recorded *sukuk* in 2010. To see the effect of changes in the *sukuk* accounting standard, the financial statements of 2013 and 2014 were compared with those of 2015.

a. Revised Sukuk Accounting Treatment

- (i) Before the *sukuk* accounting standard was introduced, each Islamic bank had a different treatment of accounting for *sukuk* treatment (Siswantoro 2015):
 - Bank Muamalat Indonesia (BMI) amortized the government *sukuk* and their Islamic sub-debt. BMI categorized *sukuk* under three categories from March to September 2010: trading, available for sale, and held to maturity.
 - BSM had *sukuk* under the category of fair value through profit and loss (*sukuk* retail). It refers to PSAK 55 Financial Instrument.
 - BNI put them under AFS.
 - Panin Bank Syariah still categorized *sukuk* as trading.
 - BMI classified *sukuk* as financial assets; others classified them as investments.
 - Bank Jabar dan Banten Syariah (BJB) records *sukuk* under HTM (PBI No.10/24/PBI/2008).
- (ii) After SFAS 110 was introduced in 2011, in general all *sukuk* were classified as 'held to maturity' (HTM) or at cost, although some retail government *sukuk* were recorded at fair value. Bank Muamalat used the cost method for a BSM *sukuk*, which was previously recorded as available for sale. They recorded retail government *sukuk* at fair value. On the other hand, BCA referred to SFAS 55 on Financial Instruments. A difference occurred when they had to treat for a *sukuk* default. Only BSM recorded a default as loss to equity, while BCA reclassified it as available for sale, and others had no specific treatment (Siswantoro, 2015).
- (iii) After the revision of SFAS 110 in 2015 three banks published their financial statements in detail online. Only Paninbank directly adopted the revised standard in June 2015. The differences are that they were using discount rates in December 2014 and June 2015, but then eliminated them in September 2015. However, they did not mention SFAS 110 explicitly in September 2015 but simply stated the use of a contractual cash flow model, which is an at cost model (see table 6).

³ Trustworthy research presupposes credibility, transferability, dependability, and confirmability. Credibility is achieved here by choosing the competent respondent and by triangulation in observing the public hearing meeting. Transferability can be explained in detail case by case. Dependability is achieved by following issues raised in *sukuk* accounting. Confirmability is achieved by explaining how to get the data so that it can be checked by others.

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Previously (before the revised *sukuk* standard), they stated that they used fair value, which affected other comprehensive income (OCI). In fact, Paninbank does not refer to discount rates but to Bank Indonesia regulation (based on earnings asset quality). The rates only apply to government *sukuk*, which do not have a reserve for potential default. Some banks, incidentally, carry no reserves for any *sukuk* default.

In December 2015 financial statement, Paninbank introduced a different accounting policy for *sukuk* that harks back to its June 2015 policy. BNI Syariah, by contrast, remained consistent with its June 2015 treatment.

Table 6. Treatment of Islamic Banks in Indonesia for Sukuk (Dec 2014 through Sept 2015)

	December 2014		
	BMI	BNI	Panin
Classification	At cost and fair value	n.a	At cost and fair value
Reference	SFAS No. 110 (revised 2011)	n.a	Implicit
Fact	Corporate sukuk at cost	n.a	All sukuk at cost Impairment with the recoverable amount (discount rate)
	June 2015		
Classification	At cost and fair value	At cost and fair value	At fair value, Held to maturity, AFS
Reference	SFAS No. 110 (revised 2011)	SFAS No. 110 (revised 2011)	SFAS No. 110 (revised 2015)
Fact	Corporate sukuk at cost	All are at cost	At cost and fair value (OCI) Impairment with discount rate
	September 2015		
Classification	n.a	n.a	At fair, Held to maturity, AFS
Reference	n.a	n.a	Implicit
Fact	n.a	n.a	Contractual cash flow model
	December 2015		
Classification	n.a	At cost and fair value through profit and lost	At cost, fair value (OCI) and fair value through profit and lost
Reference	n.a	SFAS No. 110 (revised 2015)	SFAS No. 110 (revised 2015)
Fact	n.a	All are at cost	At cost and fair value (OCI)

Source: Annual report 2014, 2015, Financial Statement June, September 2015.

BMI= Bank Muamalat Indonesia, BNI=Bank Negara Indonesia Syariah, Panin=Panin Bank Syariah.

b. Responses of Senior Managers

Some responses are given by Islamic banks as follows:

1. Classification of Sukuk Investment Accounting

The new standard adds fair value to the classification, which affects other comprehensive income (OCI). This is usually used for fixed income mutual funds in banks. In fact, the bank uses the fair value method for *sukuk*, especially for retail government *sukuk* (Bank Syariah Mandiri response). Paninbank adopted standards available for sale (AFS) before the *sukuk* standard. After the standard issuance, they applied *sukuk* prices at cost (held to maturity-HTM using contractual cash flow) based on management intention. After the revised *sukuk* standard in 2015, they used available for sale only for liquidity purposes. They recorded at fair value, which affected other comprehensive income (OCI). By contrast, Bank Muamalat has not applied the revised standard and still records any changes to profit and loss.

2. Valuation After Beginning Recognition

The previous standard explicitly stated that the change would be recognized in the income statement. Some banks still practice this accounting treatment despite the fact that the revised standard offers FVOCI. Paninbank changed the classification to fair value from available for sale. However, they changed it to “at cost” in June 2015 and then added fair value to other comprehensive income (OCI) in December 2015.

3. Sukuk Investment Fair Value

The revised fair value classification only has two types — quoted and other quoted price — but they can be observed. This change is actually easier to implement than the previous classification, which had three types: quoted, transaction, and equivalent instrument (which requires prediction). Banks that have government *sukuk* use quoted price, which is available as they use as secondary reserves or liquidity. In addition, banks bought *sukuk* with investment grade, so that the price is readily available.

4. Transition Regulation

The transition only applies to changes from fair value recognition to other comprehensive income (OCI). Some banks actually recorded *sukuk* at acquisition cost with profit and loss recognition in the income statement. As such, the transition had little effect.

More generally, the revised *sukuk* accounting treatment did not have much of an effect on the banks’ accounting treatment, as banks may have prepared for the IFRS standard even before the *sukuk* accounting standard (SFAS 110) was issued. The treatment of fair value accounting is also applied to fixed income mutual funds, where any profit or loss will affect other comprehensive income (OCI). Other banks also used the fair value method for *sukuk* through profit and loss (FVTPL). Up till now, the standard only provides for normal *sukuk* transactions, not for detailed valuation or impairment cases. These differ from IFRS 9.

Conclusion

Revised SFAS 110 shows that permissible accounting treatments are (a) cost method and (b) fair value, which offers other comprehensive income (OCI) but was previously recorded as profit or loss in the income statement. This change actually may not contradict Islamic teaching, as no principles are violated.

However, the standard does not determine the method for valuation. Up till now, the Shariah Accounting Standards Board (DSAS) prohibits the use of interest rates or discount rates, as it implies the forbidden *riba*. Problems may occur if investors must impair their *sukuk* due to default or other causes. They may forcibly use discount rates or interest rates to revalue *sukuk*. Therefore, Bank Indonesia prepares for a real sector index for the benchmarking of interest rates. So far, Islamic banks just adopt earnings asset quality regulation to determine the Allowance for *Earning Assets (PPAP)* from the Financial Services Authority (OJK). The valuation of *sukuk* in Indonesia can be standardized because it is derived from an independent body that would minimize subjectivity in the valuation.

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