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PART II

Statutory Notifications (S.R.O.)

GOVERNMENT OF PAKISTAN
SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

NOTIFICATION

Islamabad, the 28th December, 2022

S. R. O. 2310(I)/2022.—In exercise of the powers conferred under section 41B of the Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980 (the “Ordinance”), the Securities and Exchange Commission of Pakistan is hereby please to issue the following notification in order to consolidate and update various circulars, dircetives and notifications already isseud by the Commission from time to time under the said Ordinance, to facilitate and create an enabling environment for the Modaraba sector and to ensure compliance of statutory and regulatory requirements pertaining to the Modaraba sector, namely:

5395(1—61)

Price : Rs. 80.00

[14084(2022)/Ex. Gaz.]

Chapter-1

1. **Prohibition of change of sponsors, promoters, substantial shareholders, directors or the chief executive officers in the Modaraba Companies**

- 1.1. Pursuant to sections 6 and 11 of the Ordinance and conditions imposed while granting approval for registration of modaraba companies and authorising the floatation of modarabas by the Registrar Modaraba, no change shall be made in substantial shareholders, directors or chief executive officer of the modaraba company without prior approval of the Registrar Modaraba.
- 1.2. The sponsor, promoters and substantial shareholders of the modaraba company shall deposit their shares of modaraba company and the modaraba certificates in their accounts at the Central Depository Company of Pakistan Limited (CDC). The charges for opening and maintaining these accounts will be borne by the respective account holders.
- 1.3. The shares of the modaraba company and modaraba certificates held by the sponsors, promoters, or substantial shareholders, shall remain blocked in CDC and no withdrawal or transfer from the same will be allowed without prior written permission of the Registrar Modaraba.
- 1.4. Any subsequent allotment or subscription to the existing shares of the modaraba company and modaraba certificates, whether in the form of right or bonus shares/certificates or in any other manner whatsoever, shall also be deposited in the same account(s) maintained by the sponsor, promoters, or substantial shareholders of the modaraba company and modaraba, as the case may be, in a similar manner.
- 1.5. The sponsors, promoters and substantial shareholders of the modaraba company and modaraba shall not raise any financing against such shares of modaraba company and modaraba certificates and shall also not keep these shares and certificates encumbered.

Explanation: For the purposes of this circular,

1. “sponsor” or “promoter” means a person who has submitted an application to the Registrar Modaraba for registration of a modaraba company under rule 4 of the Modaraba Companies and Modaraba Rules, 1981 (the “Rules”); and

2. “substantial shareholder” of a modaraba company and modaraba means a person who, individually or in concert with his family or as part of a group, holds 10% or more share/ certificates in the paid-up capital of a modaraba company or modaraba, as the case may be.
- 1.6. The modaraba companies shall submit the Performa (Annexure-I) enumerating the information with regard to modaraba companies and modarabas within 30 days of the end of each financial year.

Chapter-2

2. Appointment of directors or chief executive officer in the modaraba companies

- 2.1. In order to ensure compliance of regulation 26 of the Modaraba Regulations, 2021 (the “Regulations”), in the event that the chief executive officer has tendered his resignation, the modaraba company shall appoint acting chief executive officer and inform the Registrar Modaraba immediately.
- 2.2. In the event, the chief executive officer has been removed before the end of his term or his term has not been renewed, the modaraba company shall appoint an acting chief executive officer and inform the Registrar Modaraba along-with reasons for such removal.
- 2.3. In the ordinary course of business, the modaraba company shall not relieve the outgoing chief executive officer unless a new chief executive officer is appointed or an acting chief executive officer is appointed to takeover charge from him.

Chapter-3

3. Raising of funds by modarabas

- 3.1. A modaraba may raise funds either by public offer, or through execution of agreement in writing with one or more scheduled Islamic banks or Islamic windows of conventional banks or Islamic financial institutions by issuing certificates of Musharakah in compliance with the requirements stipulated in Chapter-III of the Regulations.
- 3.2. Modarabas can raise funds from the general public through issuance of Sukuk, participation term certificates or any other instruments of redeemable capital for which they are required to seek prior approval of Registrar Modaraba and comply with other applicable regulatory requirements.

- 3.3. The modaraba companies shall follow the following procedure for issuance of Sukuk by modarabas¹:
- (a) Any modaraba intending to issue Sukuk, shall ensure that the transaction conforms to the admissible modes provided to its prospectus approved by the Religious Board. It will also ensure that the basic concepts of Shariah compliance are fully adhered to in the proposed instruments in accordance with the general structure for issuance of Sukuk.
 - (b) The respective modaraba company will submit draft instrument to its Shariah advisor who would examine and certify that the instrument is fully Shariah compliant with the Shariah requirements and also conforms to various aspects of the proposed module.
 - (c) The instrument will be submitted to the Registrar Modaraba along-with the compliance certificate of the Shariah advisor, who after examining and satisfying himself on all of conceptual and operational aspects, would approve the instruments for issuance.
- 3.4. The Religious Board has also approved issuance of “Modaraba Sukuks” to corporate as well as individual investors by modarabas which will cater to short-term resource mobilization for modarabas.
- 3.5. Raising of funds by the modarabas by any other way from the general public is not covered under modaraba law and therefore is disallowed. Any disallowed funds raised shall be refunded forthwith.

Chapter-4

4. Issue of right certificates by modarabas

- 4.1. All modarabas intending to issue right certificates under rule 20-B of the Rules, shall be granted permission to do so on such general and specific conditions as may be laid down by the Registrar Modaraba including any underwriting arrangement that may be deemed appropriate.

¹ Note: This conceptual framework for issuance of Sukuk by Modarabas has been approved by the Religious Board in its meeting held on March 3, 2008.

- 4.2. In granting permission, the Registrar Modaraba may ordinarily invoke the provisions stipulated in the Companies Act, 2017, to the extent considered applicable in each case.

Chapter-5

5. Permission for insertion of the words “An Islamic financial institution” after the name of a modaraba

- 5.1. The modarabas may append the phrase “An Islamic financial institution” after the name of a modaraba to represent the activities and operations carried out under the Islamic financial services².
- 5.2. In this regard, modaraba companies may insert the words “An Islamic financial institution” after the name of modaraba being managed by them in the manner as mentioned above.

Chapter-6

6. Conditions to hold, deal or trade in real estate projects

- 6.1. Pursuant to clause (xii) of regulation 9 of the Regulations, the following conditions to hold, deal or trade in real estate projects.
- 6.2. In case of a multipurpose modaraba, where investment in real estate is up to one-third (1/3rd) of the total assets of the modaraba, the modaraba shall comply with the following conditions:
- (a) Investments shall be made only in assets recognized by development authorities *i.e.* Karachi Development Authority, Capital Development Authority, Rawalpindi Development Authority, Lahore Development Authority and/or any other Development Authority in any city of Pakistan and should be accompanied by NOC relating to real estate project from the aforesaid authority; and
 - (b) The purpose of investment can be to develop properties for rental or development or mix (both rental and development) projects.
- 6.3. In case of a specific-purpose modaraba for investment in real-estate or where investment in real estate is one-third (1/3rd) or more, of the total assets of the modaraba, the modaraba, in addition to conditions

² Note: The addition of the phrase “An Islamic financial institution” following the name of a modaraba in brackets, has been approved by the Religious Board in its meeting held on March 19, 2008.

stipulated at (1) above, shall also comply with the following additional conditions:

- (a) At least two directors of the modaraba company shall have a minimum of five (5) years of experience of dealing with the real estate projects;
- (b) A valuation report from the independent valuer shall be obtained; and
- (c) The prospectus of the modaraba shall, contain information relating to the management experience of sponsors of the modaraba company in the real estate business, the type of real estate project to be undertaken, potential locations of the real-estate, investment objectives, valuation report, feasibility study, the legal status of the property, funds required, sponsors contribution and the compliance with the lock in period requirement for the sponsors.

Chapter-7

7. Mandatory certification for the professionals of modarabas

7.1. To foster human capital and enhance investor confidence in the financial markets, the following shall be adhered in the letter and spirit;

- (i) Every modaraba company shall ensure that its chief executive officer, chief investment officer, head of operation, head of compliance and head of sales (by whatever name called) and any other employee of modarabas, who is involved in the following activities related to securities, shall obtain Pakistan Markets and Regulations Program (PMRP) and Fundamentals of Capital Market (FCM) certifications currently being offered by Institute of Financial Markets of Pakistan (IFMP):—
 - (a) Investment management:—those managing the portfolio of securities including all members of investment committees;
 - (b) Operations and settlement:—those responsible for execution and settlement for trades in securities;
 - (c) Research:—those carrying out fundamental analysis of all existing and potential investment in securities;

- (d) Compliance:—those responsible for ensuring compliance with applicable securities business regulatory requirements; and
 - (e) Risk:—those responsible to ensure that securities investments are within a desirable level of risk.
 - (ii) Within a year of joining the modarabas, all new employees who will perform the aforementioned activities must be PMR and FCM certified.
- 7.2. Professionals seeking certification using the grandfathering provision can contact IFMP for further information.
- 7.3. Modarabas shall ensure that their employees obtaining certification through exam or grandfathering, shall comply with all the requirements of such certification.

Chapter-8

8. Model financing agreements for modarabas

- 8.1. All the modaraba companies shall adopt the following model financing agreement³:
- (a) Diminishing Musharaka
 - (b) Ijarah
 - (c) Istisna
 - (d) Mudarabah
 - (e) Musawamah
 - (f) Musharaka
 - (g) Murabahah
 - (h) Salam
 - (i) Syndicate Mudarabah
 - (j) Syndicate Musharakah
 - (k) Islamic CFS Murabahah

³ Note: The Religious Board in its meeting held on March 19, 2008 has approved the model financing agreements.

- 8.2. All the modaraba companies shall adopt the aforesaid model financing agreement. The modaraba companies shall also ensure that while executing the said agreements, none of the agreements contain any ingredient which violates any Islamic injunction, including those pertaining to the admissibility of any kind of Riba. Business transactions conducted on the basis of financing agreements before March 19, 2008 shall be continued till their maturity.
- 8.3. Softcopies of the agreements are placed on the web-site of the Commission.
- 8.4. The Religious Board in its 41st meeting held on December 20, 2013 has approved the changes in 'Model Financing Agreement of Ijarah' and 'Short Form Agreement of Ijarah'.
- 8.5. It has been noted that sometimes when offering Ijarah finance to clients, Ijarah assets are not readily available, and modarabas are forced to pay the supplier or producer of the stated assets in advance without having a formal contract with the client. Shariah principles prohibits the execution of a "Ijarah agreement" with a consumer when the assets are not actually there.
- 8.6. A "Letter of Agreement to Ijarah" (the "Letter") from the consumers is included here as **Annexure-II** in order to overcome the aforementioned practical difficulties and bind them morally to accept the assets on Ijarah basis on the delivery date. It is anticipated that the Letter will make it easier for Modarabas to conduct Ijarah transactions with their clients and serve as a risk mitigation tool for those transactions.

Chapter-9

9. Submission of CIB data by modarabas

Modaraba companies shall submit factual and correct data with respect to credit information to State Bank of Pakistan (SBP) under the Credit Bureau Act, 2015, in the format that SBP may specify from time to time. The data must be given to SBP on a monthly basis, but not later than the 10th of every month.

