



The Adaptation of the AAOIFI Shariah Standard *Sharikah (Musharaka)* and Modern Corporations in the Islamic Finance Industry of Pakistan: A Qualitative Study

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ABSTRACT - This research article examines the amendments introduced by the State Bank of Pakistan (SBP) in the adaptation of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) Shariah standards, with particular emphasis on conflicting clauses. It incorporates insights from stakeholder interviews to assess the implications for Pakistan's Islamic banking industry. A key area of analysis is the adaptation of the AAOIFI standard on *Sharikah (Musharaka)* and its application to modern corporations. The findings reveal significant discrepancies in profit and loss sharing (PLS) arrangements, capital guarantees, management structures and Shariah governance mechanisms. Overall, the study highlights the complexities involved in aligning Shariah-compliant financial products with modern regulatory frameworks. Notably, SBP has amended 12 out of 98 clauses, reflecting an 8.16% deviation from the original standards. The research ultimately underscores the inherent challenges in integrating Shariah principles into a contemporary financial regulation, where practical adaptations may conflict with traditional Islamic finance principles.

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INTRODUCTION

Pakistan began Islamising its economy in the 1970s (Shafiq, 2012) where President General Zia-ul-Haq collaborated with the Islamic Ideology Council (CII) to develop a *riba*-free economy. After examining the transactions, the council requested that the government halt them due to their interest-based nature. It encouraged the government to create a board of economists, Islamic jurists and legal specialists to assist in developing an Islamic financial system (Mansoori & Ayub, 2022).

In 1977, an advisory group investigated contemporary financial practices and their restoration (Ayub, 2021). The 1980 study, "The Study on the Elimination of *Riba* from the Economy," aimed to create the groundwork for Pakistan's Islamic banking and financial operations. Prepared by top Shariah and economic specialists, it addressed all aspects of establishing an interest-free economy, contributing to its Islamisation (Tlemsani et al., 2020).

Between 1979 and 1992, the Pakistani government implemented banking projects, including interest-free transactions introduced by businesses like the National Investment Trust, House Building Finance Corporation and Investment Corporation of Pakistan (Zafar & Sulaiman,

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2020). In 1980, Mudarabah companies were established and Zakat regulations mandated interest-free counters for national banks (Cheema, 2019).

Further, in 1984, the SBP published a circular identifying 12 financing methods and categorising them into three groups (SBP, 1984). SBP decided to eliminate interest rates from the current economic system and ordered banks to meet their demands. Customers with interest-based deposits were instructed to transfer their accounts to profit and loss sharing (PLS) accounts or withdraw funds by July 1985 (Marwat et al., 1992).

The Islamic banking practices in Pakistan faced criticism and protests after the 1980s. In 1991, the Federal Shariat Court (FSC) ordered the abolition of interest-based banking procedures in Pakistan (Khan, 2008). The government faced pressure from various sectors to implement FSC documents. However, some individuals opposed the decision, arguing it would leave Pakistan's economy behind and hinder its ability to compete with the global economy. They suggested the government appeal against the FSC's decision (Syed & Anwer, 1991).

The government promised religious revelries not to file a petition before the Supreme Court; however, financial organisations proceeded to do so. Due to insufficient quorum, the Supreme Court could not hear interest petitions, forcing the administration and economic institutions to deal with *riba*. In 1991, the administration formed the Commission for Islamisation of Economy to reorganise Pakistan's fiscal and monetary sectors in accordance to Islamic law (Mehmood, 2002). The FSC recently issued another ruling, giving the nation's economy until 2027 to become Shariah-compliant (FSC, 2022).

In 2002, the SBP approved the dual banking system and began issuing licenses to Islamic banks to transform the financial industry into Shariah-compliant. In 2003, a policy was issued to support growth of Islamic banking and finance in Pakistan (SBP, 2003). In 2004, recommendations and agreements for Islamic finance were issued. In 2005, the standards for Islamic funding were significantly extended (SBP, 2004). In 2008, the SBP presented its Shariah standards, developing rules for financing forms and definitions (SBP, 2008). In 2010, the SBP began adapting the Shariah standards of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) to integrate and streamline Shariah practice in Pakistan (SBP, 2010).

This research article critically reviews and analyses the nature of changes and amendments made by SBP to adapt Shariah standards in Pakistan. It highlights conflicting clauses with AAOIFI Shariah standards and incorporates interviewees' remarks and suggestions. This article provides an in-depth understanding of these changes' impact on Pakistan's Islamic banking industry.

