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B.COM HONOURS	SEMESTER 6	CALICUT UNIVERSITY	COURSE CODE: COM6EJ311

ACCOUNTING FOR ISLAMIC FINANCIAL INSTITUTIONS

EXAM REVISION NOTES

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MODULE I

1. ACCOUNTING OBJECTIVES AND THE ISLAMIC WORLDVIEW

Accounting Objectives and the Islamic Worldview: Conventional accounting is primarily anchored in neoclassical economic theory, which views the firm as a vehicle for private wealth maximization, serving the narrow interests of equity shareholders.

TAWHID (THE ONENESS OF ALLAH)

KHILAFAH (VICEGERENCY / STEWARDSHIP)

AMANAH (SACRED TRUSTEESHIP)

The Islamic Perspective of Accounting Scriptural Roots: The Arabic term for accounting is Muhasabah, which derives from the root h-s-b, meaning to calculate, take stock, or hold accountable.

- **Vertical Accountability (Murtadiah):** The individual's and institution's ultimate accountability to Allah on the Day of Judgment for every coin earned and spent.
- **Horizontal Accountability (Ijtimaiyyah):** The operational accountability of the firm to contract partners, depositors, employees, suppliers, and the broader Muslim community (*Ummah*).

Elements of Islamic Financial Statements Structural Innovations: Under the Financial Accounting Standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the balance sheet (Statement of Financial Position) of an Islamic bank features a revolutionary structural element unknown in conventional IFRS or GAAP: Equity of Investment Account Holders (EIAH).

- **1. Assets (Mawjudat):** ; Unlike conventional banks whose assets consist almost entirely of debt receivables with interest, Islamic bank assets represent physical real assets and participatory ventures.
- **2. Liabilities (Iltizamat):** Current accounts based on *Qard* (benevolent loan) or *Wadiah Yad Dhamanah* (guaranteed safekeeping).
- **3. Equity of Investment Account Holders (EIAH):** Funds deposited under Mudarabah (profit-sharing partnership).
- **4. Owners' Equity (Huquq al-Mulkiyyah):** ; Identical to conventional shareholders' equity, bearing the residual risk and operational management control.

Users of Islamic Accounting and Their Information Needs: Because an Islamic financial institution (IFI) operates under ethical and religious restrictions, its user universe is substantially broader than that of a conventional commercial bank:

SHARIAH SUPERVISORY BOARD (SSB)

ZAKAT MANAGEMENT BENEFICIARIES

REGULATORS CENTRAL BANKS

Accounting Recognition, Measurement Disclosure

ACCOUNTING RECOGNITION

ACCOUNTING MEASUREMENT

A. Accounting Disclosure: Full and Ethical Disclosure: Islamic accounting requires an expansive standard of Ethical and Social Accountability Disclosure:

- **Disclosure of Shariah Compliance:** The annual report must include the official certification report signed by the Shariah Supervisory Board (SSB) attesting that all banking contracts, investments, and revenue streams complied with Islamic rulings.
- **Disclosure of Non-Shariah Compliant Earnings:** , interest received on foreign nostro accounts held in Western banks), it cannot be recorded as bank revenue.
- **Disclosure of Zakat Obligations:** Clear disclosure of the Zakat base, the calculation method used (Net Asset vs.

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Empirical Casework: Forensic Analysis, Audit Trail Verification, and Internal Controls: Empirical accounting investigations across modern industrial enterprises illustrate that financial distortion, fraud, and misstatement rarely occur as isolated incidents; rather, they stem from structural vulnerabilities within accounting workflows, segregation-of-duties lapses, or inadequate internal audit scrutiny.

- **Ledger amp; Voucher Integrity:** ; Companies Act (Sec.
- **Revenue amp; Cost Allocation:** ; Ind AS 115 (Revenue from Contracts with Customers) amp; CAS 1 to 24 Cost Accounting Standards.
- **Fiscal Risk amp; Tax Compliance:** ; GST Law Section 16/36 Rules amp; Income Tax Act Transfer Pricing Provisions.
- **Working Capital Governance:** ; Tandon amp; Chore Committee Norms for Bank Working Capital Credit Appraisal.

Comparative Regulatory and Practical Implementation Standards: A rigorous examination of corporate commercial practice highlights the indispensable role of standardized accounting principles.

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MODULE II

1. THE NEED FOR DEDICATED ISLAMIC ACCOUNTING STANDARDS

The Need for Dedicated Islamic Accounting Standards: The rapid global expansion of Islamic banking and finance in the late 20th century exposed profound structural conflicts between Islamic financial contracts and international conventional accounting standards (principally International Financial Reporting Standards mdash; IFRS and US GAAP).