Chapter-10

10. Panel of auditors for modarabas

For the purpose of section 15 of the Ordinance read with rule 19 of the Rules, no chartered accountancy firm other than a firm from panel of auditors for modarabas shall be appointed to act as statutory auditors of a modaraba and updated panel of auditors shall be placed on the website of the Commission.

Chapter-11

11. Requirements pertaining to the Anti-Money Laundering Initiative

11.1. Every modaraba company shall:

- (i) accept deposits from an investor only after ensuring that an account has been opened in the investor's name using an account opening form that is to be developed by the respective industry associations in consultation with the Commission.
- (ii) ensure that every payment or receipt exceeding Rs. 50,000/- shall be made through crossed cheque or any other banking instrument or channel.
- (iii) put into place, a comprehensive Customer Due Diligence/ Know Your Customer policy (CDD/KYC) duly approved by the board of directors of their respective modaraba companies. CDD/KYC policy of the modarabas shall *inter-alia* include a description of the types of customers that are likely to pose a higher than average risk to the modaraba and guidelines for conducting enhanced CDD depending upon the customers' background, country of origin, public or high-profile position, nature of business etc.

11.2. Minimum requirements for account opening & identification documents

- (I) While establishing an account for a new customer, the modaraba should know the customer by understanding the customer's objectives and financial position through documenting this knowledge. The first step in meeting these objectives besides obtaining 'Title of Account', 'Contact Details', 'Specimen Signature(s)' of authorized signatories and 'Source of Income',

preferably face-to-face interaction, it is necessary to obtain certain identification documents as discussed below:

(i) Personal accounts:

The modaraba is responsible for obtaining photocopies (after reviewing the original) of acceptable identification documents from the customer entering into relationship. At least one piece of identification is required and this must bear a photograph.

The following information/documents should be obtained from individual or joint account holders:

- (a) Attested photocopy of CNIC or passport
- (b) Service card or any other evidence of service (for salaried persons)
- (c) Copy of NTN/assessment order (if available)
- (d) Power of attorney (where applicable)

In case of an illiterate person, a passport-size photograph of the new account holder, and his right and left-hand thumb impression on the specimen signature card, should also be obtained in addition to the above documents.

(ii) Corporate Accounts:

The following documents are required for opening such accounts:

- (a) Memorandum and articles of association
- (b) Certificate of incorporation
- (c) Certificate of commencement of business (in case of public limited company)
- (d) List of directors (Form 29-latest)
- (e) Resolution of board of directors for opening the account and specifying the person(s) authorized to operate the account

(f) Attested photocopies of CNICs of all the directors of the company

(g) Latest financial statements of the company (audited)

(iii) Sole Proprietor / Partnership / Joint Venture (JV).

The following documents are required for opening such accounts:

(a) Attested photocopy(ies) of CNIC of the individual(s) involved in the partnership or JV

(b) Certified copy of the partnership deed or the joint venture agreement duly signed by all the parties to the deed / agreement (in case of partnership/joint venture accounts)

(c) Attested photocopy of the registration certificate of the firm. If the firm is unregistered, this fact is to be mentioned clearly in the account opening form (AOF)

(d) Authority letter in favour of the person authorized to operate the account

(e) Latest financial statements of the firm

(iv) Clubs, Societies and Associations:

The following documents are required for opening such accounts:

(a) Certified copies of:

- certificate of registration (if registered)
- bye laws

(b) Resolution of the governing body of the customer for opening the account and authorizing persons for operating the account and attested copies of CNIC of the authorized operators of the account

(c) An undertaking signed by all the authorized persons on behalf of the institution that in the event

of any change in the persons authorized to operate the account, the modaraba will be informed immediately

(d) Latest financial statements of the club/society or association

(v) Agents' accounts:

The following documents are required for opening all such accounts, in which the agent is operating the account on behalf of the principal:

Certified copies of:

- power of attorney
- CNIC of the agent and the principal

(vi) Trust accounts:

The following documents are required for opening such accounts:

(a) Certified copies of:

- certificate of registration
- instrument of trust / trust deed
- CNIC of the trustees

(b) Legal opinion of the lawyer

(c) Copy of the latest financial statements

(vii) Executors and administrators:

The following documents are required for opening such accounts:

Certified copies of:

- letter of appointment of executor/administrator
- CNIC of the executor/administrator

(II) For all customers, the modaraba should determine whether the customer is acting on behalf of another person, and should

then take reasonable steps to obtain sufficient identification data (such as a copy of the CNIC, or other relevant documents/information) to verify the identity of the beneficiary.

- (III) For customers that are legal persons, or for legal arrangements, the modarabas are required to take reasonable measures to (i) understand the ownership and control structure of the customer and, (ii) determine that the natural persons who ultimately own or control the customer. This includes those persons who exercise ultimate effective control over a legal person or arrangement.
- (IV) Government accounts should not be opened in the personal names of the government official(s). Any such account, which is be operated by an officer of the Federal/Provincial/Local Government in his official capacity, shall be opened only on production of a special resolution / authority from the concerned administrative department.

11.3. **Verification:**

To further document the modaraba's due diligence on the customer, permanent residence and/or business information for all the customers must be obtained and verified. Preferred means of corroboration of residence and CNIC are the following:

- (I) Visit to residence
- (II) Residential address appearing on any document issued by a government agency
- (III) Copy of entry from a widely published telephone directory evidencing both customer address and phone number.
- (IV) Copy of utility bill.
- (V) Sending a registered "letter of thanks" at the given address. It should be noted that if the "letter of thanks" is returned undelivered then place "CAUTION" on the account and inquire for the discrepancy.
- (VI) Copies of CNIC shall be verified by utilizing the on-line facility of NADRA. In case the modarabas do not have the on-line facility, then CNIC shall be verified from the Regional office of NADRA.

11.4. **High Risk Customers:** All prospective customers must be screened based upon the blacklisted entities' list provided by the Office of Foreign Assets Control (OFAC), NACTA list, UNSCR list and PEP, British Government agencies, State Bank of Pakistan, Financial Action Task Force (FATF), and others. The relationship should be established and/or maintained with the approval of senior management after conducting enhanced due diligence where:

- (a) The business relationship or transaction reveals the following:
 - (i) anonymous relationships where beneficial owner is not identifiable;
 - (ii) known beneficiaries of corruption or illegal activities and high net worth customers with no clearly identifiable source of income;
 - (iii) shell/ domiciliary companies and the customers with links to offshore tax heavens;
 - (iv) accounts form list of Non-Cooperative Countries issued by FATF that do not comply with the recommendations of FATF against anti-money laundering;
 - (v) non-resident customers;
 - (vi) non-legal persons or arrangements including non-government organizations non-profit organizations (NPOs) and trusts/ charities;
 - (vii) customers dealing in high-value Items.
- (b) There is reason to believe that the customer has been refused by another financial institution.
- (c) The persons are politically exposed (including foreigners) or customers holding public or high-profile positions. For these persons, enhanced due diligence should include the following:
 - (i) Relationship should be maintained with the approval of senior management when an existing customer becomes holder of any public office or high-profile position;
 - (ii) Appropriate risk management system shall be put in place to determine whether a potential customer, existing customer or the beneficial owner, is a politically exposed person, holder of public office or the holder of high-

profile position. The source of wealth/fund of such customers, shall be monitored on a regular basis.

11.5. Low Risk Customers:

(1) Where there are low risks and information on the identification of the customer and the beneficial owner is publicly available, or where adequate checks and controls exist, the modarabas may apply simplified or reduced COD/KYC measures but not less than the minimum required in this circular. The following cases may be considered for application of simplified or reduced CDD/KYC:

- (a) Financial institutions provided they are subject to requirements to combat money laundering and terrorist financing consistent with the FATF recommendations and are supervised for compliance with those requirements.
- (b) Public listed companies that are subject to regulatory disclosure requirements, Government administrations/entities.

(2) Periodic customer review process-periodic KYC updation exercise:

The purpose of the periodic review is to determine whether significant changes have occurred in the relationship, including any changes in the customer, material changes in customer holdings, or other material expansions of activity or product type, on a periodic basis. If major changes have occurred in the relationship, the change should be recorded/updated in the KYC form with the modaraba.

(3) Documents/record retention period: The modaraba shall maintain, all necessary records on transactions and on customer identification (e.g. documents referring the legal status or the activity of our counterparts, banks or corporations), credit files and business correspondence, for at least ten years, as prescribed by the Companies Act, 2017, after the relationship is terminated.

11.6. In case the modarabas are not able to satisfactorily complete required CDD/KYC measures, the account should not be opened, business relationship should not be established and no business transactions should be carried out. Similarly, relationship with

existing customers should be terminated and reporting of suspicious transactions be considered if CDD/KYC is found unsatisfactory.

- 11.7. The above-mentioned instructions are the minimum guidelines and the modarabas are advised to follow the same or any other additional measures if deemed appropriate.

Chapter-12

12. Annual review meeting

12.1. Each modaraba shall hold an annual review meeting of its certificate holders in the town where the registered office of the modaraba is situated, to review performance of the modaraba. In this regard, following requirements shall be complied with:

- (i) The persons entitled to attend the meeting will be those certificate holders whose names are entered in the register of certificate holders, seven days before the date of the meeting.
- (ii) The chief executive officer of the modaraba will determine the date, venue and time of the meeting.
- (iii) The purpose of the meeting will be to review the performance of the modaraba during the immediately concluded financial year.
- (iv) 21-days' notice of the annual review meeting indicating the entitlement of persons to attend the meeting (as per 1 above) will be published by the modaraba in one widely circulated English and one Urdu language newspaper respectively, in the province in which registered office of the modaraba is situated. A copy of the notice published in the newspaper should also be submitted to the Registrar Modaraba within 7 days from the date of publication of the said notice.
- (v) Presents of any type gifts/incentive in lieu of gifts (token/coupons/lunches/takeaway packages) in any form or manner to the participants shall be prohibited.
- (vi) Every modaraba, shall hold, an annual review meeting within sixteen months from the date of its incorporation and thereafter once in every calendar year within a period of one hundred and twenty days following the close of its financial year:

Provided that, the Registrar Modaraba, may for any special reason extend the time within which any annual review meeting, shall be held by a period not exceeding thirty days.

Chapter-13

13. **Shariah Compliance and Shariah Audit Mechanism for modarabas⁴**

13.1. A formal mechanism known as the Shariah Compliance and Shariah Audit Mechanism (SCSAM) has been prepared and is being used to ensure and verify that the business transactions of modarabas are being carried out in accordance with the injunctions of Islam. This eliminates any risk or possibility of the modarabas violating Shariah principles..