LITERATURE REVIEW

AAOIFI is an Islamic non-profit organisation founded in 1991 that develops Shariah, governance, accounting, auditing and ethics standards for Islamic monetary organisations. It offers professional qualification programs to improve governance and human resources in the sector. AAOIFI issued 121 Shariah standards, 36 financial accounting standards, eight auditing standards, 15 governance standards and 1 code of ethics (AAOIFI, 2023). With 200 members, including Islamic financial institutions and central banks from 45 countries, AAOIFI promotes Islam by developing accounting guidelines for Islamic investment vehicles, holding public events and offering ethical, accounting and auditing guidelines.

The AAOIFI Shariah Standard on *Sharikah (Musharaka)* was initially published in 2003 (AAOIFI, 2010). It was later amended to better reflect the changing demands of Islamic finance and integrate comments from practitioners and academics. The most recent amendment was made in 2015 (AAOIFI, 2023). The standard assures that *Musharaka* arrangements are consistent with Islamic principles, including capital contribution, management, risk sharing and transparency, while also addressing how these concepts may be applied to modern corporate structures and processes.

***Musharakah*: Definition**

Musharakah is derived from the Arabic term *sharaka*, which means to share and combine the shares of numerous parties to be interchangeable. The word *Musharakah*, one of the most fundamental contracts in Islamic finance, does not signify partnership in traditional Islamic literature despite its proper linguistic origin (Yustiardi et al., 2020).

Furthermore, *Musharakah*, which means sharing, refers to a joint venture in finance, commerce and business in which all partners contribute investment capital, labour, management and knowledge while sharing the company's profit and loss (Widarjono, 2021). It is widely used in Islamic banking, but "*shirkah*" is utilised in Islamic jurisprudence. These phrases are equivalent and represent relationship principles. *Musharakah* is appropriate for investments in commercial enterprises and projects and is an effective financing vehicle in Islamic finance (Farooq & Ahmed, 2013).

***Musharakah*: Classification**

Shirkahs are divided into two types: *shirkah al-milk* (shared ownership) and *shirkah al-'Aqd* (contract partners). According to the parties' preferences, *Shirkah al-milk* may be voluntary or mandatory (Ali et al., 2022). *Shirkat-al-Aqd* is a contractual partnership that may be viewed as a joint business entity. *Shirkat-ul-Ammal*, in which partners spend funds in a commercial company; *Shirkat-ul-A'mal*, in which all partners jointly provide services; and *Shirkat-ul-Wujooh*, in which partners acquire goods at a delayed price and sell them on the spot. These shirkas can be employed in various scenarios, such as children co-owning a firm or other capital following a parent's death (Ahroum et al., 2020).

***Musharakah*: The Basic Rules**

According to Usmani (2000), the contract in Shariah requires a mutually agreed-upon profit distribution ratio for partners. This ratio should be based on actual business profit, not capital invested. No lump sums or profit rates tied to investment are allowed. The contract is invalid without this agreement (Kulmie, 2024).

Moreover, as per the guidelines of SBP (2013), "All partners of *Sharikah* shall be deemed to be trustees in respect of *Sharikah* assets; however, as trustees, they shall be jointly and severally liable for misconduct, negligence, or breach of contract." AAOIFI has a different stance on this issue. As per the rulings, *Sharikah* contracts maintain assets on a trust basis, with no liability except for misconduct, negligence, or breach of contract. Partners cannot guarantee another partner's capital (AAOIFI, 2023; Elhalaby et al., 2023). The stance of AAOIFI is derived from the sunnah of the Holy Prophet SAW. Prophet Muhammad stated that partners in financial agreements are responsible for managing assets and must return them in the agreed manner. Partners are liable for any resulting loss if negligence causes failure in this duty. Moreover, Islamic jurists generally agree that if one partner is negligent or causes harm to a partnership, they are liable for the loss, as part of the broader concept of "Daman" in Islamic law (Quraishi & Kamali, 2000).

Furthermore, in *Musharakah*, profit allocation between partners is only allowed after calculating operating costs, expenses and taxes and maintaining *Sharikah*'s capital (AAOIFI, 2023). However, as per the modifications of SBP, Islamic Banking Institutions (IBIs) can distribute profits on a gross or net basis, ensuring equity, justice and transparency (SBP, 2013). According to the classical *fiqh* literature, the Hanafi, Maliki, Shafi'i and Hanbali *Fiqh* all emphasise the importance of maintaining capital and deducting expenses before profit distribution. Key texts like "Al-Hidayah" and "*Al-Kafi fi Fiqh Abl al-Madina*" emphasise the need to account for business expenses before profit distribution. Shafi'i *Fiqh*'s "*Mughni al-Mubtaji*" emphasises preserving partnership capital and deducting expenses before distributing profits. Ibn Qudamah's "*Al-Mughni*" also emphasises the preservation of capital and expense deduction before profit distribution (Auda, 2008).

