

ISLAMIC FINANCIAL ACCOUNTING STANDARD

EXPOSURE DRAFT

IFAS 2 IJARAH

**The Institute of Chartered
Accountants of Pakistan**

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ISLAMIC FINANCIAL ACCOUNTING STANDARDS

IFAS 2 IJARAH

The standards, which have been set in bold italic type, should be read in the context of the background material and implementation guidance in this Standard. Islamic Financial Accounting Standards are not intended to apply to immaterial items

Objective

The objective of this Standard is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosure to apply in relation to Ijarah i.e. Leases.

Scope

- This Standard shall not apply in accounting for leases other than Ijarah (leases) as defined in paragraph 3.***
- This Standard applies to agreements that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets. On the other hand, this Standard does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other. This Standard also does not apply to lessors of investment property as defined in IAS 40, Investment Property.

Definitions

- The following terms are used in this Standard with the meanings specified:***

Ijarah (Lease) is a contract whereby the owner of an asset, other than consumables, transfers its usufruct to another person for an agreed period for an agreed consideration.

Whether a lease is an Ijarah or not depends on the substance of the transaction rather than the form of the contract provided it complies with the Shariah compliant essentials as prescribed.

A non-cancelable Ijarah (Lease) is an Ijarah (Lease) that is cancelable only:

- upon the occurrence of some remote contingency;***
- with the consent of the muj'ir (lessor) and the musta'jir (lessee); or***
- If the musta'jir (lessee) enters into a new Ijarah (Lease) for the same or an equivalent asset with the same muj'ir (lessor).***

The inception of the Ijarah (Lease) shall be effective from the date the asset leased out is put into musta'jir's (lessee's) possession.

The Ijarah (Lease) term is the non-cancelable period for which the musta'jir (lessee) has contracted to lease the asset together with any further terms for which the musta'jir (lessee) has the option to continue to lease the asset, with or without further payment, which option at the inception of the Ijarah (lease) it is reasonably certain that the musta'jir (lessee) will exercise.

Minimum Ujrah (lease) payments are the payments over the Ijarah (lease) term that the musta'jir (lessee) is, or can be required, to make excluding, costs for services and taxes to be paid and reimbursed to the muj'ir (lessor).

Fair value is the amount for which an asset could be exchanged or liability settled, between knowledgeable, willing parties in an arm's length transaction.

Economic life is either:

- (a) the period over which an asset is expected to be economically usable by one or more users; or***
- (b) the number of production or similar units expected to be obtained from the asset by one or more users.***

Useful life is the estimated period, from the beginning of the Ijarah (lease) term, without limitation by the Ijarah (lease) term, over which the economic benefits embodied in the asset are expected to be consumed by the enterprise.

- 4. Assets acquired for Ijarah (Lease) shall be recognized upon acquisition at historical cost. Historical cost of assets acquired for Ijarah Includes net purchasing price plus all expenditures necessary to bring the asset to its Intended use, such as custom duties, taxes, freight, Insurance, Installation, testing, etc.**

Ijarah (Leases) in the Financial Statements of Musta'jir (Lessees)

- 5. *Ujrah (Lease) payments under an Ijarah (Lease) should be recognized as an expense in the income statement on a straight line basis over the Ijarah (lease) term unless another systematic basis is representative of the time pattern of the user's benefit.***
- 6. For Ijarah (Lease), ujrah (Lease) payments (excluding costs for services such as insurance and maintenance) are recognized as an expense in the income statement on a straight line basis unless another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis.**
- 7. *Musta'jir (Lessees) should, in addition to the requirements of IAS 32, Financial Instruments: Disclosure and Presentation, make the following disclosures for Ijarah (Lease):***
 - (a) the total of future minimum ujrah (lease) payments under non-cancelable Ijarah (Lease), for each of the following periods:***
 - (i) not later than one year;***

- (ii) *later than one year and not later than five years;*
- (iii) *later than five years;*
- (b) *the total of future minimum sub-ijarah (sub-lease) payments expected to be received under non-cancelable sub-ijarah (sub-leases) at the balance sheet date;*
- (c) *ijarah (lease) and sub-ijarah (sub-lease) payments recognized in income for the period, with separate amounts for minimum lease payments and sub-ijarah (sub-lease) payments;*
- (d) *a general description of the Musta'jir's (lessee's) significant ijarah (leasing) arrangements including, but not limited to restrictions imposed by ijarah (lease) arrangements, such as those concerning dividends, additional debt, and further ijarah (leasing).*

Ijarah (Leases) in the Financial Statements of Muj'ir (Lessors)

8. *Muj'ir (Lessors) should present assets subject to Ijarah (Lease) in their balance sheet according to the nature of the asset.*
9. *Ijarah (Lease) income from Ijarah (Lease) should be recognized in income on a straight line basis over the ijarah (lease) term, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.*
10. Costs, including depreciation, incurred in earning the ijarah (lease) income are recognized as an expense. Ijarah (Lease) income (excluding receipts for services provided such as insurance and maintenance) is recognized in income on a straight line basis over the ijarah (lease) term even if the receipts are not on such a basis, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.
11. Initial direct costs incurred specifically to earn revenues from an Ijarah (Lease) are either deferred and allocated to income over the ijarah (lease) term in proportion to the recognition of rent income, or are recognized as an expense in the income statement in the period in which they are incurred.
12. *The depreciation of leased assets should be on a basis consistent with the muj'ir (lessor's) normal depreciation policy for similar assets, and the depreciation charge should be calculated on the basis set out in IAS 16, Property, Plant and Equipment.*
13. To determine whether a leased asset has become impaired, that is when the expected future economic benefits from that asset are lower than its carrying amount, an enterprise applies the International Accounting Standard dealing with impairment of assets that sets out the requirements for how an enterprise should perform the review of the carrying amount of its assets, how it should determine the recoverable amount of an asset and when it should recognize, or reverse, an impairment loss.

14. Muj'ir (Lessors) should, in addition to the requirements of IAS 32, Financial Instruments: Disclosure and Presentation, make the following disclosures for Ijarah (Leases):

(a) the future minimum ijarah (lease) payments under non-cancelable Ijarah (Lease) in the aggregate and for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years;

(iii) later than five years; and

(b) a general description of the muj'ir (lessor's) significant leasing arrangements.

15. In addition, the requirements on disclosure under IAS 16, Property, Plant and Equipment, IAS 36, Impairment of Assets, IAS 38, Intangible Assets, IAS 40, Investment Property and IAS 41, Agriculture, apply to assets leased out under Ijarah.

Effective Date

16. This Islamic Financial Accounting Standard becomes operative for financial statements covering periods beginning on or after ----- . If an enterprise applies this Standard for financial statements covering periods beginning before -----, the enterprise should disclose the fact that it has applied this Standard.