13.2. The SCSAM aimed to achieve the following objectives:

- (i) to ensure that the inflows and outflows of resources of modarabas are free from the following:
 - (a) Riba (interest, usury or any other form)
 - (b) Qimar (gambling)
 - (c) Gharar (speculation)
 - (d) Support from business prohibited by Shariah (e.g. drugs and alcohol, tobacco, pork related items, etc.)
- (ii) to introduce a mechanism which will strengthen the Shariah compliance by the modarabas in letter and spirit and ensure that the systems, procedures and policies adopted by the modaraba are in line with the Shariah principles;
- (iii) to mitigate the reputational and operational risk and enhance the image and operational framework of modaraba as Islamic financial institution and to ensure that the financial products or services being offered by modarabas are in accordance with the Shariah;
- (iv) to ensure that the agreements entered into by the modaraba are Shariah compliant, all the financing agreements are executed

⁴Note: This mechanism has been introduced to strengthen the Shariah compliance by the modarabas, in letter and spirit, and ensure that the systems, procedures and policies adopted by the modaraba are in line with the Shariah principles, with approval of the Religious Board in its meetings held on December 9, 2010 and June 13, 2011.

on the formats as approved by the Religious Board and all the related conditions are met;

- (v) to prescribe the screening process for the investments in shares and other securities;
- (vi) to provide for the process for purifications of dividend income;
- (vii) to introduce the mechanism for the management of charity;
- (viii) to identify the avenues for the investment of surplus funds;
- (ix) to prescribe procedure for appointment of Shariah advisor;
- (x) to introduce internal Shariah audit of the business transactions of modarabas to ensure that the goals and objectives of Islamic law *i.e.* Maqasad Al-Shari'ah are achieved and the financial products, instruments and transactions employed, are based on Shariah norms and principles; and
- (xi) to prescribe any other ancillary matter that may be required for Shariah compliance and Shariah audit.

13.3. Now, therefore, in order to ensure effective Shariah compliance and to maintain the trust of the stakeholders on the Islamic financial system, in terms of the certificate granted for authorization to float a modaraba read with Section 11 of the Ordinance and rule 3 (2) (e) of Rules, the following SCASM is hereby issued as an additional condition to the modaraba authorization certificate:

13.4. **Shariah Compliance and Shariah Audit Mechanism**

Shariah Compliance

- (I) **Responsibilities of the modaraba company.**—Every modaraba company shall ensure that:
- (i) the business of the modaraba managed by it, is carried out strictly in accordance with the prospectus approved by the Religious Board and the model Islamic financing agreements and the investment products approved by the Religious Board from time to time are followed;
 - (ii) major changes in any of the existing product structures, financing agreements, terms and conditions have a prior written approval from the Religious Board;

- (iii) all material changes in the existing product structures, agreements, terms and conditions are properly communicated to the concerned stakeholders, clients/customers;
 - (iv) monitoring and review system of Shariah compliance is introduced covering all activities and products of the modarabas;
 - (v) proper training is provided in the area of Shariah compliance to the relevant staff, responsible for the monitoring and review; and
 - (vi) irregularities, if any, recorded and reported by internal Shariah auditors are rectified under the guidance of the Shariah advisor.
- (II) **Investment in shares and other securities.**—The investment by the modaraba in the shares and securities shall only be made in the companies screened by the Shariah advisor of the association in accordance with screening procedure contained in clause III of this SCSAM and subject to the following conditions:
- (i) the purchase and sale of the same scrip on the same day shall not be made; and
 - (ii) the shares shall not be sold before settlement *i.e.* their title and possession has been transferred to the modaraba, in accordance with the settlement schedule of the stock exchange.
- (III) **Screening procedure.**—(1) The screening test of the selected investee company (IC) for the purpose of investment in its shares or other securities shall be conducted by the Shariah advisor of the association who shall observe the following criteria before placement of the scrip in the list of Shariah compliant securities:
- (i) the business of the IC is halal and in line with the Shariah;
 - (ii) debt to asset ratio of the IC is less than 40%. Debt in this case is classified as any interest-bearing debts. Zero coupon bonds and preference shares shall be considered as part of the debt;

- (iii) the ratio of non-compliant investments to total assets of the IC is less than 33%;
- (iv) the ratio of non-compliant income of the IC to total income is less than 5%. The income includes gross income plus any other income earned by the IC;
- (v) the ratio of illiquid assets to total assets is at least 25%;
Explanation: Illiquid asset means any asset that Shariah permits to be traded at value other than the par.
- (vi) The market price per share is greater than the net liquid assets per share calculated as: $(\text{Total Assets} - \text{Illiquid Assets} - \text{Total Liabilities}) / \text{No. of outstanding shares}$;

Provided that the investment in the modaraba certificates of a modaraba, shares of Islamic banks and takaful companies and the units of Islamic mutual funds shall not be subject to screening process.

- (2) The screening for each IC shall be performed on half yearly basis. The list of screened listed companies alongwith charity rate of the respective company shall be placed on the website of the association and a printed copy duly signed by the authorized person of the association with a confirmation of its placement on the website, shall be sent to the Registrar Modaraba on half yearly basis.

Explanation: Charity rate means the ratio of non-compliant income of the IC to total income.

- (3) The screening of unlisted companies shall be carried out by the Shariah advisor of the association on the requests made by modarabas on case-to-case basis.
- (4) The existing non-compliant investments in terms of clause III shall be divested within the period of one year from the date of this circular.
- (IV) **Dividend purification process.**—The dividend income shall be purified by deducting the amount equivalent to charity rate for the respective IC from the total dividend income received by a modaraba.

- (V) **Non-Shariah compliant income not to form part of modaraba's income.**—(1) The income received by a modaraba from non-Shariah compliant sources shall not be accounted for as part of income of a modaraba, *inter-alia* the following:
- (i) late payment penalty or surcharge received from any client;
 - (ii) the part of dividend income pertains to non-Shariah compliant business activities of IC as calculated in terms of clause-IV; and
 - (iii) any other income received by a modaraba from any transaction which was not carried out in accordance with the principles of Shariah.
- (2) All non-Shariah compliant income received by a modaraba shall be deemed as a liability of the modaraba and shall be transferred by the modaraba company to a separate account namely charity account.
- (VI) **Management of charity.**—The amount credited in the charity account shall be used in the manner and subject to the conditions stated hereunder:
- (i) all contributions or donation from the charity account shall only be made to the approved charitable organizations registered under Pakistani law as charitable organization (trusts, Hospitals etc). The Income tax exemption certificate issued by the Government of Pakistan to that effect shall be considered as an approval for the purposes. Any exception shall be submitted for approval to the Shariah advisor of the association;
 - (ii) the purpose of the donation shall be identified; and
 - (iii) the amount available in charity account shall ideally be distributed within three months of its transfer. A summary of operations of the charity account shall be published in the annual accounts of the modaraba.
- (VII) **Investment of surplus funds of modaraba.**—The surplus funds of the modaraba shall only be placed in the accounts to be opened in the Islamic banks or Islamic branches of

conventional banks or Islamic mutual funds or products offered by a modaraba or any other Shariah compliant investment schemes.

13.5. **Shariah advisor**

13.6. **Shariah advisor.**—(1) Every modaraba company shall have a Shariah advisor of the modaraba appointed on the terms and conditions as it may deem fit, having the qualification and experience and to perform the functions as specified hereunder. The term of office of the Shariah advisor shall be three years, which shall be renewable by the modaraba company. The modaraba company shall intimate to the Registrar Modaraba about the appointment of Shariah advisor and submit his qualifications and experience details within 7 days from the date of his appointment.

(2) The casual vacancy caused by the resignation or termination of the Shariah advisor shall be filled by the modaraba company within 30 days of the resignation or termination as the case may be and the intimation thereof shall be made to the Registrar Modaraba in the manner prescribed above.

13.7. **Qualification of Shariah advisor.**—(1) No person shall be appointed as Shariah advisor unless he is deemed to be a person of acceptable reputation, character and integrity and has:

(a) **Educational qualification:**

Shahadat ul Aalmia degree (*Dars e Nizami*) from any recognized Board of Madaris with minimum 70% marks and bachelor's degree with a minimum of 2nd class and sufficient understanding of banking and finance.

OR

Post graduate degree in *Islamic Jurisprudence/Usooluddin*, L.L.M. (Shariah), etc. with a minimum GPA of 3.0 or equivalent from any recognized university with exposure to banking and finance.

(b) **Experience and exposure:**

Must have at least 4 years experience of giving Shariah rulings including the period of *Takhasus fil Ifta*; or at least 5 years post qualification experience in teaching or research and development in Islamic banking and finance.

- (i) good knowledge to understand English and make out the required reports;
 - (ii) exposure in the areas of business or finance especially Islamic finance;
 - (iii) has not been terminated from any organization in any capacity; and
 - (iv) does not hold any executive or non-executive position in any modaraba or modaraba company except as Shariah advisor.
 - (2) The Registrar Modaraba may relax the requirement of educational qualification and experience in exceptional cases where the person is otherwise qualified for giving Shariah rulings on banking and financial matters.
- 13.8. **Functions and responsibilities of the Shariah advisor.**—(1) The Shariah advisor shall generally perform the following duties and functions in the modaraba:
- (i) to introduce a mechanism which will strengthen the Shariah compliance by the modaraba, in letter and spirit and ensure that the systems, procedures and policies adopted by the modaraba are in line with the Shariah principles;
 - (ii) to advise the modaraba company so as to ensure that the inflows and outflows of resources of modaraba are free from the following:
 - (a) Riba (interest, usury or any other form)
 - (b) Qimar (gambling)
 - (c) Gharar (speculation)
 - (d) Support from business prohibited by Shariah (e.g. drugs and alcohol, tobacco, pork related items, etc.)
 - (iii) to review on regular basis that the business conducted, the transactions carried out and the investments made by the modaraba are in accordance with the prospectus of the modaraba, Islamic financial accounting standards notified by

the Commission, the principles of Shariah and goals and objectives of Islamic law *i.e. Maqasad Al-Shariah* are achieved *i.e.* the financial products, services, related policies and the instruments are based on Shariah norms and principles;

- (iv) to vet the new products and services before its submission to the Registrar Modaraba for its final approval from the Religious Board;
 - (v) to make recommendations to the modaraba company for potential improvements and the formulation of policies in line with the Shariah principles and to advise about the process of rectification of irregularities pointed out by him;
 - (vi) to advise on any matter referred to him by the chief executive or the board of directors of the modaraba company;
 - (vii) to conduct and arrange Shariah training programs for the board of directors/officers and the staff of the modaraba; and
 - (viii) to determine the non-Shariah compliant income and ensure its transfer to the charity account.
- (2) The Shariah advisor shall prepare a report on the modaraba's affairs, to be called as "the Annual Shariah Advisor's Report" which shall cover the overall Shariah compliance position of the modaraba for the whole year and be prepared on the format attached as *Annexure-III*. The same shall be annexed by the modaraba company just after the statutory auditor's report of the annual audited accounts of the modaraba, to be disseminated to the certificate holders.
- (3) Notwithstanding the above, the Shariah advisor shall prepared the annual Shariah advisor's report which shall be annexed with the annual audited accounts of the modaraba. .
- 13.9. **Powers of Shariah advisor.**—(1) Every Shariah advisor shall have a right of access at all times to the books, papers, accounts, vouchers, record, information, agreements and reports of the modaraba, whether kept at the registered office of the modaraba company or elsewhere and shall be entitled to require from the directors and other officers of the modaraba company, such information and explanation as he may require for the performance

of his duties and the board of directors and all the employees of the modaraba company as well as the modaraba shall be bound to provide the requisite access to the record and information to the Shariah advisor.

- (2) The Shariah advisor shall have direct and regular communications with all levels of management.
- (3) The fatwa and ruling of the Shariah advisor in all business transactions, not being inconsistent with the ruling of the Religious Board, shall be binding on the modaraba companies.