MISCLASSIFICATION OF DEPOSITS

LEASE (IJARAH) ACCOUNTING ANOMALIES

NEGLECT OF RELIGIOUS OBLIGATIONS

FINANCIAL ACCOUNTING STANDARDS (FAS)

SHARIAH STANDARDS (SS)

GLOBAL REGULATORY STATUS

AAOIFI Code of Ethics for Islamic Professional Accountants: Accounting in Islam is fundamentally a moral calling governed by the concept of divine surveillance. The AAOIFI Code of Ethics integrates universal professional standards with transcendent Islamic virtues:

- **1. Taqwa (God-Consciousness):** ; Prevents fraudulent window-dressing, concealment of toxic assets, or manipulation of profit-sharing reserves, even when undetected by human auditors.
- **2. Sidq (Truthfulness amp; Integrity):** ; Accountants must present fair, unvarnished financial statements, refusing to sign off on dubious or deceptive valuations.
- **3. I'tidal (Objectivity amp; Justice):** ; Ensures equitable profit allocation between equity shareholders and Mudarabah investment account holders without favoritism.
- **4. Iltizam bi al-Shariah (Shariah Compliance):** ; Refusing to process, record, or conceal transactions involving interest (*Riba*), excessive uncertainty (*Gharar*), or prohibited commodities (alcohol, pork).

Corporate Governance in Islamic Financial Institutions: Corporate governance in an IFI requires a dual-governance mechanism. In addition to conventional corporate boards protecting shareholder capital, an IFI must maintain dedicated religious oversight bodies to safeguard Shariah legitimacy.

SHARIAH SUPERVISORY BOARD (SSB)

DISPLACED COMMERCIAL RISK (DCR)

CHARITABLE SOCIAL OVERSIGHT

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MODULE III

1. ACCOUNTING FOR ISLAMIC DEPOSIT AND INVESTMENT ACCOUNTS

Accounting for Islamic Deposit and Investment Accounts: The liability and funding structure of an Islamic Financial Institution (IFI) is governed by specific Shariah legal contracts, each requiring distinct accounting treatment under AAOIFI FAS 1 and FAS 3:

CURRENT ACCOUNTS (QARD / WADIAH)

UNRESTRICTED INVESTMENT ACCOUNTS (URIA)

Accounting for Mudarabah Financing (AAOIFI FAS 3): In an asset-side Mudarabah financing contract, the Islamic bank acts as the capital provider (Rab-ul-Mal) providing 100% of the financial capital, while the entrepreneur/client acts as the managing partner (Mudarib) contributing labor, technical expertise, and management.

CAPITAL VALUATION DISBURSEMENT

PROFIT LOSS DISTRIBUTION RULES

- **1. Capital Disbursement:** Dr.
- **2. Recognition of Realized Profit:** Dr.
- **3. Recognition of Operational Loss:** Dr.
- **4. Contract Settlement amp; Capital Repayment:** Dr.

Accounting for Musharakah Financing (AAOIFI FAS 4): A Musharakah contract is an equity joint venture where both the Islamic bank and the customer contribute capital to a commercial enterprise.

A. Diminishing Musharakah (Musharakah Mutanaqisah): Widely used in Islamic home and commercial property financing. The bank and client jointly purchase an asset.

- **Ijarah contract:** The customer leases the bank's share of the property under an , paying periodic rent.
- The customer concurrently purchases the bank's equity units in periodic tranches.

Accounting for Murabahah to the Purchase Orderer (AAOIFI FAS 2): Murabahah is a cost-plus sale where the bank discloses its original acquisition cost and agreed profit markup to the customer.

Practical Numerical Accounting Problems Solutions: Case Data: Al-Baraka Islamic Bank enters into a 1-year Mudarabah financing contract with an entrepreneur, Mr. Tariq.

- **Case Data:** Crescent Islamic Bank forms a Musharakah joint venture with Beta Ltd to manufacture eco-packaging.

- **Case Data:** On 1st January 2026, Noor Islamic Bank enters into a Murabahah to Purchase Orderer contract with Horizon Logistics to finance commercial transport vehicles: bull; Purchase price of vehicles paid by bank to vendor = ₹30,00,000 cash.