Moreover, the AAOIFI clause emphasises issuing new shares at fair value, consistent with Shariah values of equity and justice AAOIFI (2023). This guarantees that all shareholders are

treated fairly, with no one profiting at the expense of another. The SBP's permission to issue shares below market value can still be consistent with Shariah principles if it is carried out honestly and does not cause any injustice or injury to parties of the contract (*ẓulm*). However, vigilance must be exercised to avoid circumstances in which current owners who cannot afford to purchase more shares at the discounted price are unfairly disadvantaged (Altameemi & Al-Slehat, 2022).

Islamic law prohibits *gharar* (excessive uncertainty) and deception in transactions (Yan Hao et al., 2022). Issuing new shares at a fair value ensures no deception or unfair advantage, aligning with the prohibition of *gharar*. Prophet Muhammad (ﷺ) said, "He who deceives is not of us." This safeguards new and existing shareholders from potential deception. Usmani (2000), an Islamic scholar, emphasises the importance of issuing shares at a fair value to prevent injustice and ensure equity among shareholders, asserting that any premium or discount should be based on market conditions and the company's intrinsic value.

METHODOLOGY

In line with the objective of this study—to explore and analyse the changes and deviations introduced by the SBP in adapting the AAOIFI Shariah standard on *Sharikah (Musharaka)* and Modern Corporations—two key aspects were examined: (i) the nature of the changes and (ii), their implications. To this end, in-depth interviews were conducted. The interview questions focused specifically on the nature of the SBP's modifications to the AAOIFI-adapted Shariah. Respondents were presented with both the original AAOIFI clauses and the corresponding amended clauses by the SBP. Their views were solicited on each pair of clauses to assess the perceived rational and implications of the changes:

1. If changing is just clarifying, is it a general clarification or a further extension of the AAOIFI clause?
2. On the other hand, if the changes are about amendments to AAOIFI clauses, what is the potential reason behind these amendments?
3. If the potential reason is to meet the requirements of the local industry, then due to this amendment, is there any contradiction through the general values of Islamic finance or not and what is his/her opinion on it?

The respondents of this study comprised Shariah scholars, including Shariah advisors, Shariah auditors, Shariah managers and Shariah compliance officers. A Shariah scholar is defined as an individual who qualifies Shahadtul Almiyya, Master in Shariah or Islamic jurisprudence or Usul al-Din (SBP, 2018). In addition, the respondents held AAOIFI certifications—specifically Certified Shariah Advisors and Auditors—and possessed a minimum of five years of professional experience in Islamic financial institutions.

Shariah scholars were included because they are directly involved in the implementation, advisory and oversight of Shariah standards within Islamic financial institutions. As such, they represent the most relevant and informed respondents for the purpose of this research. In line with the recommendations of previous studies (Doll, 2017; Dworkin, 2012; Hennink & Kaiser, 2022; Marshall et al., 2013; Sandelowski, 1995) five interviews were conducted, focusing on the 12 clauses that were amended or modified by the SBP.

Interviews were conducted both in person and online (via Zoom), depending on the respondents' convenience, in order to adhere to the interview protocol. With the respondents' consent, all interviews were recorded to ensure the accuracy and reliability of the responses. The recordings were subsequently transcribed and translated to English. The arguments and analysis presented in this research were developed in consideration of the insights obtained from these interviews.

RESULT

SS 12: *Sharikah (Musharaka)* and Modern Corporations

The SBP has made specific amendments and clarifications to AAOIFI Shariah Standard No. 12, which deals with *Sharikah (Musharaka)* and Modern Corporations. The total number of clauses in the AAOIFI Shariah standard *Sharikah (Musharaka)* and Modern Corporations is 98, but SBP clarified 11 Clauses of the AAOIFI Shariah standard. SBP has provided further clarification regarding the amended clauses in the context of the local environment.

Scope of the Standard (AAOIFI Clause)

“This standard applies to all forms of traditional *fiqh*-nominated partnerships based on *Sharikah al-aqd* (contractual partnership), except the partnerships explicitly excluded by this standard as indicated below. The standard also applies to all modern forms of partnerships, including diminishing *Musharakah*. The standard does not apply to ownership partnerships where the parties jointly own an asset. It does not include rules for *Sharikat al-mufawada* because the practical application of this form of partnership is rare and if need be, reference should be made to *fiqh* books. The standard does not apply to Mudarabah because this form of partnership has a separate standard. Similarly, it does not apply to sharecropping partnerships, such as irrigation and agricultural partnerships. The standard does not deal, as far as modern partnerships are concerned, with regulatory policies and procedures necessary for operations in the market.”