13.10. **Reporting of Shariah advisor.**—The Shariah advisor shall report to the board of directors of the modaraba.

13.11. **Dispute resolution.**—In case of any dispute or difference of opinion arises between modaraba company and the internal Shariah auditor on the matters relating to Shariah interpretation, the same shall be referred to the Shariah advisor for the decision. In case of difference of opinion between the Shariah advisor of the modaraba and the Registrar Modaraba on any matter came to his knowledge, the matter shall be referred by the Registrar Modaraba to the Religious Board, whose decision shall be final.

13.12. **Performance review of the Shariah advisor.**—(1) The performance of Shariah advisor shall be reviewed by the Registrar Modaraba from time-to-time.

- (2) The Registrar Modaraba, after being satisfied that the Shariah advisor is not performing his duties as required under this mechanism may direct the modaraba company to terminate the services of the Shariah advisor before expiry of three years.

13.13. **Internal Shariah audit**

I. **Internal Shariah audit.**—(1) Every modaraba shall strengthen its existing internal audit department, either by appointing a trained internal Shariah auditor having relevant qualification and experience of the Shariah audit or train at least one of its existing employees in the internal audit department for the purpose of internal Shariah audit.

- (2) The training of the internal Shariah auditor shall be arranged from a well known Shariah training institute.

- II. **Duties of internal Shariah auditor.**—(1) The internal Shariah auditor shall follow the same reporting norms, as are applicable on the internal auditor under Listed Companies (Code of Corporate Governance), Regulations, 2019.
- (2) The minimum required duties of the internal Shariah auditor shall be to verify on day to basis that the:
- (i) business transactions of the modaraba are Shariah compliant;
 - (ii) agreements entered into by the modaraba are Shariah compliant and financing agreements executed on the formats as approved by the Religious Board, without any major change, and all the related conditions are met;
 - (iii) investments of the modaraba in the shares and other securities are as per list of the companies screened by the Shariah advisor of the association;
 - (iv) process for purifications of dividend income has been carried out by the modaraba company;
 - (v) non-Shariah compliant income has been transferred in charity account and distributed in accordance with the manner prescribed in this circular;
 - (vi) surplus funds have been invested in the avenues prescribed in this circular; and
 - (vii) to share his findings with the chief executive and Shariah advisor in respect of all the above items including irregularities, inadequacy in risk management, governance and internal controls which are necessary to avoid non-Shariah compliant business transactions in the modaraba.
- (3) The internal Shariah auditor shall submit his report on quarterly basis to the board of directors with a copy of the report to the Shariah advisor of the modaraba.
- (4) The internal Shariah auditor shall maintain a liaison with the Shariah advisor and seek his guidance and help in case of any difficulty in ensuring Shariah compliance of any particular transaction.

III. Compliance on the internal Shariah auditor's report.—

The board of directors of the modaraba company, in consultation with the Shariah advisor, shall take necessary steps on the observations/ recommendation of the internal Shariah auditor and prepare an action plan with a timetable for compliance. The audit committee of the modaraba shall monitor the compliance/implementation of the action plan.

- 13.14. Since the Shariah review system is imperative in ensuring such compliance and an effective Shariah framework will harmonize the Shariah interpretations, strengthen the regulatory and supervisory oversight of the modaraba sector and nurture a pool of competent Shariah auditors, the implementation of SCSAM will help the management of modaraba companies to achieve the objectives of halal business as enshrined in the Shariah and emerge as a responsible member of the Islamic financial regime.
- 13.15. The provisions contained in the SCSAM are the minimum requirements for Shariah compliance to be followed by the modaraba companies and modarabas in the course of their operations. The modaraba and the modaraba companies may include additional requirements and control in their procedures for the sake of more effective Shariah compliance and prudence.
- 13.16. All the modaraba companies are directed to ensure the implementation of the SCSAM in letter and spirit and initiate necessary action for its compliance with immediate effect.

Chapter-14**14. Application of International Financial Reporting Standards on modarabas**

- 14.1. The modarabas are required to follow the Islamic Financial Accounting Standards 1 and 2 (**Annexure IV and V**) respectively, as notified by the Commission under the Companies Act, 2017, while preparing the financial statements by modarabas in the context of historical cost convention while accounting for Murabaha transactions carried out by a bank and accounting for Ijarah (Lease) transactions, as defined by the aforementioned standards respectively:

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 Standards.

- 14.2. The modarabas (other than trading modarabas) are advised to follow the requirements of IFRS 7 with regard to their accounts and preparation of their financial statements in pursuance of the provisions of sub-section (1) of section 225 of the Companies Act, 2017.
- 14.3. The modarabas (other than trading modarabas) are required to prepare their financial statements in accordance with the requirements of IFRS 7, insofar as these requirements are not inconsistent with the requirements of the Act, including the Fourth Schedule, and in case of any conflict or inconsistency, the requirements of the Act, including the Fourth Schedule, shall prevail over the requirements contained in IFRS 7.
- 14.4. All modaraba companies are required to prepare financial statements of the modarabas in conformity with such International Financial Reporting standards and IFAS-I & IFAS-2 and other standards as notified by the Commission under section 225 of the Companies Act, 2017 in true letter and spirit.

Chapter-15

15. **Transmission of quarterly accounts by modarabas/additional condition to modaraba authorization certificate**

- 15.1. In exercise of the powers conferred by section 11 of the Ordinance, read with the certificate of authorization for floatation of modaraba issued under rule 3 (2) (e) of the Rules, the following additional condition is imposed on modarabas and shall be deemed to be a part of the conditions of the certificate of authorization for floatation of modaraba:
 - (i) The modaraba companies shall within one month from the close of first and third quarters of the accounting year of the modaraba, prepare and transmit, by registered post, to the stock exchange(s) on which the modaraba certificates are listed and, under postal certificate, to the holders of modaraba certificates a condensed balance sheet as at the end of the quarter and a condensed profit and loss account, cash flow statement and statement of changes in equity for the quarter then ended and cumulative for the accounting

year to date along with selected notes to the accounts, whether audited or otherwise. Simultaneously with the transmission of the quarterly profit and loss account and balance sheet to the members and stock exchanges, they shall file three copies thereof to the Registrar Modaraba.

- (ii) The quarterly accounts shall be prepared in accordance with IAS 34 and comparative figures shall be provided, when such figures are available.
 - (iii) Quarterly accounts are to be transmitted in the manner of annual and half yearly accounts.
 - (iv) Approval of the board of directors shall be mandatory for circulation of quarterly accounts.
 - (v) Provisions of rule 12 of the Rules shall apply to the quarterly accounts/financial statements.
 - (vi) The half-yearly and annual accounts shall continue to be submitted as usual.
- 15.2. Every modaraba is required by rule 10 to send its first, second, and third quarterly accounts to its certificate holders within a certain amount of time. The Registrar Modaraba has given permission to post the quarterly accounts of the modarabas on their website rather than sending them to the certificate holders by mail after taking into account the practical difficulties that sending periodical accounts to all the certificate holders by mail is an expensive and time-consuming exercise and the goal of the provisions in the said rule 10 would be achieved. The posting of quarterly accounts on the Modarabas website shall be recognised as compliance with the requirements of rule 10 of the rules, subject to fulfillment of the following conditions:
- (i) The modaraba companies intending to place the quarterly accounts of the modarabas on their website, instead of sending the same by post to the certificate holders, shall be required to seek the consent of its certificate holders and also to consult the respective stock exchanges.
 - (ii) The modaraba companies shall be required to seek prior permission of Registrar Modaraba for transmitting their quarterly accounts through their website. The application made by a modaraba company for this purpose shall indicate its website address and Registrar Modaraba would grant permission after visiting the website and finding it in order.

The website address shall not be changed except with the approval of the Registrar Modaraba.

- (iii) The modaraba company, after obtaining the requisite permission, shall inform its certificate holders through an advertisement in the press that the subsequent quarterly accounts would be transmitted to them through the modaraba website.
- (iv) The respective stock exchange and the Registrar Modaraba shall be informed in writing, by post.
- (v) The requirement of filing the prescribed number of copies of periodical accounts with the Registrar Modaraba/Commission and the stock exchange(s) by post, shall be fulfilled, in addition to transmission of the same through the website of the Commission and the stock exchange(s).
- (vi) The modaraba companies shall supply the of the quarterly accounts to the certificate holders, on demand, at their registered addresses free of cost, within one week of such demand.
- (vii) The modaraba companies shall also be required to transmit their periodical accounts electronically to the concerned stock exchange(s) so as to place the same on their website.
- (viii) A group of companies under the same management may maintain a single website instead of having an independent website for each modaraba. Such a website however, would display the link to each company at a prominent place on its website.
- (ix) The Registrar Modaraba would maintain a list of modarabas, who have been granted such permission, and this list would be placed on the Commission's website.

Chapter-16

16. **Filing of monthly returns through specialized companies return system**

All the modaraba companies and modarabas are required to submit their monthly statements through the specialized companies return system (SCRS) by the 10th of every month.

Chapter-17

17. Filing of semi-annual returns by modarabas regarding information on related party exposure

- 17.1. Formats for standardized periodic reporting of information by the modarabas pertaining to their exposure in related party are attached as Annexure-II. The term related party would carry the same meaning as defined in IAS 24, adopted in Pakistan.
- 17.2. All the modarabas are required to submit the information as per the attached formats on six monthly bases.
- 17.3. The information shall be submitted in a manner that for the period ended on 30th day of June every year, the information should be submitted by the following 30th day of September while for the period ended on 31st day December every year the information should be submitted to the Commission by the following 31' day of March.

Chapter-18

18. Miscellaneous clarifications

- 18.1. A modaraba may sell or transfer Ijarah (lease) assets in the ordinary course of business without being subject to the disclosure requirements outlined in clause 3(ii) of Part-II of the third schedule to the Rules.
- 18.2. The restriction that the management fee can only be paid out of net profit of the modaraba after wiping off the accumulated losses as laid out in section 18 of the Ordinance, read with rule 16 of the Rules, is replaced with the following additional condition to the modarabas in order to bring the management fee in line with the concept of modaraba as well as the provisions of sections 18 and 37 of the Ordinance:

“The modaraba company may charge the prescribed management fee out of the net annual profit of the modaraba on the basis of annual audited accounts provided that 90% of the profit available for appropriation may also distributed to the certificate holders of the modaraba after setting aside out of the profit of the modaraba such sums as it thinks proper as reserve in accordance with

regulatory framework applicable for modarabas. The management fee shall be charged only once on the profit of a modaraba i.e. the portion of profit carried forward should not again be subject to deduction of management fee.’’

- 18.3.** For any violation of the guidelines in this Circular, apart from any other penal action likely to be taken against the management, may result in cancellation of registration of modaraba company and its removal from management of the modaraba floated by it.

