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# THE ROLE OF SHARI'A ACCOUNTING STANDARDS IN ORGANIZING AND GUIDING ISLAMIC FINANCIAL INSTITUTIONS

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**ABSTRACT**

This research aims to analyze Shari'a standards in Islamic financial accounting using a descriptive and analytical approach while examining the role and significance of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) in regulating Islamic financial institutions. Through an analysis of the theoretical frameworks and fundamental principles of Islamic accounting, we have assessed the impact of AAOIFI standards on transparency and governance in the sector. The findings indicate that the accountability of Islamic financial institutions is based on the application of Islamic accounting principles, ensuring the credibility of financial statements and the transparency of financial disclosures, thereby safeguarding the rights of all stakeholders. The rigorous application of Shari'a accounting standards contributes to a more efficient organization of Islamic financial institutions, strengthening their governance and the reliability of financial information.

**KEYWORDS**

Islamic Accounting, Shari'a Standards, Accounting and Auditing Authority for Islamic Financial Institutions

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**Introduction.**

Islamic financial institutions have become a tangible reality, not only in the lives of the Islamic nation but also across the world. Their activities have witnessed remarkable growth, both in terms of their presence and financial results, as well as their achievements, gaining recognition on local and international levels. Many conventional financial institutions have introduced Islamic financial services known for their quality and alignment with economic well-being, combining professional expertise with Sharia compliance while maintaining a balanced level of risk—neither guaranteeing fixed returns like interest-based instruments nor exhibiting excessive risk like gambling tools. Islamic banking is founded on attracting savings and investing them in various economic activities according to Islamic principles and Sharia standards, with profit distribution determined by accounting rules and Sharia guidelines, avoiding interest-based transactions. This has created a need for Sharia boards to develop and guide the operations of these institutions.

To provide a fair and accurate representation of the financial positions of Islamic financial institutions, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has issued standards focused on presentation and disclosure. These standards encourage Islamic banks to adopt transparency and fairness in their operations by standardizing accounting treatments and financial disclosure methods, aiming to gain the trust of stakeholders and financial statement users.

This paper seeks to answer the following question: "What is the role of Sharia accounting standards in regulating and guiding the operations of Islamic financial institutions?"

The study aims to achieve several objectives, primarily introducing Islamic accounting, the organization responsible for issuing its standards (AAOIFI), and the key goals it strives to accomplish. Additionally, it reviews the most important Sharia accounting standards and highlights their role in directing and regulating Islamic banking.

To address the research problem, we adopted the descriptive-analytical approach as it is the most suitable method for our study due to its ability to provide an accurate and in-depth diagnosis of facts. This approach involves collecting and organizing data systematically to encompass various concepts related to Islamic accounting, the organization responsible for issuing its standards, and the role of these standards in regulating Islamic banking operations. The study relies on multiple references, including books, scientific journals, and other relevant academic sources.

**1- The General Framework of Islamic Accounting and the Organization Issuing Its Standards**

Islam places as much emphasis on transactions as it does on acts of worship, establishing numerous rules governing commercial dealings and the financial interactions of the Islamic state with others. It also contributed to the development of financial recording methods that were previously practiced by the Arabs. Over time, financial documentation evolved, specialists emerged in the field, accounting records were introduced, and accounting systems were designed. Therefore, this section will address the following aspects.

**1-1. Definition of Islamic Accounting.**

Islamic accounting can be defined as a discipline that adheres to the principles of Islamic Sharia, comprising a set of rules and principles used to collect, analyze, and record financial transactions to measure the performance of economic enterprises and prepare and present financial statements in accordance with Islamic law (Samhan, 2009, p. 16).

Islamic accounting is a structured and systematic process that includes procedures, rules, and mechanisms for recording, classifying, organizing, summarizing, and communicating financial events to relevant stakeholders. It facilitates Islamic decision-making by conveying financial information and distributing the outcomes of financial events (such as profit distribution or incurred losses) over a given fiscal period, following the frameworks and principles of Islamic Sharia (Wisam, 2019/2020, p. 10).