Clarification/amendment by SBP

The following is added as a footnote to this para: “The Standard would not be applicable on *Sharikat-ul-Milk* as separate Standard is issued. Furthermore, the Standard would not apply to *Sukuk al Musharakah*, as it has been covered under AAOIFI Shariah Standard No. 17, related to the ‘Investment Sukuk Standard’.”

Interviewee 1 remarks

“SBP has issued a separate Shariah standard on “*Sharikat-ul-Milk*” vide Islamic Banking Division (IBD) Circular No. 2 of 2013 (2/2013), which is clarified in the scope. Moreover, SBP clarified that this would not apply to *Sukuk of Musharakah*, which was not mentioned but implied.”

Interviewee 2 remarks

“The original provision broadly applies to traditional and modern relationships, concentrating on contractual partnerships. SBP’s revision adds precision by identifying further exclusions (*Sharikat-ul-Milk* and *Sukuk al Musharakah*), ensuring the standard’s application is clearly defined.”

Discussion

The original text indicates that the standard does not apply to “ownership partnerships where the parties jointly own an asset,” which relates to “*Sharikat-ul-Milk*”. The SBP explanation reiterates this, indicating that *Sharikat-ul-Milk* has a different standard. The original clause does not mention *Sukuk al Musharakah*. The SBP clarifies that this rule does not apply to *Sukuk al Musharakah*, which is governed under AAOIFI Shariah standard No. 17. At this stage, the SBP has provided clarification on the relevant and applicable Shariah standards.

Original Clause 3/1/1/3 of AAOIFI

“It is permissible for the institutions to include conventional banks as partners in a syndicated financing which operates based on Shariah, provided that the institution secures the right to manage the partnership’s operations and that such operations are subject to the Shariah supervision.”

Clarification/amendment by SBP

The following is added as a footnote to the clause: “The conventional bank, not having duly licensed Islamic Banking Department (IBD), shall not act as lead arranger in a syndicated Islamic financing; it may, however, participate in the syndicate as a partner.”

Interviewee 1 remarks

“SBP has further clarified that if the conventional bank has an Islamic banking window, it can lead the partnership.”

Interviewee 2 remarks

“The original statement allows for partnership with conventional banks while the Islamic institution maintains rigorous management and Shariah control. The SBP amendment also prohibits conventional banks from directing such financings unless they establish an IBD, which ensures Shariah norms are followed from the outset.”

Discussion

AAOIFI does not explicitly limit the role of conventional banks to Shariah compliance and operational management by an organisation. The SBP says conventional banks without an IBD cannot act as lead arrangers. While both clauses attempt to engage conventional banks in Shariah-compliant financing, the SBP amendment provides additional safeguards by requiring a licensed IBD to hold key roles. This move is more closely associated with ensuring Shariah compliance and operational integrity, but it comes at the cost of reducing flexibility and potential participation from conventional banks. The AAOIFI provision, on the other hand, allows for greater flexibility but carries the risks of less stringent Shariah enforcement. These differing approaches reflect distinct institutional priorities: AAOIFI emphasises broader inclusion, while the SBP prioritises strict compliance and regulatory oversight.

Original Clause 3/1/4/1 of AAOIFI

“All partners in a *Sharikah* contract maintain the assets of the *Sharikah* on a trust basis. Therefore, no one is liable except in cases of misconduct, negligence, or breach of contract. It is not permitted to stipulate that a partner in a *Sharikah* contract guarantees the capital of another partner.”

Clarification/amendment by SBP

The following is added as a footnote to the clause: “All partners of *Sharikah* shall be deemed to be trustees in respect of *Sharikah* assets; however, as trustees, they shall be jointly and severally liable for misconduct, negligence or breach of contract.”

Interviewee 1 remarks

“SBP has further clarified that the liability in case of misconduct, negligence or breach can be individually and jointly and severally, in any case.”

Interviewee 2 remarks

“Both rules strive to specify partners’ duties, obligations and liabilities in *Sharikah* contracts in accordance to Islamic financial principles. The original AAOIFI provision emphasises limited responsibility and non-capital guarantees, encouraging risk-sharing and ethical behaviour. The SBP clarification/amendment improves accountability through joint and several responsibilities, which might boost governance.”