19. Repeal and saving: (1) The following instruments, herein after referred to as repealed instruments, shall stand repealed-

Sr.No.	Circular/ Directive	Dated	Subject
1	Circular No. 6 of 1999	31-Mar-99	Advisability of arbitration clause in the Modaraba agreements
2	Circular No. 8 of 1999	10-Apr-99	Work relating to Prudential Regulations of Modarabas
3	Circular No. 11 of 1999	06-May-99	Appointment of Directors/Chief Executive in Modaraba Companies
4	Circular No. 5 of 2000	20-Apr-00	Additional conditions No. 1/2000 to Modaraba Authorization Certificate
5	Circular No. 7 of 2000	25-May-00	Appointment of directors/chief executive in Modaraba Companies
6	Circular No. 10 of 2000	10-Aug-00	Additional Condition No. 1/2000 to Modaraba Authorization Certificate -
7	Circular No. 13 of 2000	18-Aug-00	Issue of right certificates by Modarabas
8	Circular No. 19 of 2000	27-Nov-00	Annual Review Meeting under Prudential Regulations of Modarabas

9	Circular No. 20 of 2000	21-Dec-00	Amendments in Circular No. 5 of 2000 dated April 20, 2000
10	Circular	14-Jun-01	Increase in maintenance of statutory reserves by Modarabas from 10% to 20%
11	Circular	13-Dec-01	Quarterly Accounts Additional Condition to Modaraba Authorization Certificate
12	Circular No. 11 of 2002	06-Jun-02	Application of International Accounting Standard 30 to Investment Banks, Modarabas and Leasing Companies
13	Circular No. 5 of 2003	21-Feb-03	Requirements for Anti Money Laundering Initiative-Additional condition No.1/2003 to modaraba authorization certificate.
14	Circular No. 7 of 2003	27-Feb-03	Appointment of Director/Chief Executive in the Modaraba Companies
15	Circular No. 16 of 2003	18-Jul-03	Amendments in Modaraba Companies and Modaraba Rules 1981
16	Circular No. 22 of 2003	11-Sep-03	Applicability of international accounting standard 30 to investment banks, leasing companies and modarabas (other than trading modarabas)
17	Circular No. 4 of 2004	28-Jan-04	Prudential Regulations for Modarabas
18	Circular No. 5 of 2004	29-Jan-04	Filing fee deposited with the statements under Prudential Regulations for Modarabas
19	Circular No. 10 of 2004	13-Feb-04	Applicability of International Accounting Standard (IAS) 17 to Modarabas
20	Circular No. 16 of 2004	02-Apr-04	Clarification-Validity old National Identity Cards for the business of Modarabas

21	Circular No. 18 of 2004	06-Apr-04	Submission of CIB data by Modarabas
22	Circular No. 21 of 2004	21-Apr-04	Transmission of quarterly accounts by Modarabas
23	Circular No. 25 of 2004	05-Jul-04	Prudential Regulations for Modarabas
24	Circular No. 4 of 2005	23-May-05	Raising of Funds from General Public by Modarabas
25	Circular No. 16 of 2005	22-Sep-05	Prudential Regulations for Modarabas
26	Circular No. 4 of 2006	22-Mar-06	Amendment in the Guidelines for Issuance of Certificates of Musharakah
27	Circular No. 10 of 2006	16-Jun-06	Conditions applicable to Promoters / Major Share Holders of Modaraba Management Companies
28	Circular No. 11 of 2006	18-Jul-06	Enhancement in the upper limit on creation and building up of Reserves by Modarabas in terms of sub-Regulation (a) of Regulation 2 of Part-III of the Prudential Regulations for Modarabas
29	Circular No. 4 of 2008	07-Apr-08	Amendments in the Guidelines approved by the Religious Board for Issuance of Certificates of Musharakah by Modarabas
30	Circular No. 6 of 2008	08-May-08	Model Financing Agreements for Modarabas
31	Circular No. 9 of 2008	16-May-08	Permission for insertion of the words "An Islamic Financial Institution" after the name of a Modaraba
32	Circular No. 10 of 2008	02-Jun-08	Amendments in the Prudential Regulations for Modarabas

33	Circular No. 10 of 2009	06-Mar-09	Conditions applicable to Promoters / Major Share Holders of Modaraba Management Companies / Modarabas
34	Circular No. 9 of 2009	25-Mar-09	Electronic submission of periodic statements under the Prudential Regulations for Modarabas
35	Circular No. 15 of 2009	04-May-09	Additional conditions to Modaraba Authorization Certificate
36	Circular No. 16 of 2009	05-May-09	Reconstitution of the Religious Board
37	Circular No. 18 of 2009	01-Jun-09	Revised 2 nd Schedule to the Modaraba Companies and Modaraba Rules, 1981
38	Circular No. 28 of 2009	04-Sep-09	Additional condition to Modaraba Authorization Certificate - Addition in Panel of Auditors for Modarabas
39	Circular No. 29 of 2009	09-Sep-09	Anti-Money Laundering Measures- Customer Due Diligence (CDD) / Know Your Customers (KYC)
40	Circular No. 2 of 2010	15-Jan-10	Filing of monthly returns through Specialized Companies Return System
41	Circular No. 7 of 2010	31-Mar-10	Applicability of Islamic Financial Accounting Standard I - Murabaha (IFAS-I)
42	Circular No. 18 of 2010	16-Jul-10	Additional Condition to the Modaraba Authorization Certificate
43	Circular No. 21 of 2010	10-Aug-10	Clarification on clause 3(ii) of Part II of the 3rd Schedule of the Modaraba Companies and Modaraba Rules, 1981
44	Circular No. 22 of 2010	24-Aug-10	Revised 2 nd Schedule to the Modaraba Companies and Modaraba Rules, 1981

45	Circular No. 15 of 2011	30-Nov-11	Additional condition to the Modaraba Authorization Certificate
46	Circular No.8 of 2012	03-Feb-12	Shari'ah Compliance and Shari'ah Audit Mechanism (SCSAM) for Modarabas
47	Circular No. 16 of 2012	31-May-12	Regarding Ijarah Financing
48	Circular No. 25 of 2012	24-Jul-12	Amendments in Modaraba Ordinance
49	Circular No. 28 of 2012	12-Sep-12	Filing of semi-annual returns by Modarabas regarding information on related party exposure.
50	Circular No. 42 of 2012	31-Dec-12	Filing of Monthly returns through Specialized Companies Return System (SCRS)
51	Circular No. 2 of 2014	22-Jan-14	Model Financing Agreements
52	Circular No. 12 of 2015	17-Apr-15	Mandatory certification for the professional of Modarabas
53	Circular No. 22 of 2015	29-Jun-15	Placement of Jamapunji web link and logo on the websites of Modarabas
54	Circular No. 49 of 2015	31-Dec-15	Mandatory certification for the professional of Modarabas
55	Circular No. 4 of 2016	22-Jan-16	Regulatory requirements for branches of Modarabas
56	Circular No. 17 of 2016	25-Apr-16	Amendments in the Prudential Regulations for Modarabas
57	Direction No. 1 of 2017	17-Apr-17	Reporting by Modaraba Companies and Modarabas
58	Circular No. 9 of 2018	03-Jul-18	Mandatory certification for the professional of Modarabas

59	Circular No. 17 of 2018	24-Sep-18	Amendments in Prudential Regulations for Modarabas
60	Circular No. 19 of 2018	16-Oct-18	Amendments in the Prudential Regulations for Modarabas
61	Direction No. 1 of 2019	19-Mar-19	Reporting by Modaraba Companies and Modarabas
62	Circular No. 15 of 2020	24-Apr-20	Facilitation to Modarabas
63	Circular No. 28 of 2020	10-Sep-20	Relaxation to lending modarabas under regulation 5 of the Prudential Regulations for Modarabas
64	Circular No. 30 of 2020	30-Sep-20	Amendments in the Prudential Regulations for Modarabas
65	Circular No. 33 of 2020	14-Dec-20	Amendments in the Prudential Regulations for Modarabas
66	Circular No. 22 of 2021	19-Jul-21	COVID-19 Vaccination at the Workplace
67	SRO 1546(I)/2022	15-Aug-22	Notification to specify conditions to hold, deal or trade in real estate projects

Provided that repeal of the repealed instrument shall not-

- (a) revive anything not in force at the time at which the repeal take effect; or
- (b) affect the previous operation of the repealed instruments or anything duly done or suffered thereunder; or
- (c) affect any right, privilege, obligation or liability acquired, accrued or incurred under or in respect of the said repealed instruments; or
- (d) affect any penalty imposed, forfeiture made or punishment incurred in respect of any offence committed against or in violation of the repealed instrument; or
- (e) affect any inspection, investigation, prosecution, legal proceeding or remedy in respect of any obligation, liability, penalty, forfeiture or punishment as aforesaid, and any such inspection, investigation, prosecution, legal proceedings or remedy may be made, continued or enforced and any such penalty, forfeiture or punishment may be imposed, as if these regulations has not been notified.

2. Save as otherwise specifically provided, nothing in the repealed instruments shall affect or deemed to effect any action taken, orders issued, relaxation granted unless withdrawn, fee paid or accrued, resolution passed, direction given under the repealed instruments shall, if in force at the effective date of this notification and not inconsistent with provision of this notification, shall continue to be in force and have effect as if it were respectively taken, made, directed, passed, given, executed or issued under this notification.

Annexure-I

ANNUAL SUMMARY INFORMATION REPORT BY MODARABA COMPANY

For the period ending on _____

1. MODARABA MANAGEMENT COMPANY [NAME OF THE COMPANY]

a. Company details

- i. Registration date: dd/mm/yyyy
- ii. Chief executive officer (name, mobile number, email, postal address)
- iii. Contact person (name, mobile number, email, postal address)

b. Board of Directors

- i. Chairman (name, mobile number, email, postal address, date of appointment)
- ii. Shareholder directors (name, mobile number, email, postal address, date of appointment)
- iii. Independent directors (name, mobile number, email, postal address, date of appointment)

c. Substantial shareholders (holding more than 10%)

- i. Name, phone number, email, postal address, no and percentage of shares held

d. Other key information

- i. Name of auditors and date of appointment
- ii. Any other information deemed relevant by the company

2. MODARABA [NAME OF THE MODARABA]

a. Key information

- i. Date of flotation and listing
- ii. Category: Financial Sector/Other
- iii. Paid-up capital and equity
- iv. Number of free float certificates and its percentage to total certificates

b. Substantial certificate holders (holding more than 10%)

- i. Name, phone number, email, postal address, no and percentage of shares held

***Note:** This report may be submitted through email at islamic.finance@secp.gov.pk or surface mail to Islamic Finance Department, Securities and Exchange Commission of Pakistan, Head Office, NICL Building, Jinnah Avenue, Blue Area, Islamabad.*

Annexure-II

LETTER OF AGREEMENT TO IJARAH

Date:

The Manager

_____ Modaraba

Dear Sir,

I / We refer to your offer letter dated _____ to _____ (name of Modaraba).

Address: _____

_____ for acquiring Asset
_____ (hereinafter referred to as "Modaraba" which expression shall be deemed to mean and include where the context so requires its successors in interest and assigns) whereby I/we requested _____ Modaraba to Ijarah to me/us the Asset(s) to be acquired by _____ Modaraba for this purpose.

1. Whereas _____ Modaraba has agreed to acquire the specified Asset(s) ("Asset(s)") to be subsequently taken on Ijarah to me/us as per the terms of the Ijarah agreement to be executed between _____ Modaraba and ourselves (Ijarah agreement the cost of the Asset(s) paid / to be paid by _____ Modaraba in respect of its acquisitions shall be Rs. _____/- (Rupees Only).
2. And whereas, I/we have agreed to take on Ijarah the Asset(s) to be acquired upon the terms and conditions set forth as follows:

NOW THEREFORE THIS LETTER WITNESSES AS FOLLOWS:

1. Ijarah of Asset(s)

In consideration of _____ Modaraba, acquiring the Asset(s) at my/our request for the purposes of making available the Asset(s) to me/us by way of a Ijarah, I/we hereby agreed and irrevocably agree to take on Ijarah the Asset(s) from _____ Modaraba on the date mentioned in appendix "A" hereto or on such other date as the Asset(s) are delivered to me/us ("Ijarah Date") by execution of the Ijarah Agreement and its ancillary Ijarah Documents in the form required by _____ Modaraba.