Islamic Sharia has encompassed accounting and established a rich intellectual foundation that has been applied for fourteen and a half centuries under various similar terms, such as financial recording and the science of earning, among others (Qantaji, 2003). The accounting tools and techniques developed by Islamic civilization can be summarized in the following diagram.

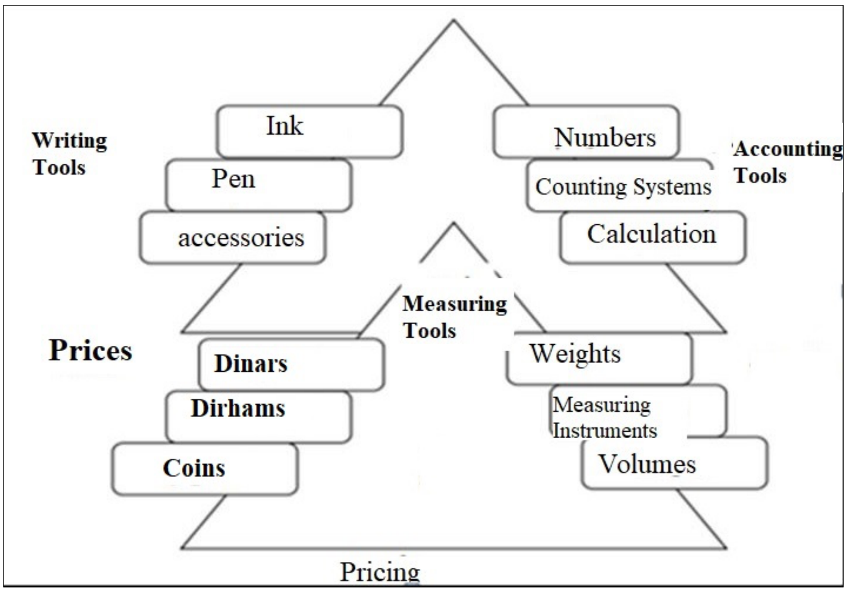


*Fig. 1. Accounting Tools and Techniques Developed by Islamic Civilization (Qantaji, 2003)*

From this diagram, it becomes clear that the development of writing and calculation tools has supported accounting in adhering to Sharia principles, granting it consistency and stability over a long period that extends to the present day. One notable example is the reintroduction of the Islamic gold dinar in Malaysia and its adoption as a means of transaction since mid-2003.

**1-2. Principles of Islamic Accounting**

The principles of accounting in Islam were established to reflect the accounting rules derived from Islamic Sharia, forming the framework that defines the Islamic accounting methodology. Some of the most important principles include:

- **Legitimacy of Transactions:** This principle ensures that the objectives, activities, and means used in financial transactions are lawful. It is fundamental, as the absence of transaction legitimacy invalidates the application of other principles.
- **Legal Entity Concept:** This principle separates investment activities from the individual providing the financing, recognizing the company as having an independent financial liability distinct from its owners.
- **Continuity:** It assumes that a business entity will continue its operations indefinitely, and any classification or cessation of its activities is an exception unless indicators suggest otherwise. The lifespan of the entity is not tied to that of its owners, reinforcing the separation between the financial liability of the business and that of its owners. (Saada, 2013, p. 307)
- **Presentation and Disclosure:** Disclosure refers to preparing financial reports in a clear, simple, and accessible manner to help users obtain the necessary information when needed. Islamic accounting emphasizes the importance of full presentation and disclosure of financial data, which should clearly reflect all assets, liabilities, and business outcomes. A Muslim accountant must adhere to honesty and integrity in presenting accounting information and avoid misrepresentation, concealment, fraud, and falsification.
- **Historical Recording of Transactions:** This principle requires that transactions be recorded in the registers as they occur, with dates indicating the day, month, and year. This ensures the ability to track activities. The basis for this principle is the Quranic verse: "O you who have believed, when you contract a debt for a specified term, write it down..." (Surah Al-Baqarah, 2:282). This was practiced in the Islamic state when the Bayt al-Mal (Treasury of the Muslims) was established, with records kept for its expenses and revenues, documenting transactions in a chronological order.
- **Achieving Growth:** In Islamic jurisprudence, profit is seen as the growth of wealth over the course of a year, whether the money changes from goods to cash or not. Profit exists in both cases. There are two types of growth (profit): one is actual growth, which refers to an increase in wealth due to business expansion, and the other is potential growth, meaning that the wealth is capable of growth. For example, when calculating the zakat on wealth, it is not necessary to wait until the wealth grows; the key factor in evaluation is the occurrence of profit, not its appearance through sales. Based on this, assets are evaluated at the end of the year (Hawl), and the growth is estimated and added to the actual profit.

