

Journal Entries for AAOIFI Financial Accounting Standards

This guide summarizes the typical journal entries for Islamic-finance transactions under the current AAOIFI FAS. Each section follows the transaction lifecycle (initial recognition, revenue/profit recognition, periodic accounting, and settlement/termination) and uses generic account names (e.g. *Musharaka Investment*, *Salam Receivable*, *Deferred Profit*). Citations to AAOIFI guidance and examples are provided.

FAS 4: Musharaka Financing

Concept: A Musharaka is a joint-venture partnership. The bank contributes capital (cash or kind) and shares profit and loss with partners according to a pre-agreed ratio ¹ ².

- **Initial Recognition:** Record the bank's capital contribution.
 - *If cash:*
Dr Musharaka Investment A/c (cash contributed)
Cr Bank/Cash (payment of capital) ¹.
 - *If non-cash asset:*
Dr Musharaka Investment A/c (fair value of asset)
Cr Noncash Asset A/c (e.g. Inventory/Fixed Asset)
Cr Gain on Disposal of Asset (if asset's book value is lower than fair value) ³.
- **Profit Sharing:** When profits are earned and distributed:
Dr Bank/Cash (dividend/cash received)
Cr Musharaka Income (share of profit).
If profits are declared but not yet paid:
Dr Musharaka Income Receivable
Cr Musharaka Income (recognize accrued profit).
- **Loss Sharing:** If losses occur:
Dr Musharaka Loss (or *Impairment Loss*)
Cr Musharaka Investment A/c (reduce capital) ².
(If losses exceed the bank's capital, the excess is a receivable from the partner.)
- **Periodic Entries:** There are generally no periodic accruals beyond profit/loss events. The investment remains at historical cost except for adjustments above.
- **Settlement/Termination:** Upon liquidation or buy-out:
 - If the partner repays/buys out the bank's share:
Dr Bank/Cash (proceeds received)
Cr Musharaka Investment A/c (derecognize investment)
Cr/Dr Musharaka Income/Loss (for any gain or loss on sale of the investment).
 - If the partner fails to pay and bank's share remains receivable:
Dr Receivable from Partner
Cr Musharaka Investment A/c (bank replaces its capital asset with a receivable).

FAS 7: Salam and Parallel Salam

Concept: In a Salam contract, the bank (buyer) pays cash in advance for goods delivered later. In a *parallel Salam*, the bank immediately sells (typically the same) goods to a third party. AAOIFI requires recognizing the advance payment as an asset and deferring profit until delivery ⁴ ⁵.

- **Initial Recognition (Advance Payment):** When payment (or equivalent asset transfer) is made under Salam:

- *Cash payment:*

Dr Investment in Salam (Salam Receivable)

Cr Bank/Cash (advance paid) ⁶.

- *In-kind payment (e.g. a machine or goods):*

Dr Investment in Salam (fair value of asset given)

Cr Asset Contributed (e.g. *Fixed Asset* at book value)

Cr Gain on Sale of Asset (for difference between fair value and book value) ⁷.

- **Deferred Period:** No further entries until delivery. If applicable, the Salam asset is carried at cost unless evidence of permanent impairment appears (e.g. commodity value fall – adjust to net realizable value).

- **Revenue Recognition (Delivery):** When the Salam commodity is delivered (by the farmer) to the bank, and simultaneously the bank delivers to the customer under the parallel Salam, record:

Dr Cash/Receivable from Parallel Buyer (sale proceeds)

Cr Salam Receivable (remove the original Salam asset)

Cr Profit on Parallel Salam (the difference as profit) ⁴.

Example: Bank paid \$150M for wheat and sold it for \$160M; it would debit cash \$160M, credit Salam Receivable \$150M and credit Salam Profit \$10M.

- **Settlement/Termination:** After delivery, the bank has no remaining Salam asset. If there are shortfalls or disputes (e.g. lower grade commodity), losses are charged to profit (per AAOIFI guidelines). Any final adjustments are made at settlement.

FAS 8: Murabahah (Revised Standard)

Concept: In a Murabaha sale, the bank buys an asset and immediately sells it to a customer at a marked-up price, with deferred payment. Profit is recognized over time. (Note: FAS 28 is the current Murabaha standard, superseding earlier guidance.)

- **Initial Recognition (Purchase):** When the bank buys the asset:

Dr Murabaha Inventory (at cost price)

Cr Bank/Cash ⁸.