Discussion

The original AAOIFI rule emphasises a trust-based system in which partners are not held accountable unless there is misconduct, encouraging ethical behaviour and risk-sharing without

guaranteeing each other's capital. The SBP clarified that the amendment increases responsibility by holding partners jointly and severally accountable for any wrongdoing, carelessness, or breach. This guarantees that all partners share equal responsibility for the partnership's activities, perhaps leading to improved governance and supervision. Here is a crucial difference between the approach of both regulators: the SBP amendment raises the risk for each partner by establishing joint and multiple liability, which encourages more compact monitoring within partnerships but may make partners more hesitant to participate in such arrangements. In contrast, the original clause of the AAOIFI emphasises individual responsibility, encouraging a trust-based approach but with less group accountability.

Regarding the remarks of Interviewee 1, they emphasise the flexibility of liability—both individual and joint—as well as the comprehensiveness of the SBP's revision. Interviewee 2 acknowledges that while both clauses are consistent with Islamic finance principles, the SBP's amendments enhance governance by introducing improved accountability measures.

Original Clause 3/1/5/6 of AAOIFI

"It is not permitted to start the allocation of profit between the partners unless the operating costs, expenses and taxes are deducted in calculating the profit and the capital of the *Sharikah* is maintained intact."

Clarification/amendment by SBP

The following is added as a footnote to this clause: "IBIs may share/distribute profits on gross or net basis while ensuring equity, justice and transparency."

Interviewee 1 remarks

"The AAOIFI clause is principled, emphasising financial integrity while strictly adhering to Shariah principles. The SBP amendment gives practical freedom while demanding strict oversight to guarantee that the core objectives of equity, fairness and transparency are not affected."

Interviewee 2 remarks

"Both regulations attempt to reconcile financial activity with Islamic beliefs but use different methods. The AAOIFI clause is more severe, emphasising capital preservation and comprehensive spending coverage to ensure fairness and stability. In contrast, the SBP amendment allows profit sharing to be either gross or net, provided that equity, justice and transparency are maintained. While this freedom may be beneficial in some cases, it requires tight supervision to ensure compliance with essential Islamic financial principles."

Discussion

The AAOIFI clause is rigorous, dispersing earnings only after all costs, fees and taxes have been deducted, ensuring that capital is protected. This emphasises financial integrity and adheres to Shariah norms, assuring justice and stability. The SBP amendment increases flexibility by allowing IBIs to split earnings on a gross or net basis. This is practical and adaptable if equality, justice and transparency are maintained. If not carefully supervised, the SBP's flexibility may lead to actions that violate Shariah standards. For example, dividing gross revenues without ultimately paying expenses may result in unjust outcomes, with one party benefiting unfairly.

Interviewee 1 supports AAOIFI clause's core viewpoint while acknowledging the practical flexibility offered by the SBP's amendments and stressing the importance of rigorous control to maintain underlying Shariah principles. The AAOIFI clause promotes a rigid and consistent approach to profit allocation, ensuring that all expenditures are covered while capital is preserved. The SBP's amendment enhances flexibility by permitting various profit-sharing methods, while highlighting the importance of robust control to safeguard principles such as equality, fairness and transparency.

Original Clause 3/1/5/9 of AAOIFI

“Considering the provisions of item 3/11/5/3, it is permissible to agree that if the profit realised is above a certain ceiling, the profit above such a ceiling belongs to a particular partner. The parties may agree that if the profit is not over or below the ceiling, the distribution will be by their agreement.”

Clarification/amendment by SBP

The first sentence of the clause is modified as follows: “Taking into account the provision of item 3/1/5/3, it is permissible to agree that if the profit realised is above a certain ceiling, the profit over such ceiling may, at the discretion of other parties, be given to a particular partner.” Further, the word “may” appear in the second sentence of the clause is replaced with the word “shall.” The revised sentence shall be read as: “The parties shall also agree that if the profit is not over the ceiling or is below the ceiling, the distribution will be under their agreement.”

Interviewee 1 remarks

“The SBP has made clarifications in sentence structure which do not add or omit in AAOIFI given standard.”

Interviewee 2 remarks

“The original AAOIFI rule establishes a clear and flexible structure for profit distribution, focusing on specified agreements and fair treatment of partners. The SBP amendment adds discretionary aspects and an obligatory agreement, which can provide flexibility and clarity but also necessitates careful management to avoid conflicts and guarantee fairness. Both sections seek to protect Islamic financial principles, but the SBP’s changes reflect a more dynamic approach, demanding strong measures to ensure equality and transparency.”