In Islamic accounting, profit is only recognized after preserving the true capital, as growth only happens after ensuring the integrity of the source, which is the invested capital. This is supported by the saying of the Prophet Muhammad (PBUH): "The example of the believer is like that of a merchant; his profit is not secured until his capital is safe..." (Sahih al-Bukhari).

- **Matching Revenues with Expenses:** This is based on the principle of *ghunm bi-ghurm* (profit with risk). *Ghunm* refers to the gain, benefit, or profit derived from something according to Sharia, while *ghurm* refers to the loss, cost, or expense. Islamic accounting aims to measure business outcomes over a specific period by matching revenues with expenses, in order to determine the zakat base and assess the profitability of the project. This principle was applied in the Bayt al-Mal (Muslim Treasury), where revenues from various sources such as taxes, jizyah, alms, and zakat were matched with expenses to assess the surplus or deficit.
- **Accrual Basis:** This principle dictates that the accounting period should be charged with its own expenses and revenues, regardless of whether they have been paid or received. In this context, Ibn Rushd states: "If a person spends from his wealth before the year ends, or if it is lost, there is no zakat on it. He will pay zakat on the remaining wealth if it reaches the end of the year." The purpose of this principle is to balance the financial years by accounting for what should be included without overstatement or understatement, ensuring that expenses or revenues are recorded when they occur, not when they are paid or received. (Hassan, 2020, p. 95-94)
- **Materiality:** This principle states that when preparing financial statements, the needs of the users must be considered in terms of the significance of the information, both in quality and quantity. When determining the materiality of a specific item, its nature and value must be taken into account.

The Prophet Muhammad (PBUH) illustrated the concept of materiality with the example of two men—one who donated one dirham and another who donated 100,000 dirhams. However, the first man donated half of his wealth, while the second donated only a small portion of his wealth. The first man is considered superior despite donating a smaller amount in absolute terms. The Prophet said: "*A dirham preceded two dirhams," and when asked how, he explained: "There was a man with two dirhams who donated one. Then, another man took from his wealth and donated 100,000 dirhams.*" This hadith is narrated in **Musnad Ahmad** and other collections. Let me know if you need a specific citation or further details.

- **Consistency:** Islamic accounting emphasizes consistency and standardization in the fundamental principles so that they do not change with time or place. To this end, the overall framework of the accounting system for the Bayt al-Mal in the Islamic state was consistent and unified in terms of concepts, foundations, and terminology. The principle of consistency is a well-established accounting principle that was applied in the Bayt al-Mal. (Hassan, 2020, p. 96)

Objectives of Islamic Financial Accounting: Generally, accounting aims to provide financial information, and the most important of this information includes the following: (Awwar, 2019, p. 30)

- To determine the result of the economic unit's activity over a specific period (profit, loss).
- To determine the financial position of the economic unit, i.e., the sources of funds obtained and their uses.
- To know and calculate the net cash flows of the economic unit during the same period.
- To provide a means of monitoring financial operations of the economic unit, particularly cash transactions.