- **Sale to Customer:** At the point of sale under Murabaha (for the total price):

Dr Murabaha Receivable (customer's total payable amount)

Cr Sales Revenue (cost portion of sale price) ⁹

Cr Deferred Profit (Unearned Income) (the markup portion) ⁹.

At the same time:

Dr Cost of Sales (cost of the asset)

Cr Murabaha Inventory (remove inventory) ¹⁰.

- **Deferred Profit Amortization (Periodic):** Over the payment term (typically using the effective-profit-rate method), recognize profit:

Each period (e.g. year)

Dr Deferred Profit (amortize portion of markup)

Cr Profit from Murabaha (Income) ¹¹.

Simultaneously, as instalments arrive:

Dr Bank/Cash (instalment received)
Cr Murabaha Receivable (customer liability reduced) ¹¹ .

(See Table 8 for an example of annual profit amortization.)

- **Unrealized Profit:** If any profit is earned but not yet due or received by period end, it remains in Deferred Profit.
- **Settlement:** Upon final payment: same as above (receipt of cash, reduction of receivable, full amortization). The Murabaha Receivable balance should be zero once all payments and profit amortization are complete.

FAS 9 & FAS 32: Ijarah and Ijarah Muntahia Bittamleek

Concept: In an Ijarah (lease), the bank (lessor) acquires an asset and leases it to a customer. The bank recognizes rental income over the lease term. *Ijarah Muntahia Bittamleek* includes a transfer of ownership at lease-end. FAS 32 (2019) supersedes earlier Ijarah standards.

- **Initial Recognition (Lease Asset):** When the bank acquires the asset for leasing:

Dr Ijarah Asset (cost of the leased asset)
Cr Bank/Cash (payment made).

(If the asset is sold-and-leased-back or donated, record accordingly.)

- **Depreciation:** Record periodic depreciation of the leased asset:

Dr Depreciation Expense
Cr Accumulated Depreciation - Ijarah Asset .

- **Lease Revenue (Periodic):** Rental income is recognized on an accrual basis over each period (often on a straight-line or effective rate basis). For each period:

Dr Ijarah Receivable (or *Unearned Ijarah Income*)
Cr Ijarah Rental Income ¹² .

When the cash rent is received:

Dr Bank/Cash
Cr Ijarah Receivable ¹³ .

- **Lease Assets at Termination:**

- For operating leases (no ownership transfer), when the lease ends, the asset remains on the bank's books (and may be re-leased or sold).
- For Ijarah MMB (ownership transfer lease), upon transfer: derecognize the asset. Example entries:

Dr Bank/Cash (final payment or transfer consideration)
Cr Ijarah Receivable (if any receivable remained)

PLUS

Dr Accumulated Depreciation - Ijarah Asset (clear depreciation)
Cr Ijarah Asset (remove asset)
Cr/Dr Gain or Loss on Sale of Asset (difference, if any).

FAS 10: Istisna'a and Parallel Istisna'a

Concept: An Istisna'a contract is a manufacturing contract: the bank commissions (or finances) the construction/manufacture of an asset for a buyer, with payment deferred. *Parallel Istisna'a* means the

bank arranges both purchase and sale contracts. Accounting is similar to construction contracts under AAOIFI guidance.

- **Initial Recognition:** Typically, no entry at contract signing unless there is an initial deposit. If the bank pays advance to a manufacturer:

Dr Istisna'a Asset (WIP Inventory) (for payments or costs)

Cr Bank/Cash .

- **Work-in-Progress (Costs):** As costs are incurred on the project:

Dr Istisna'a Work-in-Progress (accumulated costs)

Cr Bank/Cash or Accounts Payable ¹⁴ .

- **Revenue Recognition:** Using percentage-of-completion or completed-contract methods, recognize revenue. Under percentage-of-completion:

Dr Istisna'a Work-in-Progress (for recognized profit portion)

Dr Cost of Istisna'a Revenue

Cr Istisna'a Revenue (Income) ¹⁵ .

- **Billing and Collections:** As billing occurs:

Dr Istisna'a Accounts Receivable

Cr Istisna'a Billings (liability) ¹⁶ .

When cash is received:

Dr Bank/Cash

Cr Istisna'a Accounts Receivable ¹⁶ .

- **Settlement (Delivery):** On final delivery of the manufactured asset:

Dr Istisna'a Accounts Receivable (total contract price)

Cr Istisna'a Revenue (remaining revenue)

Cr Istisna'a Work-in-Progress (remove accumulated cost)

Cr/Dr Inventory/Asset (if transferred) and

Cr/Dr Profit/Loss on Istisna'a (any residual profit or loss).