2. Payment of Advance Against Ijarah Rentals

- 2.1 I/We agree to pay to _____ Modaraba advance against Ijarah rentals, if _____ Modaraba demands, in the amount and on the dates mentioned in appendix "B" hereunder (Advance Ijarah Rentals). Upon commencement of the Ijarah Agreement the amount received by way of Advance Ijarah Rentals shall be adjusted as Ijarah rentals due and payable under the Ijarah agreement after confirmation of the delivery of the asset.



- 2.2 In case the Ijarah does not commence due to any reason whatsoever on my side or due to any negligence on my side the Advance Ijarah Rentals shall be refunded to me/us after deduction of all dues/cost incurred by lessor in acquiring the asset(s) and any other outstanding of _____ Modaraba hereunder or otherwise in relation to the provision of the Ijarah finance facility.
- 2.3 In case the Ijarah does not commence due to any reason whatsoever on the side of Lessor or due to the negligence of the Lessor the Advance against Ijarah Rentals shall be refunded to me in full without any deduction.

3. Act of Default

- 3.1 There shall be an act of default (Act of Default on my part") hereunder if:
- 3.1.1 I/we fail to take on Ijarah Asset(s) at the time of delivery by Lessor as specified under clause -1, herein above for any reason whatsoever.
- 3.1.2 Any representation or warranty made or deemed to be made hereunder is or proved to have been incorrect in any material respect.
- 3.2 I/We hereby undertake that at any time after the happening of an Action of default hereunder and upon notice to me/us of such default by _____ Modaraba I/we shall purchase the Asset(s) from _____ Modaraba at the purchase price which shall be the facility amount together with all other costs, charges, expenses and damages etc, incurred / sustained by _____ Modaraba in respect of the acquisition, registration and Takaful / insurance of the Asset(s) ("Purchase Price").
- 3.3 In the event of default by me/us you are authorized and entitled to exercise all rights and remedies to sell the Assets (s) in the market to recover the Purchase Price and other actual cost incurred. I/we shall pay to you the difference (if any) between the price at which the Asset(s) was sold by you and the Purchase Price along with any cost incurred in acquiring the said Asset (s) the by _____ Modaraba.

4. Indemnities

- 4.1 I/We shall indemnify _____ Modaraba against any loss or expense which _____ Modaraba shall claim as having been incurred by it as a consequence of (i) any default in payment by me/us of any amount due hereunder (ii) the occurrence of an Action of Default (iii) my/our failure to take on Ijarah Assets pursuant to clause 1 herein above.
- 4.2 I/we hereby authorized the Lessor to cancel/revoke the Ijarah facility before the execution of Ijarah Agreement at any time, if the Lessor found;
- a) Financial position of Lessee is not sound
 - b) Negative CWR from SBP — Overdue reporting
 - c) Charged in by the Financial Institution
 - d) Defaulted in any other executed financial facility
 - e) Substantial Change in Ijarah value as agreed at the time of execution of this

agreement.

5. Government Levies:

If any law or regulation or any order of any court, tribunal or authority has the effect of subjecting _____ Modaraba to any stamp duty, fees, charges, penalties, or other government levies and other charges relating to the use of the assets or relating to Ijarah facility either on the date of execution of this Letter of Agreement to Ijarah or in future (hereinafter collectively referred to as "Duties") I/we shall be liable to pay such Duties/levies to _____ Modaraba in addition to any amounts payable hereunder.

6. Representations and Warranties

6.1 I/We hereby represent and warrant to _____ Modaraba as under:

6.1.1	That I/we have full legal right, power and authority to enter into, execute and deliver this Letter of Agreement to Ijarah and to perform my/our obligations hereunder.
6.1.2	That this Letter of Agreement to Ijarah has been duly and validly authorized and executed and constitutes our valid and binding obligation, enforceable against us in accordance with its terms.

7. Duration

This Agreement to Ijarah shall come into effect on the date of its execution by me/us and shall expire on the date I/we Ijarah the assets from _____ Modaraba in accordance with clause 1 herein above.

8. Assignment

This Letter of Agreement to Ijarah is personal to me/us and I/we shall not subcontract or otherwise delegate or assign any of my/our obligations hereunder without the prior written consent of _____ Modaraba.

A/c Name _____

Witness-1

Signature _____

Name _____

CNIC _____

Witness-2

Signature _____

Name _____

CNIC _____

Annexure-III**Annexure- A****Specimen of Annual *Shari'ah* Advisor's Report**

I have conducted the *Shari'ah* review of _____ Modaraba managed by _____ Modaraba Management Company for the financial year ended _____ in accordance with the requirements of the *Shari'ah* Compliance and *Shari'ah* Audit Mechanism for Modarabas and report that except the observations as reported hereunder, in my opinion:

- i. the Modaraba has introduced a mechanism which has strengthened the *Shari'ah* compliance, in letter and spirit and the systems, procedures and policies adopted by the Modaraba are in line with the *Shari'ah* principles;
- ii. following were the major developments that took place during the year:
 - a) Research and new product development (Brief on the research and new product development, if applicable)
 - b) Training and Development (detail of training conducted by the *Shari'ah* Advisor of the Modaraba management and staff, if any).
- iii. the agreement(s) entered into by the Modaraba are *Shari'ah* compliant and the financing agreement(s) have been executed on the formats as approved by the Religious Board and all the related conditions have been met;
- iv. to the best of my information and according to the explanations given to me, the business transactions undertaken by the Modaraba and all other matters incidental thereto are in conformity with the *Shari'ah* requirements as well as the requirements of the Prospectus, Islamic Financial Accounting Standards as applicable in Pakistan and the *Shari'ah* Compliance and *Shari'ah* Audit Regulations for Modarabas
- v. profit sharing ratios, profits and charging of losses (if any) relating to any deposit raising product conform to the basis and principles of *Shari'ah*.
- vi. the earnings that have been realized from the sources or by means prohibited by *Shari'ah* have been credited to charity accounts.

Observation(s)

Recommendation(s)

Conclusion

Dated:

Signature

Stamp of the *Shari'ah* Advisor

Annexure IV

The Commission has notified Islamic Financial Accounting Standard 1 on Murababa vide S.R.O 865(1)/2005 August 24, 2005 under the Companies Act, 2017. The same SRO is added here for information purposes only.

ANNEXURE

ISLAMIC FINANCIAL ACCOUNTING STANDARD

IFAS 1 MURABAHA

**The Institute of Chartered
Accountants of Pakistan**

ISLAMIC FINANCIAL ACCOUNTING STANDARD**IFAS 1 MURABAHA****1. Background**

- 1.1 Since early eighties banks and similar financial institutions (referred to as "bank(s)" in the Standard) in the Islamic countries have been faced with the problem of financing different sectors of economy through modes which do not contravene the injunctions of *Shariah* regarding *nba* or interest.
- 1.2 One of the most popular modes used by banks in Islamic countries to promote *riba* free transactions is Murabaha. The ratio in which this instrument is being used varies from bank to bank.
- 1.3 Basically Murabaha is a particular type of sale. Ideal mode of financing according to *Shariah* would be Mudarabah or Musharakah. However, in the perspective of the current economic set up there are certain practical difficulties in using Mudarabah and Musharakah instruments in every type of financing. Therefore, the contemporary *Shariah* experts have emphasized on Murabaha basically as a trading mode of transaction but in the contemporary context, the use of Murabaha subject to certain conditions on deferred payment basis has been allowed as a permissible mode.
- 1.4 It should be emphasized here that the instrument of Murabaha should be used as a transitory step taken in the process of the Islamization of the economy, and its use should be restricted only to those cases where the Mudarabah and Musharakah are not practicable.
- 1.5 The second important point is that the Murabaha transaction does not come into existence by merely replacing the word "interest" by the words "profit" or "mark-up". Unless basic conditions as laid down by *Shariah* are fully observed, a Murabaha is not valid. In fact, it is the observance of these conditions, which can draw a clear line of distinction between the interest-bearing loan and a trading transaction of Murabaha. If any of these conditions is not met, the transaction ceases to be Murabaha according to *Shariah*.
- 1.6 The accounting treatment of Murabaha and its disclosure and presentation in the financial statements also varies from bank to bank.
- 1.7 Such diversity of accounting treatment and disclosure has reduced the utility of financial statements of such banks to the users of such statements.
- 1.8 Hence there is a need to formulate an accounting standard regarding

Murabaha to be observed in the presentation of financial statements of banks and to promote their widest possible acceptance and observance.

1.9 Definitions

Murabaha : Murabaha is a particular kind of sale where seller expressly mentions the cost he has incurred on the commodities to be sold and sells it to another person by adding some profit or mark up thereon which is known to the buyer.

Thus Murabaha is a cost plus transaction where the seller expressly mentions the cost of a commodity sold and sells it to another person by adding mutually agreed profit thereon which can be either in lump-sum or through an agreed ratio of profit to be charged over the cost, thus resulting in an absolute price.

Inventories : Inventories are assets held for sale under Murabaha transactions in the ordinary course of business.

2. Basic Shariah Principles and Features of Murabaha

Basic principles governing Murabaha can be divided into three categories. Principles regarding sale, deferred payment and other principles.

2.1 Principles regarding sale

2.1.1 "Sale" is defined in *Shariah* as " the exchange of a thing of value by another thing of value with mutual consent".

2.1.2 The subject matter of sale must be existing at the time of sale.

Thus, a thing, which has not yet come into existence, cannot be sold. If a non-existent thing has been sold, though by mutual consent, the sale is void according to *Shariah*.

Example: A sells the unborn calf of his cow to B. The sale is void.

2.1.3 The subject matter of sale must be in the ownership of the seller at the time of sale, and he must have a good title to it.

Thus, what is not owned by the seller cannot be sold. If he sells something before acquiring its ownership, the sale is void according to *Shariah*.

Example: A sells to B a car, which is presently owned, by C, but A is hopeful that he will buy it from C and shall deliver it to B subsequently. The sale is void.

2.1.4 The subject matter of sale must be in the physical or constructive possession of the seller when he sells it to another person.

Examples: i) A has purchased a car from B. B has not yet delivered it to A or to his agent. A cannot sell the car to C. If he sells it before taking its delivery real or constructive from B, the sale is void.

ii) A has purchased a car from B. B has placed the car in a garage where A has free access and B has allowed him to take the delivery real or constructive from that place whenever he wishes. The car is in the constructive possession of A. If A sells the car to C without acquiring physical possession, the sale is valid.

2.1.5 The gist of the principles mentioned in paras 2.1.2 to 2.1.4 is that a sale under Murabaha arrangement is not valid under Shariah principles unless a thing or commodity:-

- is in existence
- is owned by the seller.
- is in the physical or constructive possession of the seller.