Comprehensive Calicut University Academic Examination Bank

- **Asset Acquisition Stage:** The bank buys the requested asset from the supplier.
- **Execution of Murabahah Sale:** Upon delivering the goods, the bank enters into the Murabahah contract with the customer.
- **Profit Recognition:** Profit is not recognized upfront on the sale date.
- **Accounting Safeguards:** Any late payment charge collected from defaulters is directly credited to a Charity Payable Fund, ensuring that penalty charges never inflate bank profits.
- **Introduction:** Define Islamic financial intermediation.

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MODULE IV

1. ACCOUNTING FOR IJARAH FINANCING (AAOIFI FAS 32)

Accounting for Ijarah Financing (AAOIFI FAS 32): In Islamic jurisprudence, Ijarah is a contract whereby the owner of an asset (the lessor) transfers its usufruct (the right to use the asset) to another party (the lessee) for an agreed period against specified rental payments, while the legal ownership and major underlying risks of the asset remain with the lessor.

- **real asset ownership:** Unlike conventional leasing under IFRS 16 (which converts leases into finance loans and strips assets off the balance sheet), Shariah requires that the lessor retains .

ASSET CAPITALIZATION DEPRECIATION

MAINTENANCE TAXATION ALLOCATION

A. Ijarah Muntahiya Bittamleek (Ijarah wa Iqtina): Ijarah Muntahiya Bittamleek (IMB) is a lease contract that concludes with the transfer of ownership of the leased asset to the lessee.

VIA GIFT (HIBAH)

VIA TOKEN PRICE

FAIR MARKET VALUE

Accounting for Securities Financing (Sukuk — AAOIFI FAS 33 34): Sukuk (commonly referred to as Islamic bonds) are undivided proportionate ownership certificates representing an undivided beneficial interest in an underlying pool of tangible assets, usufructs, or services.

- **1. Sukuk al-Ijarah:** , government buildings, aircraft).
- **2. Sukuk al-Mudarabah:** Investors act as *Rab-ul-Mal* funding a commercial enterprise managed by the issuer (*Mudarib*).
- **3. Sukuk al-Murabahah:** ; Classified as debt receivables.

Principles of Zakat and Zakat Accounting (AAOIFI FAS 9): Zakat is one of the Five Pillars of Islam, representing a mandatory religious levy on qualifying wealth owned by eligible Muslims for distribution to eight specified categories of beneficiaries (Surah At-Tawbah 9:60).

NISAB (MINIMUM WEALTH THRESHOLD)

HAWL (ONE FULL LUNAR YEAR HOLDING)

A. The Two AAOIFI Methods for Computing the Zakat Base: METHOD 1: THE NET ASSETS METHOD (CURRENT REALIZABLE WEALTH METHOD) Zakat Base=Zakatable Current Assets−Deductible Short-Term Liabilities (+) Zakatable Assets include: Cash on hand and in banks + Marketable equity investments/Sukuk held for trading (at Fair Market Value) + Finished goods inventory and raw materials (at Current Cash Equivalent / Market Realizable Value) + Net Trade Receivables (gross receivables minus bad debt allowance).

Practical Numerical Accounting Problems Step-by-Step Solutions: Case Data: Amanah Islamic Bank purchases medical diagnostic equipment for ₹40,00,000 cash and leases it to Medicare Hospital under an Ijarah Muntahiya Bittamleek contract for a 4-year term on 1st January 2026: bull; Annual lease rental agreed: ₹13,00,000 payable at the end of each calendar year.

- **Case Data:** The Sum of marized balance sheet of Al-Hikmah Trading Corporation as on 31st December 2026 (Solar Accounting Year) reveals the following financial position:
- **Total Assets: ₹1,35,00,000:** Total Liabilities amp; Equity: ₹1,35,00,000

Comprehensive Calicut University Academic Examination Bank: Define Zakat as an institutionalized religious obligation designed to redistribute surplus wealth, eradicate poverty, prevent wealth hoarding (*Kanz*), and purify commercial enterprise.

- **Theoretical Foundation:** The method calculates the enterprise's net liquid and trade wealth that completed the Hawl, deducting current debts that must be settled out of that wealth: Zakat Base=Zakatable Assets−Deductible Liabilities
- **Zakatable Assets:** Cash and Bank Balances: All liquid funds, call deposits, and foreign currencies held at the balance sheet date.
- **Current Realizable Cash Equivalent Value:** Trade Merchandise Inventory: Raw materials, work-in-progress, and finished goods valued at (market selling price, not historical cost).
- **Net Trade Receivables:** Short-term customer debts due for collection, excluding doubtful debts.
- **Short-Term Marketable Securities:** Quoted equity shares and Sukuk held for short-term trading valued at fair market value.

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