Discussion

The original clause allows for flexibility in profit distribution agreements. It specifies that any profit exceeding a predetermined threshold may be allocated to a particular partner, while profits up to and including that threshold is to be distributed according to the prior agreement. This technique promotes fairness and allows partners to decide on profit-sharing contracts by mutual consent. The SBP alters the language such that excess profit can be distributed to a specific partner at the discretion of the other party. This adds discretion and may increase profit allocation options. Furthermore, the phrase “may” is replaced with “shall,” making it necessary for the parties to agree on profit distribution if it is neither above nor below the ceiling.

Interviewee 1 argues that the changes introduced by the SBP are primarily modifications in phrasing that do not alter the underlying spirit of the AAOIFI standards. These adjustments serve to provide greater detail without changing the fundamental concepts.

The second response applauds the original AAOIFI rule’s simple and adaptable framework, which promotes equitable treatment of partners through individual agreements. Furthermore, he points out that the SBP adjustment includes a discretionary component and needs agreement on profit distribution, which may result in greater flexibility and openness. However, he stresses that this approach requires careful supervision to reduce disagreements and ensure fairness. Both policies aim to safeguard Islamic financial values, but the SBP’s amendments take a more dynamic approach. This strategy necessitates significant measures.

Original Clause 3/1/6/2 of AAOIFI

“It is permissible for a partner to issue a binding promise to buy, either within the period of operation or at the time of liquidation, all the assets of the *Sharikah* as per their market value or as per agreement at the date of buying. It is not permissible, however, to promise to buy the assets of the *Sharikah* based on face value.”

Clarification/amendment by SBP

The following is added as a footnote to the clause: “Being *Sharikat ul Aqd*, it is not permissible, however, to promise to buy the assets of the *Sharikah* based on face value or pre-agreed value.”

Interviewee 1 remarks

“The original provision offers greater flexibility regarding agreements at the time of acquisition, which might be advantageous for strategic planning. The SBP’s modification, while restrictive, creates clearer compliance requirements, reducing the risk of conflicts and ensuring more accurate market value transactions.”

Interviewee 2 remarks

“The original AAOIFI regulation provides a balanced approach with some flexibility. However, the SBP’s amendment increases clarity and Shariah compliance by explicitly prohibiting purchase of assets at face value and pre-agreed value transactions, thus promoting fairness and transparency.”

Discussion

The SBP’s amendment has a more stringent interpretation than AAOIFI, prohibiting the acquisition of *Sharikah* assets at both face value and any pre-agreed value. In contrast, AAOIFI permits the purchase at either market value or a mutually agreed-upon value at the time of sale. SBP’s strategy is to ensure that transactions are always completed at the current market value, improving fairness and transparency while restricting partners’ flexibility. While both methods aim to accord with Shariah principles, the SBP’s modification takes a more conservative approach, featuring the significance of representing genuine market circumstances at the time of the transaction.

Original Clause 3/2/1 of AAOIFI

“A partnership in creditworthiness (a partnership of liability) is a bilateral agreement between two or more parties to conclude a partnership to buy assets on credit based on their reputation to make a profit, whereby they undertake to fulfil their obligations according to the percentages determined by the parties. In addition, the parties should determine for each partner the percentage of profit sharing and liability sharing, which latter may, by agreement, differ, downwards or upwards, from the percentage of profit sharing.”

Clarification/amendment by SBP

The following is added as a footnote to the clause: “A Credit Partnership is an agreement between two or more parties to buy assets on credit and bear liability for the price of purchase of goods and share profit according to the ratio determined by the parties.”

Interviewee 1 remarks

“SBP further clarifies the definition of the partnership in creditworthiness.”

Interviewee 2 remarks

“The AAOIFI clause is better appropriate for persons who require a precise and flexible framework and can negotiate its complexities. SBP adjustment suits those seeking simplicity and clarity, even if it means giving up part of the original clause’s complexities. A balanced approach may involve utilising the SBP’s clarity while merging critical components of the AAOIFI’s comprehensive information to ensure both comprehension and completeness.”

Discussion

The original provision allows partners to personalise their partnership agreement depending on their preferences and risk tolerance. For example, a partner may agree to accept additional liability in exchange for a higher profit share or vice versa. This flexibility can benefit complex corporate partnerships when participants have varying experience levels, financial strength and risk tolerance.

By not expressly allowing this flexibility, the SBP amendment aims for a more explicit and potentially less customisable approach. The emphasis is on sharing liability and profit according to a predefined ratio, which may simplify the agreement but limit the partners' flexibility to build the partnership to meet their objectives best.