(This mirrors Murabaha/Salam sale accounting once the asset is handed over.)

FAS 12: Sharikah and Modern Corporations (Revised Standard)

Concept: *Sharikah* broadly refers to joint ventures or partnerships (including corporate shareholdings) where profits and losses are shared. (This AAOIFI standard covers accounting for such equity-type participations.) The treatment is analogous to Musharaka: the bank's share of joint-venture capital is recorded, and its share of profit or loss is recognized in income.

- **Initial Recognition:** Record contribution to the partnership or corporate investment:

Dr Sharikah Investment A/c (capital or share value)

Cr Bank/Cash .

(If acquiring shares, use *Investments – Associates* or similar.)

- **Profit and Loss Sharing:** When the joint venture earns profits or losses:

Dr Bank/Cash (cash dividend) or Dr Profit Receivable (if not yet distributed)

Cr Sharikah Income (the bank's share of profit).

If losses are allocated:

Dr Sharikah Loss (P/L)

Cr Sharikah Investment A/c .

- **Equity Method (if applicable):** If shareholding is substantial, the bank may use equity accounting: record "Investment in Associate" at cost and adjust for share of retained earnings.

- **Settlement/Realization:** On realization (e.g. sale of the share or winding up):

Dr Bank/Cash (sale proceeds)

Cr Sharikah Investment A/c
Cr/Dr Gain or Loss on Sale of Investment.

FAS 28: Murabaha and Other Deferred Payment Sales

This supersedes earlier Murabaha standards (including FAS 8). The entries are essentially the same as above under FAS 8. For completeness:

- **Initial Purchase:** Dr Murabaha Inventory, Cr Bank/Cash.
- **Sale on Murabaha:** Dr Murabaha Receivable, Cr Sales Revenue; and Cr Deferred Profit (Unearned Income), plus Dr Cost of Sales, Cr Inventory as in FAS 8⁸.
- **Profit Amortization:** Periodic amortization of markup: Dr Deferred Profit, Cr Income.
- **Receipts:** Dr Bank/Cash, Cr Murabaha Receivable.

FAS 32: Ijarah

AAOIFI FAS 32 (2019) on Ijarah (leasing) aligns closely with the above FAS 9 entries. In summary:

- **Asset Recognition:** Dr Ijarah Asset, Cr Cash when leasing asset is acquired.
- **Lease Revenue Recognition:** As described under FAS 9 (see above), accrual of rent: Dr Ijarah Receivable, Cr Ijarah Income¹²; on receipt: Dr Cash, Cr Receivable¹³.
- **Depreciation:** Same as FAS 9: debit depreciation, credit accumulated depreciation each period.
- **Termination:** On lease end, derecognize asset and related accumulations, similar to FAS 9 above.

Sources: AAOIFI standards and literature provide detailed guidance on each contract. For example, AAOIFI FAS 28 on Murabaha specifies recording Murabaha receivables at face value and amortizing profit on a time-proportionate basis¹⁸. AAOIFI guidance also confirms recording Salam advances as an asset and recognizing profit on delivery⁴. The journal entry examples above are adapted from standard sources and illustrative literature⁸¹⁷⁴¹⁴¹⁶.

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- 1 **AAOIFI's CIPA Course Material - Prepared & Presented by Yasir Waseem | PPT**
<https://www.slideshare.net/slideshow/aaofis-cipa-course-material-prepared-presented-by-yasir-waseem/108705497>
 - 2 **Agenda: Accounting For Musharaka Financing | PDF | Historical Cost | Islamic Banking**
 - 3 **And Finance**
<https://www.scribd.com/presentation/580028428/04-Mushraka>
 - 4 5 6 **(PDF) Salam Accounting**
7 https://www.researchgate.net/publication/273939033_Salam_Accounting
 - 8 9 10 **An Overview of Islamic Accounting: The Murabaha Contract**
11 17 18 <https://www.mdpi.com/1911-8074/16/7/335>
 - 12 13 **Accounting for Sharia Lectures | PDF | Islamic Banking And Finance | Balance Sheet**
<https://www.scribd.com/document/850665210/Accounting-for-Sharia-Lectures>
 - 14 15 16 **Accounting For Istisna | PDF | Islamic Banking And Finance | Revenue**
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