### 1-3 Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)

It is an international non-profit organization based in the Kingdom of Bahrain, responsible for preparing and issuing accounting, auditing, governance, ethics, and Sharia standards for Islamic financial institutions in particular, and for the Islamic banking and financial industry in general. (Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), 2025).

The organization also manages a number of professional development programs (especially the Islamic Certified Accountant program, and the Islamic Auditor and Sharia Auditor programs) in its efforts to enhance the skills of the human resources working in this industry and to develop the governance structures and controls within its institutions.

The organization was established under the founding agreement signed by several Islamic financial institutions on 1 Safar 1410 AH, corresponding to February 26, 1990, in Algeria, and the organization was registered on 11 Ramadan 1411 AH, corresponding to March 27, 1991, in Bahrain.

As an independent international organization, the AAOIFI enjoys the support of a large number of institutions with legal status around the world (200 members from over 45 countries, as of now), including central banks, Islamic financial institutions, and other parties involved in the international Islamic financial and banking industry.

The General Assembly of the Accounting and Auditing Organization for Islamic Financial Institutions consists of all founding members, participating members, supporting members, observer members, and members representing supervisory and regulatory authorities. Observer and supporting members have the right to attend its meetings but do not have the right to vote. The General Assembly is considered the highest authority in the organization and meets at least once a year. Since its establishment in 1411 AH (1991 AD) until 1415 AH (1995 AD), the organizational structure of the organization consisted of:

The Supervisory Committee, consisting of seventeen members, the Financial Accounting Standards Board, consisting of twenty-one members, an Executive Committee appointed from among the members of the Financial Accounting Standards Board, and a Sharia Committee consisting of four scholars. (Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), 2025). The following figure (Figure 02) shows the current organizational structure of the Accounting and Auditing Organization for Islamic Financial Institutions as follows: (Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), 2025)


*Fig. 2. Auditing Organization for Islamic Financial Institutions (AAOIFI, 2025).*

**2- Standards of the Accounting and Auditing Organization for Islamic Financial Institutions**

The Islamic accounting standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions are an important tool to ensure that Islamic financial institutions comply with Sharia standards and achieve transparency and credibility in their financial reports, in order to enhance trust between financial institutions, their clients, and society in general.

**2-1 Concept of Sharia Standards**

These refer to the set of guidelines, instructions, and recommendations that must be followed when implementing accounting operations such as recording, measuring, presenting, and disclosing transactions carried out by Islamic banks over a specific period of time. They also serve as the necessary benchmark for evaluating accounting performance in terms of implementation and providing neutral technical opinions regarding the information in the financial statements.

Sharia standards are also defined as means or formulations for explaining the selected Sharia rulings related to various banking activities such as financing, investment services, and related issues where there are multiple legal opinions, aiming to favor one opinion for implementation in institutions. This can be summarized as the rules and methods that govern and organize banking operations in accordance with Islamic law (Al-Dafie, 2017, pp. 88-87)

**2-2 Types of Standards Issued by the Accounting and Auditing Organization for Islamic Financial Institutions**

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) issues five types of standards, as follows:

• **Sharia Standards**: These concern the Sharia compliance of products. They aim to align the perceptions and practices between the Sharia supervisory boards of Islamic financial institutions to avoid contradictions between fatwas and applications by these institutions, thereby activating the role of the Sharia supervisory boards of these institutions. (Al-Bashir and Sharfa, 2022, p. 55)

Currently, there are 58 Sharia standards, including: Murabaha (cost-plus financing), Ijara (leasing) ending in ownership, Salam and parallel Salam contracts, Istisna and parallel Istisna (Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), 2025)

• **Financial Accounting Standards**: Due to the differences between the characteristics of the Islamic environment and those of the traditional environment, it was necessary to develop specific accounting objectives for the Islamic work environment, while taking into account the achievements of others. This was done by evaluating the objectives of traditional accounting against Sharia principles—what aligns with it was accepted, and what contradicts it was rejected. In this regard, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has issued standards that focus on determining the type and nature of the information that must be included in financial reports to assist users of the information in making economic decisions within the framework of Islamic law. (Suleiman & Bumattari, 2009).