2.1.6 The major difference between an actual sale and a mere promise to sell is that an actual sale cannot be effected unless the above three conditions are fulfilled. However one can promise to sell something, which is not yet owned or possessed by him. This promise initially creates just a moral obligation on the promisor to fulfill his promise, which is normally not legally enforceable.

But the actual sale will have to be effected after the commodity comes into the possession of the seller. This will require separate offer and acceptance, and unless the sale is effected in this manner, the legal consequences of the sale shall not follow.

2.1.7 The sale must be prompt and absolute. Thus a sale attributed to a future date or a sale contingent on a future event is void. If the parties wish to effect a valid sale, they will have to effect it fresh when the future date comes or the contingency actually occurs.

2.1.8 The subject matter of sale must be a property of value. Thus, a thing having no value according to the usage or custom or trade cannot be sold or purchased. Further the subject matter of sale must be specifically known and identified to the buyer.

Explanation: The subject matter of sale may be identified either by pointation or by detailed specification, which can distinguish it from other things not sold.

Example: There is a building comprising of a number of apartments built on the same pattern. A, the owner of the building says to B " I sell one of these apartments to you". B accepts it. The sale is void

unless the apartment intended to be sold is specifically identified or pointed out to the buyer.

And lastly it should not be a thing, which is forbidden (Haram) by *Shariah*.

- 2.1.9 The delivery of the sold commodity to the buyer must be certain and should not depend on a contingency or chance.

Example: A sells his car stolen by an anonymous person and the buyer purchases it under the hope that he will manage to recover it. The sale is void.

- 2.1.10 The absolute certainty of price is a necessary condition for the validity of a sale. If the price is uncertain, the sale is void.

Example: A says to B, "if you pay within a month, the price is Rs.50/-. But if you pay after two months, the price is Rs.55/- B agrees without absolutely determining one of the two prices. In this case as the price remains uncertain the sale is void, unless anyone of the two alternatives is settled by the parties at the time of concluding the transaction.

- 2.1.11 The sale must be unconditional. A conditional sale is invalid, unless the condition is recognized as a part of the transaction according to the usage of or custom of trade.

Example: (1) A buys a car from B, with a condition that B will employ his son in his firm. The sale is conditional, hence invalid.

(2) A buys a refrigerator from B, with a condition that B undertake its free service for 2 years. The condition, being recognized as a part of the transaction, is valid and the sale is lawful.

- 2.1.12 In case of imports the issuance of bill of lading in favour of bank would be considered constructive possession.

2.2 Principles regarding deferred payment

- 2.2.1 A sale in which the parties agree that the payment of price shall be deferred is called a "*Bai'Mu'ajjal*".

- 2.2.2 *Bai'Mu'ajjal* is valid if the price and due date of payment is fixed in an unambiguous manner.

- 2.2.3 The due time of payment can be fixed either with reference to a particular date, or by specifying a period of time, but it cannot be fixed with reference to a future event, the exact date of which is

unknown or is uncertain. If the time of payment is unknown or uncertain, the sale is void.

2.2.4 If a particular period is fixed for payment, like one month, it will deem to commence from the time of delivery, unless the parties have agreed to otherwise.

2.2.5 The deferred price may be more than the cash price, but it must be fixed at the time of sale.

2.2.6 Once the price is fixed, it cannot be decreased in case of earlier payment, nor can it be increased in case of default.

2.2.7 In order to ensure the buyer pays the installments promptly, he may be asked to promise that in case of a default, he will pay certain amount of penalty for a charitable purpose. Such penalty shall not constitute bank's income and shall be utilized for charitable purposes only.

2.2.8 If a commodity is sold on installments, the seller may put a condition on the buyer that if he fails to pay any installment on its due date, the remaining installments will become due immediately.

2.2.9 In order to secure the payment of price, the seller may ask the buyer to furnish a security whether in the form of a mortgage or in the form of a lien or a charge on any of his existing assets.

2.2.10 The buyer can also be asked to sign a promissory note or a bill of exchange, but such promissory note or bill or any evidence of indebtedness cannot be assigned or transferred on a price different from its face value.

2.3 Other Principles regarding Murabaha

2.3.1 Murabaha would be valid in case a commodity is to be imported and its exact cost is unknown but the seller (bank), who is importing the commodity, and the eventual buyer (client) have agreed to some profit or margin of profit which could be on FOB or C&F cost or on the final landed cost. Further, the elements of cost to be incurred by the bank and to be included in the calculation of any of these costs have been agreed to beforehand by the client.

2.3.1.1 It is not necessary that the bank should bear full cost of import. It may make itself responsible for FOB or C&F cost only and all other duties, levies and importation charges or any part thereof may be borne by the client.

2.3.1.2 The FOB or C&F cost may be fixed beforehand with reference to a fixed or forward rate of conversion or only the foreign currency cost may be

agreed to initially and the conversion to the local currency may be left to actual rate prevailing on the date of payment for import.

- 2.4 The essential of Islamic Modes of Financing relating to Murabaha issued by Shariah Board of the State Bank of Pakistan enclosed as Appendix "A" are an integral part of the Standard.

3.0 Modalities of Murabaha

- 3.1 The Murabaha should fulfill all the conditions necessary for a valid sale, i.e.:-

- The thing or commodity is in existence.
- It is owned by the seller.
- The bank must have a good title to the commodity before it sells it to its client.
- The commodity must come into the possession of the bank, whether physically or constructive, in the sense that the commodity must be at its risk, though for a short period.

- 3.2 For a Murabaha transaction, the bank itself may purchase the commodity and keep it in its own possession, or purchase the commodity through a third person appointed by the bank as agent, before bank sells it to the customer. However it is also allowed that bank makes the customer its agent to buy the commodity on its behalf. In this case the client first purchases the commodity and takes its possession as such on behalf of the bank. Thereafter, he purchases commodity from the bank for a deferred price. His possession over the commodity in the first instance is in the capacity of an agent of his bank. In this capacity he is only a custodian while the ownership vests in the bank and the risk of the commodity is also borne by the bank as a logical incidence of the ownership. But as soon as the client purchases the commodity from the bank, the ownership, as well as the risk, passes to the client.

- 3.3 As mentioned earlier, the sale cannot take place unless the commodity comes into the possession of the seller, but the seller can sign an "agreement to sell" after the bank has acquired ownership title to the goods though the commodity is not in its possession.

- 3.4 Having regard to the Shariah principles of the Murabaha a bank can use the Murabaha by adopting the following procedure:-

- 3.4.1 The client and the bank sign an " agreement to sell " whereby the bank promises to sell and the client promises to buy commodity up to a maximum amount of purchases at a profit margin of X percentage or amount over cost.

- 3.4.2 The bank appoints the client as his agent for purchasing the commodity on its behalf, and an agreement of agency is signed by both the parties.

- 3.4.3 The client purchases the commodity on behalf of the bank and takes its possession as an agent of the bank.
- 3.4.4 The client informs the bank that he has purchased the commodity on its behalf and has taken possession thereof, and at the same time, makes an offer to purchase it from the bank at profit margin over cost as agreed to in the " agreement to sell " referred to in 3.4.1.
- 3.4.5 The bank accepts the offer and the sale is concluded whereby the ownership as well as the risk of the commodity is transferred to the client. An invoice shall be raised by the bank in respect of the commodity sold to the client.
- 3.4.6 Another very important point to be followed is that the Purchase Order, Material Receiving Report and Delivery Challan, by whatever name called, should be in the name of the bank.
- 3.4.7 Finally the payment for the commodity purchased may be made directly by the bank to the supplier or through the agent.
- 3.5 The purchase of the commodity from the client himself on "buy back" agreement is not allowed in *Shariah*.
- 3.6 The above-mentioned procedure of the Murabaha is a complex transaction where the parties involved have different capacities in different stages.
 - 3.6.1 At the first stage, the bank and the client agree to sell and purchase commodity in future. This is not an actual sale. It is just a promise to effect a sale in future on Murabaha basis. Thus at this stage the relationship between the bank and the client is that of a promisor and a promisee.
 - 3.6.2 At the second stage, the relationship between the parties is that of a principal and an agent.
 - 3.6.3 At the third stage, the relationship between the bank and the supplier is that of a buyer and a seller.
 - 3.6.4 At the fourth and fifth stage, the relationship of seller and buyer comes into operation between the bank and the client and thereby relationship of a debtor and creditor emerges.
- 4. **Standard Accounting Practice**
 - 4.1 Scope -This Standard should be applied to financial statements prepared in the context of historical cost convention in accounting for Murabaha transactions undertaken by a bank.
 - 4.2 Cost of inventories should comprise all costs of purchases and other costs

incurred in bringing the inventories to their present location and condition.

- 4.3 Inventories remaining unsold with the bank on the balance sheet date shall constitute bank's inventory and shall be valued in accordance with International Accounting Standard applicable to inventories and shown under "Other Assets".
- 4.4 The financial statements of a bank should disclose all the information prescribed by International Accounting Standard applicable to inventories.
- 4.5 In case the inventories were acquired by the bank for a client who has eventually defaulted on his promise to purchase the inventories, it shall be valued in accordance with International Accounting Standard applicable to ~ inventories.
- 4.6 Murabaha receivable shall be recorded by the bank at the invoiced amount and disclosed as such in the balance sheet.
- 4.7 Profit Recognition
 - (a) Purchases and sales under Murabaha and the resultant profit should be accounted for on the culmination of Murabaha transaction;
 - (b) However, the profit on that portion of sales revenue not due for payment should be deferred by accounting for by a debit to "Unearned Murabaha Income" account with the corresponding credit to "Deferred Murabaha Income" account and shown in the balance sheet as a liability.

5. Effective date

This standard shall be effective for financial statements of banks for the financial periods beginning on or after 1-01-2006.

APPENDIX 'A'

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN
SHARIAH ESSENTIALS ISSUED BY SHARIAH BOARD
OF
THE STATE BANK OF PAKISTAN

This appendix is an integral part of the IFAS-1 'Murabaha'

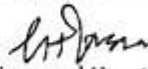
Murabaha (Agreed profit margin sale with cash or deferred payment of price)

- I) Murabaha means a sale of goods by a person to another under an arrangement whereby the seller is obliged to disclose to the buyer the cost of goods sold either on cash basis or deferred payment basis and a margin of profit included in the sale price of goods agreed to be sold.
- II) Goods to be traded should be real goods but not credit documents.
- III) Being a sale transaction, it is essential that the commodities which are the subject of sale in a Murabaha transaction, must be existing, owned by the seller and in his physical or constructive possession. Therefore, it is necessary that the seller must have assumed the risks of ownership before selling the commodities to the buyer/customer.
- IV) Murabaha, like any other sale, requires an offer and acceptance which will include certainty of price, place of delivery, and date on which the price, if deferred, will be paid.
- V) In a Murabaha transaction, the appointment of an agent, if any, the purchase of goods by or for and on behalf of the bank and the ultimate sale of such goods to the customer shall all be transactions independent of each other and shall be so separately documented. An agreement to sell, however, may embody all the aforesaid events and transactions and can be entered into at the time of inception of relationship. The agent would first purchase the commodity on behalf of his principal i.e. financier and take its possession as such. Thereafter, the client would purchase the commodity from the financier, through an offer and acceptance. According to Sharia it is sufficient in respect of the condition of 'possession' that the supplier from whom the bank has purchased the item, gives possession to the bank or its agent in such a manner that subject matter of the sale comes under the risk of the bank. In other words, the commodity will remain in the risk of the financier during the period of purchase of the commodity by the agent and its ultimate sale to the client (agent/buyer) and its possession by him.
- VI) The invoice issued by the supplier will be in the name of the financier as the

commodity would be purchased by an agent on behalf of such financier. It is preferable that the payment for such commodities should be made by the financier directly to the supplier.