The first respondent stresses the need for SBP's explanation to improve understanding of collaboration in creditworthiness. The second respondent discusses the trade-off between complexity and simplicity.

Original Clause 3/3/1 of AAOIFI

"A service partnership is an agreement between two or more parties to provide services about a profession, vocation or skilled trade or to render some services or professional advice or to manufacture goods and to share the profit according to an agreed-upon ratio."

Clarification/amendment by SBP

The following is added as a footnote to the clause to cater to the treatment of loss: "In case of loss to service partnership due to negligence of either of the partners or otherwise, the same shall be borne by all the partners as per their agreed profit-sharing ratio."

Interviewee 1 remarks

"SBP further clarifies in the clause about the act of negligence on the part of the partner or as a whole; the liability shall be borne by all the partners as per their agreed profit-sharing ratio. This addition is not based on fair treatment and in case of negligence of a particular partner, why should the others share the loss? However, in case of negligence of a partner and loss of any other person outside, they can claim separately and jointly, and the partners are liable to pay. However, this loss should be borne by the negligent partner if established."

Interviewee 2 remarks

"Amendment explains the theoretical approach to loss sharing; its actual application may differ depending on the characteristics of the partnership agreement and the legal environment within which it works. Practical concerns like enforcement and dispute resolution methods help ensure such clauses are practical."

Discussion

The first respondent criticised the fairness of SBP's amendment and argue that it is unfair for all partners to share damage caused by one partner's irresponsibility. If the negligent partner is found to be at fault, it is suggested that he suffer the loss. While costs resulting from external claims should be shared, the irresponsible partner should pay internal losses caused by carelessness.

The second respondent points out that while the theoretical basis for loss sharing has been explained, actual enforcement and dispute settlement are critical to the clause's efficacy. It emphasises that unique partnership agreements and legal settings may determine the clause's accurate interpretation.

The debate displays a deep understanding of the service partnership structure. The original AAOIFI establishes a sound platform for forming service partnerships but lacks specifics on loss handling. The SBP's clarification solves this gap by clarifying loss sharing, but it raises possible fairness concerns by requiring all partners to share losses caused by individual carelessness. A reasonable approach might include revising the SBP's amendment to ensure that negligence is

treated equitably while retaining clear loss-sharing criteria. This might contain procedures to hold negligent partners.

Original Clause 4/1/1/1 of AAOIFI

“A stock company is a company of which the capital is partitioned into equal units of tradable shares and each shareholder’s (co-owners) liability is limited to his share in the capital. It is a form of financing partnership. The rules of *Sharikat al-Inan* apply to this company except on the issue of the limited liability of the shareholders and the fact that this type of company cannot be unilaterally terminated by one party or a minority of its shareholders (see items 4/1/2/1 and 4/ 1/2/9).”

Clarification/amendment by SBP

“The word ‘partitioned’ used in the clause is changed to ‘divided.’”

Interviewee 1 remarks

“SBP has clarified a word, which has no impact on the general meanings of the clause.”

Interviewee 2 remarks

“The SBP adjustment, which changes the term “partitioned” to “divided” in Clause 4/1/1/1 of AAOIFI, is a modest but significant improvement aimed at enhancing clarity and conformity with conventional financial language. While the adjustment does not affect the clause’s substantive meaning, it improves the document’s readability and accessibility, allowing stakeholders to comprehend and apply it more effectively.”

Discussion

The debate emphasises the value of linguistic clarity in legal and financial contracts. The original AAOIFI provision defines a stock company comprehensively, guaranteeing an explicit knowledge of its structure and stockholders’ restricted liability. SBP’s minor modification improves the clause’s readability and accessibility by adopting a more usual phrase, “divided”, rather than “partitioned.”

The change from “partitioned” to “divided” does not affect the clause’s Shariah conformity. The fundamental principles are preserved since the clause continues to reflect the essential character of a stock company by Islamic finance rules, namely, that the capital is divided into equal shares and each shareholder’s liability is restricted to their portion.

The first respondent’s comments imply that the alteration is mainly insignificant to the meaning, featuring its minimal influence. On the other hand, the second respondent values increased clarity and readability, highlighting the significance of accessible language in guaranteeing good communication and comprehension.

Original Clause 4/1/2/3 of AAOIFI

“It is permissible to issue new shares to increase the capital, provided the new shares are issued at the fair value of the old shares. This should be done based on experts’ opinions on the valuation of the company’s assets. In other words, the new issues can be issued at a premium or a discount to their nominal value or at a market value.”