Currently, the financial accounting standards consist of 28 standards, including: presentation and disclosure in the financial statements of Islamic banks, investment accounts, Murabaha and Murabaha for the order to purchase...etc.

• **Auditing Standards**: Auditing standards in Islamic financial institutions are defined as: "A set of general, fixed principles and rulings that govern the personal formation, scientific and practical preparation, and professional performance of the auditor, derived from the sources of Islamic law and Sharia-compliant reasoning. These standards serve as a guide and direction for the auditor in their work and the basis for evaluating their performance and accountability, determining reward and punishment." (Amara & Al-Arabi, 2014, p. 78). Currently, there are 5 standards, which include the objectives of auditing and its principles, the external audit report, and the external auditor's examination of compliance with the principles and rulings of Islamic law...etc.

• **Governance Standards**: Governance standards refer to the set of Islamic Sharia principles that regulate and organize the relationships between shareholders and the management of the institution in a way that ensures efficient performance and the protection of rights, allowing shareholders to oversee and monitor performance. Currently, there are 7 standards, which include the appointment of the Sharia Supervisory Board, Sharia supervision, internal Sharia supervision, audit committee and controls for Islamic financial institutions, the independence of the Sharia Supervisory Board, the statement of control principles, and the social responsibility of the company. (Al-Bashir & Sharfa, 2022, p. 57)

• **Ethics Standards**: The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has issued two standards on ethics. The first pertains to the ethics of accountants and external auditors in Islamic financial institutions, and the second pertains to the ethics of employees working in Islamic financial institutions. The ethics of accountants, external auditors, or employees in Islamic financial institutions are, in general, the ethics of a Muslim, and specifically the ethics of a Muslim trader. Therefore, when selecting employees, they must embody these Islamic values and ethics (Baradiya & Al-Shwayat, 2015, p. 80).

### 2-3 Importance of Sharia Accounting Standards

Sharia accounting standards are highly significant due to their role in enhancing the efficiency of accounting performance in Islamic banks, especially for new accountants. They also contribute to comparing the financial statements of different Islamic banks to support decision-making processes. These standards serve as an objective tool for evaluating and improving accounting performance, especially in the context of globalization, in addition to being a reference for external regulatory bodies, such as banks, monetary institutions, and auditors. They help build trust in the financial statements published at both the national and global levels, as well as promote cooperation and coordination between institutions, bodies, and global accounting centers. Furthermore, these standards assist in standardizing regulatory references, procedures, and accounting treatments within Islamic banks.

Due to the differences between the characteristics of the Islamic environment and the traditional environment, it was necessary to develop accounting objectives specific to the Islamic work environment, taking into account the findings of others. This was done by presenting traditional accounting objectives in light of Sharia principles, accepting those that align with it and rejecting those that do not. The Accounting and Auditing Organization for Islamic Financial Institutions adopted this approach, developing Islamic financial institutions' accounting standards based on traditional accounting objectives and presenting them to Sharia law. (Shriqi, 2014, p. 13) The following Figure (03) illustrates this mechanism:

