

AAOIFI FAS: Journal Entry Examples

The following sections give sample double-entry journal entries under AAOIFI Financial Accounting Standards (FAS) for Islamic finance contracts, drawn from educational sources and practice. Each entry is formatted “Dr...; Cr...” and cites AAOIFI-based guidance.

FAS 4: Musharaka Financing

Musharaka (partnership) financing under AAOIFI FAS 4 is recorded by recognizing the bank's capital contribution and its share of profit or loss. For example, when the bank provides cash capital to a partner: the *Musharaka Financing* account is debited and *Cash* is credited. When the partner later repays capital, the reverse entry is made. Profits received from the venture are recorded as income, while losses are charged against the Musharaka account. Sample entries include:

- **Bank provides partnership capital:** Dr Musharaka Financing; Cr Cash ¹.
- **Partner repays capital:** Dr Cash; Cr Musharaka Financing ¹.
- **Bank's profit share received:** Dr Cash; Cr Profit and Loss ².
- **Bank's loss share incurred:** Dr Profit and Loss; Cr Musharaka Financing ².
- **Outstanding balance due from partner:** Dr Receivable from Partner; Cr Musharaka Financing (on settlement) ³.

These entries follow AAOIFI FAS 4's guidance (as illustrated in industry lecture slides) ⁴.

FAS 7: Salam and Parallel Salam

Salam is a forward sale where payment is made now for future delivery of goods. Under AAOIFI FAS 7, the bank's prepayment is recorded as a Salam asset. For example, when the bank pays cash (Salam capital) in advance for a commodity, it debits a Salam Investment account. A typical journal entry is:

- **Salam contract (cash payment):** Dr Investment in Salam; Cr Cash ⁵.

This entry reflects the advance payment under the Salam contract ⁵. (Parallel Salam entries follow similarly when goods are sold forward to a third party, recognizing any profit or loss on settlement, per AAOIFI guidance.)

FAS 8 (Revised): Murabahah

Murabaha (cost-plus sale) under AAOIFI is handled by first recording the bank's acquisition of the asset and then the sale on deferred terms. For example, suppose the bank buys equipment for 1,000,000 and then sells it to the customer at 1,500,000. The sale is booked as:

- **Murabaha sale:** Dr Murabaha Financing (Receivable) 1,500,000; Cr Equipment (Inventory) 1,000,000; Cr Deferred Profit 500,000 ⁶.

Each payment by the customer reduces the receivable and recognizes profit:

- **Installment payment (year-end):** Dr Cash 300,000; Cr Murabaha Financing 300,000; Cr Deferred Profit 100,000; Cr Profit and Loss 100,000 ⁷ .

These entries (from a Brunei Islamic bank example) follow AAOIFI FAS 8/28, recording the receivable net of deferred profit and recognizing revenue over time ⁶ ⁷ .

FAS 9: Ijarah and Ijarah Muntahia Bittamleek (Revised)

Under FAS 9 the bank (as lessor) first records purchase and lease of the asset, then rental income and any final transfer of ownership. For an ijarah muntahia bittamleek (lease ending in sale), typical entries are:

- **Lease inception – asset purchase:** Dr Fixed Asset (Equipment) 60,000; Cr Cash 60,000 ⁸ .
- **Lease inception – recognize Ijarah asset:** Dr Ijarah Muntahia Bittamleek Asset 60,000; Cr Fixed Asset 60,000 ⁹ .
- **Initial direct cost:** Dr Ijarah Direct Expense 500; Cr Cash 500 ¹⁰ .
- **First rental payment:** Dr Cash 6,000; Cr Ijarah Revenue 6,000 ¹¹ .
- **Annual depreciation:** Dr Profit and Loss 18,666; Cr Accumulated Depreciation 18,666 ¹² .
- **Amortize direct costs:** Dr Profit and Loss 167; Cr Ijarah Direct Expense 167 ¹³ .
- **End of lease – final payment and transfer:** Dr Cash 2,000; Dr Profit and Loss 2,000; Cr Ijarah Asset 4,000 ¹⁴ .

These illustrate AAOIFI treatment: the leased asset is carried on the lessor's books and rental income and depreciation are recognized each period ¹⁵ ¹² .