- VII) Once the sale transaction has been concluded, the selling price determined can not be changed.
- VIII) It can be stipulated while entering into the agreement that in case of late payment or default by the client, he shall be liable to pay penalty calculated at percent per day or per annum that will go to the charity fund constituted by the bank. The amount of penalty cannot be taken to be a source of further return to the bank (the seller of the goods) but shall be used for charitable purposes including the projects intended to ameliorate economic conditions of the sections of the society possessing little or nothing i.e. needy people/peoples without means.
- IX) The banks can also approach competent courts for award of solatium which shall be determined by the Courts at their discretion, on the basis of direct and indirect costs incurred, other than opportunity cost. Also, security or collateral can be sold by the bank (seller) without intervention of the court.
- X) The buyer may be required to furnish security in the form of pledge, hypothecation, lien, mortgage or any other form of encumbrance on asset. However, the mortgagee or the charge-holder shall not derive any financial benefit from such security.
- xi) A Murabaha contract cannot be rolled over because the goods once sold by the bank become property of the client and, hence, cannot be resold.
- xii) Buy-back arrangement is prohibited. Therefore, commodities already owned by the client cannot become the subject of a Murabaha transaction between him and the same financier.
- xiii) The promissory note or bill of exchange or any evidence of indebtedness cannot be assigned or transferred on a price different from its face value.

[No. 9(1) PSPD/PS/2004]


(Mohammad Hayat Jabra)
Secretary

Annexure V

The Commission has notified Islamic Financial Accounting Standard 2 on Ijarah vide S.R.O. 431(I)/2007 dated May 22, 2007 under the Companies Act, 2017. The same SRO is added here for information purposes only.

ISLAMIC FINANCIAL ACCOUNTING STANDARD

IFAS 2 IJARAH

Issued By

The Institute of Chartered Accountants of Pakistan

IFAS 2

ISLAMIC FINANCIAL ACCOUNTING STANDARD

IFAS 2 IJARAH

- I. 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

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

Scope

3. This Standard shall apply in accounting for *Ijarah* as defined in paragraph 5 but shall not apply to:
 - 3.1 lease agreements to explore for or use minerals, oil, natural gas and similar non-regenerative resources;
 - 3.2 licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights;
 - 3.3 lessors of investment property leased out under operating leases (see IAS 40 Investment Property); and
 - 3.4 lessors of biological assets leased out under operating leases (see IAS 41 Agriculture).
4. 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.

Definitions

5. The following terms are used in this Standard with the meanings specified:

- 5.1 *Ijarah* is a contract whereby the owner of an asset, other than consumable, transfers its usufruct to another person for an agreed period for an agreed consideration.

Explanation:

The term *Ijarah* for the purpose of this Standard also includes a contract of sub-lease executed by the lessee with the express permission of the lessor (being the owner).

Whether a transaction is an *Ijarah* or not depends on its substance rather than the form of the contract provided it complies with the Shariah essentials as may be prescribed from time to time.

- 5.2 Prescribed means as prescribed by any law or regulations or directives for the time being in force.
- 5.3 An *Ijarah* is an *Ijarah* that is cancelable only:
 - 5.3.1 upon the occurrence of some remote contingency such as force majeure;
 - 5.3.2 with the mutual consent of the *muj'ir* (lessor) and the *musta'jir* (lessee); or
 - 5.3.3 If the *musta'jir* (lessee) enters into a new *Ijarah* for the same or an equivalent asset with the same *muj'ir* (lessor).

- 5.4 The inception of the Ijarah shall be effective from the date the asset leased out is put into musta'jir's (lessee's) possession pursuant to an Ijarah contract.
- 5.5 The term of the Ijarah is the 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 it is reasonably certain that the musta'jir (lessee) will exercise.
- 5.6 Ujrah (lease) payments are the payments over the Ijarah term that the musta'jir is, contractually required to pay.
- 5.7 Fair value is the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
- 5.8 Economic life is either:
- 5.8.1 the period over which an asset is expected to be economically usable by one or more users; or
- 5.8.2 the number of production or similar units expected to be obtained from the asset by one or more users.
- 5.9 Useful life is the estimated period, from the beginning of the Ijarah term, without limitation by the Ijarah term, over which the economic benefits embodied in the asset are expected to be consumed by the enterprise.
6. Assets acquired for Ijarah shall be recognized upon acquisition at historical cost. Historical cost of assets acquired for Ijarah includes net purchasing price plus wherever applicable all expenditures necessary to bring the asset to its intended use, such as custom duties, taxes, freight, insurance, installation, testing, etc.

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

7. Ujrah payments under an Ijarah should be recognized as an expense in the income statement on a straight-line basis over the Ijarah term unless another systematic basis is representative of the time pattern of the user's benefit.
8. For Ijarah, ujrah payments 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.
9. Musta'jir (Lessees) should, in addition to meeting the requirements of IAS 32, Financial Instruments: Disclosure and Presentation, make the following disclosures for Ijarah:
- 9.1 the total of future ujrah payments under Ijarah, 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;

- 9.2 the total of future sub-ijarah payments expected to be received under sub-ijarah at the balance sheet date;
- 9.3 Ijarah and sub-ijarah payments recognized in income for the period, with separate amounts for Ijarah payments and sub-ijarah payments;
- 9.4 a general description of the Musta'jir's (lessee's) significant Ijarah arrangements including, but not limited to restrictions imposed by Ijarah arrangements, such as those concerning dividends, additional debt, and further Ijarah.

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

10.

- 10.1 Muj'ir (Lessors) should present assets subject to Ijarah in their balance sheet according to the nature of the asset, distinguished from the assets in own use.
- 10.2 Ijarah income from Ijarah should be recognized in income on accrual basis as and when the rental becomes due, unless another ~ systematic basis is more representative of the time pattern in which benefit of use derived from the leased asset is diminished.
- 10.3 Costs, including depreciation, incurred in earning the Ijarah income are recognized as an expense.
- 10.4 Ijarah income is recognized in income on accrual basis as and when the rental becomes due, 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 are either deferred and allocated to income over the Ijarah term in proportion to the recognition of Ujrah, or are recognized as an expense in the income statement in the period in which they are incurred.

- 12. Assets leased out should be depreciated over the period of lease term using depreciation methods set out in IAS 16

However, in the event of an asset expected to be available for re-ijarah after its first term, depreciation should be charged over the economic life of such asset on the basis set out in IAS-I 6.

- 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.

Sale and Leaseback Transactions

14. A sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the same asset back to the vendor.
15. *When an asset is sold with an intention to enter into an Ijarah arrangement, any profit or loss based on the asset's fair value should be recognised immediately. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.*
16. Muj'ir (Lessors) should, in addition to meeting the requirements of IAS 32, Financial Instruments: Disclosure and Presentation, make the following disclosures for Ijarah (Leases):
 - 16.1 the future Ijarah payments 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
 - 16.2 a general description of the muj'ir (lessor's) significant leasing arrangements.
17. In addition, the requirements on disclosure under IAS 16, Property, Plant and Equipment, IAS 36, Impairment of Assets, IAS 38, Intangible Assets and IAS 40, Investment Property, apply to assets leased out under Ijarah.

Effective Date

18. This Islamic Financial Accounting Standard becomes operative for financial statements covering periods beginning on or after first day of July 2007.. If an enterprise applies this Standard for financial statements covering periods beginning before first day of July 2007, the enterprise should disclose the fact that it has applied this Standard.

It is also clarified that this Standard will be required to be followed on those Ijaraahs which commence after the above-mentioned effective date. However financial institutions who have entered into Ijarah agreements before the effective date of this standard will have the option for early compliance with the requirements of this before the effective date.

Appendix

Essentials and Model Agreements for Islamic Modes of Financing

Introduction

The Commission for Transformation of Financial System set up in the State Bank of Pakistan

pursuant to the Supreme Court Judgment on Riba dated December 23, 1999 approved essentials of Islamic modes of financing including Musharaka, Mudaraba, Murabaha, Musawama, Leasing, Salam and Istisna. The recently established State Bank of Pakistan's Shariah Board has reviewed and approved these essentials of Islamic modes of financing and recommended that the same may be circulated to the banks conducting Islamic banking business in Pakistan as guidelines that would form the basis for Prudential Regulations on Islamic banking in due course. It does not preclude the possibility of developing new modes or instruments of financing, modifications or variants of the modes provided they are Shariah compliant. The Ijarah Essentials are given below:

Ijarah (Leasing)

- i) In Ijara/leasing, the corpus of leased commodity remains in the ownership of the lessor and only its usufruct is transferred to the lessee. Any thing, which cannot be used without consuming the same, cannot be leased out like money, edibles, fuel, etc. Only such assets, which are owned by the lessor, can be leased out except that a sub-lease is effected by the lessee with the express permission of the lessor
- ii) Until such time that assets to be leased are delivered to the lessee, lease rentals do not become due and payable.
- iii) During the entire term of the lease, the lessor must retain title to the assets, and bear all risks and rewards pertaining to ownership. However, if any damage or loss is caused to the leased assets due to the fault or negligence of the lessee, the consequences thereof shall be borne by the lessee. The consequences arising from non-customary use of the asset without mutual agreement will also be borne by the lessee. The lessee is also responsible for all risks and consequences in relation to third party liability, arising from or incidental to operation or use of the leased assets.
- iv) The insurance of the leased asset should be in the name of lessor and the cost of such insurance borne by him.

(It is hoped that arrangement shall soon be made for Islamic Takaful to replace the existing insurance system).
- v) A lease can be terminated before expiry of the term of the lease but only with the mutual consent of the parties.
- vi) Either party can make a unilateral promise to buy/sell the assets upon expiry of the term of lease, or earlier at a price and at such terms and conditions as are agreed, provided that the lease agreement shall not be conditional upon such sale. Alternatively, the lessor may make a promise to gift the asset to the lessee upon termination of the lease, provided the lessee has fulfilled all his obligations. However, there shall not be any stipulation in the lease agreement purporting to transfer of ownership of the leased assets at a future date.
- vii) The amount of rental must be agreed in advance in an unambiguous manner either for the full term of the lease or for a specific period in absolute terms.
- viii) Assignment of only the lease rentals is not permissible except at par value.
- ix) Contract of lease will be considered terminated if the leased asset ceases to give the

service for which it was rented. However, if the leased asset is damaged during the period of the contract but is capable of being repaired, the contract will remain valid.

- x) A penalty can be agreed ab initio in the lease agreement for delay in payment of rental by the lessee. In that case, lessee shall be liable to pay penalty calculated at the agreed rate in percent per day/annum. However, that penalty shall be used for the purposes of charity. The banks can also approach competent courts for award of damages, at discretion of the courts, which shall be determined on the basis of direct and indirect costs incurred, other than opportunity cost. Also, security or collateral can be sold by the bank (purchaser) without intervention of the court.
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BILAL RASUL,
Secretary to the Commission.