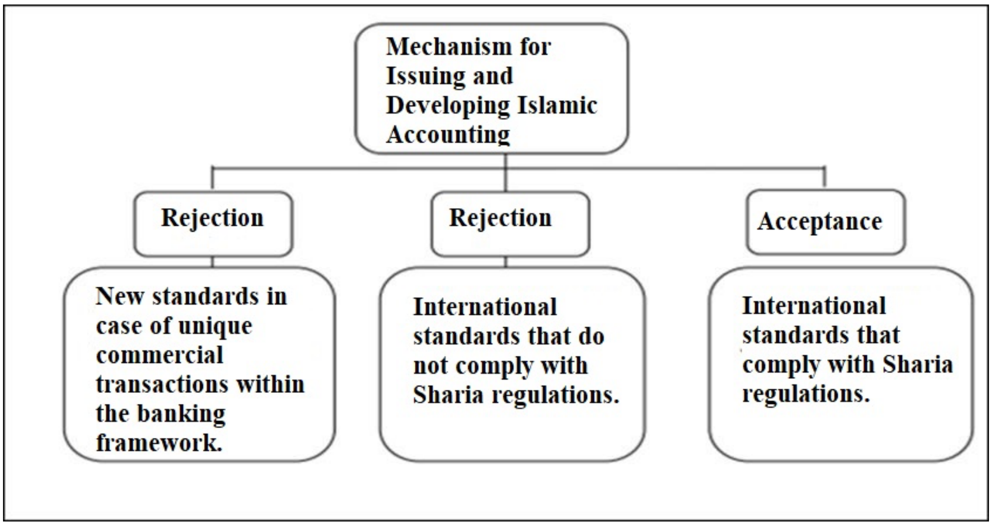


*Fig. 3. The Methodology of Developing Sharia Accounting Standards (Shahul, 2007, p. 08)*

**3. Sharia Standards as the Basis for Regulating the Work of Islamic Financial Institutions**

In this regard, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has issued two standards: the first focuses on the ethics of accountants and external auditors for Islamic financial institutions, and the second pertains to the ethics of employees working in these institutions. The code of ethics for accountants and external auditors issued by the organization is derived from the principles of Islamic law and from the ethical principles outlined in professional accounting codes of ethics that do not contradict Sharia rulings. This code consists of the Sharia foundations for the ethics of accountants, the ethical principles of accountants, and the rules of ethical conduct for accountants, along with guidelines such as the Advisory Statement No. (1) for adopting accounting standards for the first time by an Islamic financial institution (Al-Bashir & Sharfa, 2022, p. 58).

The standards issued by the AAOIFI are considered one of the most important references for Sharia supervision in Islamic banks. Adhering to these standards reflects the commitment of Islamic banks to Sharia rulings. Furthermore, they regulate their transactions and significantly reduce differences in fatwas among Sharia supervisory boards of Islamic banks. Compliance with these Sharia standards also protects Islamic banks from manipulation and concealment under various Islamic finance terms.

**3.1. The Importance of Banks' Adherence to Sharia Accounting Standards**

The importance of adhering to Sharia accounting standards is reflected in the following points: (Hossam El-Din Afana, 2024)

- The existence of these Sharia and accounting standards benefits external audit firms by providing clear criteria for internal auditing and supervision based on defined standards and weights.
- Adhering to these standards facilitates the process of classification and quality control, as it allows for competition based on quality.
- Adherence to these standards leads to development, which is achievable through the ability to audit according to these standards, in light of the necessity for work and application. The jurisprudence of application and experience is one of the most important types of jurisprudence.

On the other hand, the adoption of these standards supports the global expansion and recognition of Islamic banking, with formal recognition from various governmental and international institutions. The importance of Sharia accounting standards within institutions is also demonstrated by their role in providing trust and credibility in financial reports, which represent the outputs of the accounting information system within the financial institution. They clearly outline the sources and uses of funds and the items in which they were spent, leading to increased trust and creditworthiness for Islamic financial institutions.

Despite the high administrative costs associated with adopting these standards, such as the training of accountants and auditors, this will ultimately benefit the institutions. It can lead to greater discipline through their contribution in providing the necessary guarantees to ensure that funds are used appropriately in lawful activities that benefit everyone and align with the objectives for which the institutions were established. Additionally, the requirement to design disclosures according to Islamic accounting standards ensures the improvement of the quality of the financial reports presented. These reports are a key element in achieving financial market efficiency, as they provide the information relied upon in determining the prices of stocks and sukuk on a sound basis.