Clarification/amendment by SBP

The following is added as a footnote to the clause: “The right shares can also be issued at lower than the market value as per the market norms and practices and the legal framework.”

Interviewee 1 remarks

“The approach of AAOIFI is associated with the unbiased treatment for all prospective shareholders to issue new shares at fair value irrespective of the existing or new shareholders. SBP

can consider customary practices and legal frameworks while issuing new shares to existing shareholders. Offering prices at a discount will impact the value of existing shares and, ultimately, the wealth of all existing shareholders, which is not considered against equitable treatment. Although such rights are given to all existing shareholders, this approach will be advantageous only to those shareholders who will avail such discount.”

Interviewee 2 remarks

“The SBP modification allows for the issue of right shares below market value, which adds a potential departure from the rigorous adherence to fair value.”

Discussion

The AAOIFI clause emphasises issuing new shares at fair value, consistent with Shariah values of equity and justice. This guarantees that all shareholders are treated fairly, with no one profiting at the expense of another.

The SBP’s permission to issue shares below market value can still be consistent with Shariah principles if it is carried out honestly and does not cause any party injustice or injury (*ẓulm*). However, vigilance must be exercised to avoid circumstances in which current owners who cannot afford to purchase more shares at the discounted price are unfairly disadvantaged.

The SBP’s modification is not fundamentally contradictory to Shariah principles; nonetheless, it establishes a practice that must be adequately controlled to maintain conformity with those principles. The main concerns are justice, openness and preventing investor harm. Suppose the issue of right shares below market value is done so that all shareholders understand and agree to and it does not result in unjust financial results. In that case, it can be called Shariah compatible. However, it is more adaptable than the AAOIFI model, which rigidly conforms to the premise of issuing shares at fair value to safeguard all stakeholders proportionally.

Original Clause 4/2 to 4/5 of AAOIFI

“Clauses related to 4/2 Joint-liability Company, 4/3 Partnership in Commended, 4/4 Company Limited by Share and 4/5 Allotment Partnership.”

Clarification/amendment by SBP

“Since these clauses are not applicable in Pakistan, they are not adopted.”

Interviewee 1 remarks

“AAOIFI Standards are prepared with the aim of global coverage and such types of partnerships are available in other areas of the world. Since SBP is the regulator for Pakistan, these partnerships are not prevalent in the domestic market and not adopted here.”

Discussion

The SBP’s decision not to implement AAOIFI rules relating to certain partnership forms reflects the local market situation in Pakistan, where such business structures are uncommon. While the AAOIFI’s standards are internationally orientated, the SBP has taken a more pragmatic approach, integrating the regulatory framework with domestic circumstances.

Original Clause 5 of AAOIFI

“Clause related to Diminishing *Musharakah*.”

Clarification/amendment by SBP

The following is added as a footnote to the clause: “A self-contained Shariah Standard on ‘*Sharikat ul Milk* and Diminishing *Musharakah*’ is notified vide IBD Circular No. 2 of 2013.”

Interviewee 1 remarks

“SBP has issued its own Shariah standard related to this, which was omitted during the adaptation.”

Discussion

“SBP has issued its Shariah standard on ‘*Sharikat ul Milk* and Diminishing *Musharakah*’.”

CONCLUSION

The AAOIFI Standard emphasises a strict profit-and-loss-sharing mechanism in which partners distribute profits according to pre-agreed ratios and bear losses in proportion to their capital contributions. However, SBP has allowed some flexibility in the PLS mechanism to accommodate local market practices, such as permitting profit distribution methods that ensure a minimum return for one partner. Additionally, the SBP’s guidelines allow for more structured management agreements, such as fixed fees for managing partners. This allowance may conflict with the pure profit-sharing principle outlined by AAOIFI. The SBP endorses diminishing *Musharakah*, a widely used mode of Islamic financing, particularly in the house financing sector. Nevertheless, the SBP’s guidelines often permit practices that AAOIFI might consider compromising the essence of *Musharakah*, such as predetermined schedules for partner exit. AAOIFI’s approach to *Musharakah* contracts restricts the use of guarantees and collateral to ensure that all partners share the risk. In contrast, the SBP’s guidelines may allow for a more extensive use of guarantees and collateral to mitigate risk for financial institutions, a practice not endorsed by the AAOIFI. Upon termination of a *Musharakah* contract, the assets must be liquidated and the proceeds distributed according to the partners’ PLS ratios. This study is limited to the AAOIFI Shariah standard on *Musharakah*; however, SBP has also amended twenty-four other AAOIFI Shariah standards. Future research may explore these additional amendments to provide a more comprehensive understanding of their implications.

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