

**Shari'ah Standard No. (47)**

**Rules for Calculating Profit in  
Financial Transactions**



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***IN THE NAME OF ALLAH, THE ALL-MERCIFUL, THE MOST MERCIFUL***  
All praise be to Allah, the Lord of all the worlds, and blessings and peace be upon our master, Muhammad, and his household and all his companions

## **Preface**

This Standard aims to explain the rules and methods of calculation and distribution of profits in financing or investment activities of Institutions.<sup>(1)</sup>

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(1) The word (Institution/Institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

## Statement of the Standard

### 1. Scope of the Standard

This Standard covers profit, its validity in Shari'ah and rules and methods of calculating and distributing it. It also explains who is entitled to profit earned from the financing and investment activities of the institutions. This Standard does not cover profit distribution in investment accounts because that is provided in a separate Standard.

### 2. Definition of Profit and Methods of Calculation

In the context of this Standard, Profit means the amount generated in excess of the original capital or of the cost in the operations of financing and investment activities. Calculation of profit refers to the methods used to determine the amount of profit in the institution's operations.

### 3. Permissible and Impermissible Profit

3/1 Permissible profit is that which results from a permissible transaction such as a sale, lease or partnership, in compliance with Shari'ah rules relating to contracts.

3/2 Impermissible profit is that which results from a prohibited transaction such as interest-based contracts, trade in forbidden commodities and/or invalid contracts.

### 4. Determining the Profit Rate in Transactions

4/1 There is no upper limit for profits, provided that the transaction is based on mutual consent, with due consideration for values of kindness, contentment and clemency.

4/2 In principle, it is impermissible for a regulator to cap profits. However, in monopoly situations, extraordinary circumstances and cases of clear public interest, it is permissible to fix the profit rate, provided it is not prejudicial.

## **5. Increasing the Profit Rate for Credit Sales over Cash Sales**

It is permissible to increase the profit in credit sales as compared to cash sales, provided that it is incorporated into the price and that the amount of debt is not increased due to any late payment.

## **6. Determining Profit in Amounts or Percentages**

6/1 The profit in a Murabahah contract may be stipulated as a fixed amount added to the cost price, or as a percentage of the cost price.

6/2 It is permissible to resort to a well-established benchmark/index mutually agreed upon between the parties in determining the profit during the undertaking stage (Wa'd) or when concluding the transaction. In all cases, the total price, the dates and amounts of the installments, if any, must be stipulated and must not vary with the movement of the benchmark/index. [see Shari'ah Standard No. (8) on Murabahah, item 4/6]

## **7. Setting Different Ratios or Rates for Profit Distribution in Mudarabah Financing**

7/1 In Mudarabah financing it is permissible to set different profit ratios or rates as per the different tenors of the Mudarabah. The different rates may also be triggered upon the profit of either party reaching a specified hurdle rate. In all cases, no party to a Mudarabah contract may be totally deprived of profit. [see Shari'ah Standard No. (13) on Mudarabah, item 8/5]

7/2 It is permissible for the capital provider to stipulate that the mudarib does not employ the funds in investment activities where the expected profit rate falls below a specific percentage, taking into consideration that it is not permissible to either guarantee the capital, or the profit or both. [see Shari'ah Standard No. (46) on Investment Agency]

## **8. Profit Distribution in Shari'ah-Compliant Deferred Transactions**

8/1 It is permissible to adopt customary accounting practices that are required by supervisory and/or regulatory bodies for calculating and distributing profit in deferred transactions across several financial

periods, provided they are in accordance with Shari'ah. Whenever possible, AAOIFI's Accounting Standards shall be adopted in this process.

8/2 When preparing their financial statements, institutions must avoid any methods of profit calculation or distribution that are misleading or deceptive.