Therefore, it is crucial to prepare financial reports that adhere to rules governing the accuracy and integrity of the information they contain. Islamic accounting standards are the tool that can help in preparing reliable and credible financial reports. Furthermore, the commitment of Sharia supervisory bodies in Islamic banks to adopt these standards significantly reduces the differences in fatwas between them, increases the trust of clients in Islamic banks, and deepens confidence in the validity of their transactions. (Baradiya, 2016/2015, p. 130).

### 3-2 The Role of Sharia Standards in Islamic Financial Institutions

The Sharia standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) play a significant role in organizing, directing, and developing the Islamic financial industry, as seen in the following: (Al-Bashir & Sharifa, 2022, p. 60)

- They provide a guide on the application of Sharia in the fields of investment and financing, which is an important factor for institutions to verify that their products and services meet Sharia requirements and are free from any doubt or ambiguity.
- They play a significant role in ensuring that financial reports reflect the essence of financial transactions that comply with Sharia. They combine Sharia principles with accounting fundamentals and their applications.
- Sharia standards increase the efficiency of Sharia auditing, reduce errors by workers, and protect Sharia boards from management pressures.
- They assist accountants and auditors in preparing their financial reports based on these standards to verify their compliance with Sharia and adhere to the latest practices in accounting and auditing.
- They enhance uniformity in practices, transactions, and Islamic financial products.
- They unify references and standardize applications. Sharia and accounting standards have contributed to two main features in Islamic banking: unifying the reference for Islamic banking practices and auditing for regulatory oversight, and standardizing applications to the extent that they appear identical or similar. It should be noted that standardization, in this sense of similarity or alignment, eliminates potential conflicts but does not require eliminating diversity or forcing applications into a single legal opinion. Rather, the Sharia standard is envisioned to include the Sharia bases for more than one legal opinion.
- The unification of the Sharia reference, which AAOIFI aims for, helps reduce the additional costs associated with Sharia compliance components and enhances the opportunities for the global application of Islamic alternatives.
- They strengthen the confidence of shareholders, clients, investors, and the community in Islamic financial institutions.
- They assist lawyers and legal professionals in terms of drafting, regulation, and interpretation, and help judges by referring to them and consulting them when ruling on disputes related to Islamic transactions.

### Conclusions

The nature of accounting work and its influence by the environment in which it operates has led Islamic financial institutions to establish their own financial accounting and accounting standards derived from Islamic thought. Therefore, supporting institutions for banking operations, led by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), have sought to issue and unify accounting, auditing, and Sharia standards for Islamic financial institutions to apply and be guided by, due to the uniqueness of their operations. The adoption of these standards contributes to supporting the global reach of Islamic banking, its worldwide expansion, and its formal recognition by various governmental and international institutions. Consequently, the existence and adherence to these standards benefit the state, central banks, and regulatory and auditing bodies by providing guidance on how to interact with Islamic financial institutions, regulate their activities, and understand their operations and contracts, as well as how to audit them based on the principles and guidelines set by the Sharia standards.

Through this study, and in our effort to answer the research problem, we reached a set of conclusions, the most prominent of which is that the accounting of Islamic financial institutions is an application of the concept and principles of Islamic accounting thought, and not an independent practice in itself. Furthermore, the Sharia standards issued by AAOIFI are considered one of the most important tools for unifying the reference at the international level, and they form a fundamental reference for accountants when recording accounting transactions, which contributes to the ability to compare financial statements between different financial and banking institutions. Additionally, Sharia accounting standards ensure the protection of the rights of parties involved in the Islamic financial industry, and adherence to them leads to organizing and directing the work of Islamic institutions efficiently and effectively.

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