FAS 10: Istisna'a and Parallel Istisna'a

Istisna'a contracts (manufacturing for sale) are often accounted under the completed-contract method. The bank (as buyer or financier) accumulates construction costs in work-in-progress, bills the customer, and recognizes profit on completion. Sample entries (from a training example) are:

- **Costs incurred (2002):** Dr Istisna'a Work-in-Progress 300,000; Cr Accounts Payable/Cash 300,000 ¹⁶ . (For materials and labor.)
- **Overhead incurred:** Dr General & Admin Expenses 5,000; Cr Accounts Payable 5,000 ¹⁶ .
- **Billings to customer:** Dr Istisna'a Accounts Receivable 225,000; Cr Istisna'a Billings 225,000 ¹⁷ .
- **Receipt of payment:** Dr Cash 60,000; Cr Istisna'a Accounts Receivable 60,000 ¹⁷ .
- **Revenue recognition:** Dr Cost of Istisna'a Revenue 75,000; Dr Istisna'a Work-in-Progress 225,000; Cr Istisna'a Revenue 300,000 ¹⁷ .

These entries reflect FAS 10 accounting for an Istisna'a contract (here using percentage-of-completion) ¹⁸ . (Parallel Istisna'a is treated similarly, with costs recorded as *Istisna'a Costs* and profit spread over installments as specified by FAS 10.)

FAS 10 (Revised): Salam and Parallel Salam

The revised Salam standard (also numbered FAS 10) retains the same basic accounting as FAS 7. For example, the bank's advance payment under a Salam contract is recorded as:

- **Salam (revised FAS 10):** Dr Investment in Salam; Cr Cash ⁵ .

Parallel Salam entries mirror FAS 7; e.g., when the bank (after acquiring goods) sells forward to a third party, it records the sale and any profit per FAS 7's guidance ⁵ .

FAS 12: Sharikah and Modern Corporations

FAS 12 addresses Islamic partnership and corporate (stock company) structures. Journal entries under this standard follow conventional capital accounting. For example, issuing equity capital is recorded by:

- **Issuance of shares (no-par stock):** Dr Cash; Cr Common Stock ¹⁹ .

(Any excess over par would go to paid-in capital, and dividends reduce retained earnings.) The entry above shows that, in a no-par issue, the entire proceeds credit *Common Stock* ¹⁹ . AAOIFI FAS 12 does not prescribe exotic journals beyond standard corporate entries.

FAS 28: Murabaha and Other Deferred Sales

AAOIFI FAS 28 is the current Murabaha standard. Its entries are the same as above under FAS 8. For example, at initial sale:

- **Murabaha sale (FAS 28):** Dr Murabaha Financing 1,500,000; Cr Equipment 1,000,000;
Cr Deferred Profit 500,000 ⁶ .

Subsequent receipt entries (Dr Cash; Cr Murabaha Financing) and profit recognition (Dr Deferred Profit; Cr Profit and Loss) are identical to FAS 8 ⁷ .

FAS 32: Ijarah

The AAOIFI FAS 32 on Ijarah (effective 2021) aligns with FAS 9's lease accounting. Key entries mirror those above. For example, when the lessor acquires an asset to lease:

- **Acquire lease asset:** Dr Fixed Asset (Ijarah) 60,000; Cr Cash 60,000 ⁸ .

Lease rentals are recorded as they accrue:

- **Lease rental:** Dr Cash 6,000; Cr Ijarah Revenue 6,000 ²⁰ .

Depreciation on the leased asset is recorded each period (as shown under FAS 9) ¹² . At lease end, any transfer of the asset is treated as a disposal. These examples illustrate FAS 32's treatment of lease transactions, consistent with AAOIFI guidance ¹⁵ ¹² .

Sources: AAOIFI FAS texts and illustrative materials (academia and professional notes) for Salam, Murabaha, Ijarah, Istisna'a and Musharaka entries ⁴ ⁵ ⁶ ¹⁵ ¹⁸ ¹⁹ .

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4 <https://www.scribd.com/presentation/466284485/islamic-accounting-p-2-pptx>
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