9. **The Institution Must Disclose Its Method of Profit Calculation** and allow its clients to inquire about such methods. Likewise, it must disclose such methods when mentioning profit in its advertising campaigns and product marketing brochures in order to prevent any deception. In contracts, Institution must disclose the total price or the cost price and the profit, either as a lump sum or as a percentage of the cost price. Where profit rate is time-bound, it is impermissible to re-schedule debt obligations through increasing the profit and/or total amount by extending the duration.
10. **It Is Permissible to Adopt Shari'ah-Ccompliant Customary Accounting Practices to Calculate Profit** based on the length of the financing period such as a calculation method that determines profit for the entire period on the basis of an annualised percentage of the total amount of financing provided or a calculation method that determines profit on the basis of an annualised percentage of the amount of financing outstanding according to an amortised payment schedule, provided that it does so transparently and with full disclosure and that the total sale price is stated as a fixed amount.
11. **It Is Permissible for the Institution to Grant Its Client a Rebate for Early Payment** provided that this rebate was not stipulated in the contract, taking into consideration regulatory directives.
12. **Contractual Relationship Between the Institution and Its Client Is Not Affected by the Method Adopted in Booking Its Profits** in its internal records, as in separating the profit account from the expense account. Institutions should regularly upgrade their systems and computer software in order to be consistent with Shari'ah standards and rulings.



### **13. Date of Issuance of the Standard**

This Standard was issued on 26 Jumada II, 1432 A.H., corresponding to 29 May 2011 A.D.

## **Adoption of the Standard**

The Shari'ah Board adopted this Standard in its meeting No. (30) held in the Kingdom of Bahrain during the period of 24-26 Jumada II, 1432 A.H., corresponding to 27-29 May 2011 A.D.

## **Appendix (A)**

### **Brief History of the Preparation of the Standard**

On 14 Rabi' I, 1429 A.H., corresponding to 20 April 2008 A.D., the General Secretariat decided to commission a Shari'ah consultant to prepare a juristic study on Calculating Profit in Financial Transactions.

In its meeting held in Kuwait, on 24 Ramadan 1431 A.H., corresponding to 28 January 2010 A.D., the Shari'ah Standards Committee discussed the draft of a Shari'ah Standard on Calculating Profit in Financial Transactions and made necessary amendments.

The revised draft of the Shari'ah Standard was presented to the Shari'ah Board in its 28th meeting held in the Kingdom of Bahrain, during the period of 12-14 Dhul-Qadah 1431 A.H., corresponding to 20-22 October 2010 A.D. The amendments that were deemed appropriate were included.

The General Secretariat held a public hearing in the Kingdom of Bahrain, on 25 Jumada II, 1432 A.H., corresponding to 28 May 2011 A.D. All the comments made in the public hearing were listened to, and a representative of the Shari'ah Board answered these comments and made commentary on them.

In its meeting No. (30) held in the Kingdom of Bahrain, during the period of 24-26 Jumada II, 1432 A.H., corresponding to 27-29 May 2011 A.D., the Shari'ah Board discussed the amendments proposed by the participants in the public hearing and incorporated the amendments that it deemed appropriate, and adopted the Standard.

In its meeting held in Al-Madinah Al-Munawwarah, on 30 Sha'ban 1436 A.H., corresponding to 17 June 2015 A.D., the Shari'ah Standards Review Committee reviewed this Standard. After deliberation, the committee approved necessary amendments, and the Standard was adopted in its current amended version.

## Appendix (B)

### The Shari'ah Basis for the Standard

- The basis for not stipulating a maximum profit limit is the Quranic Verse: ***{“...except it be a trade amongst you, by mutual consent”}***.<sup>(2)</sup> This ruling is also confirmed by Resolution No. (46) 5/8 of the Islamic Fiqh Academy, which states: “There is no fixed specific profit rate that traders are bound by.”
- The basis for the permissibility of increased profit/price in a deferred/credit sale is the Quranic Verse: ***{“Allah has permitted sale”}***<sup>(3)</sup> as referring to the deferred sale in order for the comparison between it and interest, which also involves an increase, to be valid. Accounting Standard No. (20) has been issued on deferred sales.
- The basis for the permissibility of using different rates in Mudarabah transactions is because such a provision does not disrupt the sharing of profits by all parties.



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(2) [Al-Nisa' (The Women): 29].

(3) [Al-Baqarah (The Cow): 275]