EXCLUSIVE INTERVIEW

ICMA: How can Pakistan's financial system better align with Islamic principles, and what role can AAOIFI's standards play in this transformation?

Omar Mustafa: To align with Islamic principles, Pakistan's financial system must adopt a comprehensive framework that governs product structures, operations, and ethics. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), established in 1991 and based in Bahrain, supports this transition by offering globally recognized standards in five areas: Shari'ah, Accounting, Auditing, Governance, and Ethics. The AAOIFI's 59 Shari'ah standards provide foundational guidance on permissible financial products like Murabahah and Ijarah, ensuring consistency and doctrinal clarity. Complementing this, 36 Financial Accounting Standards (FAS) and 7 auditing standards enhance financial transparency and regulatory confidence globally.

These frameworks help maintain the distinct identity of Islamic finance. Structural alignment must be supported by strong internal systems. AAOIFI's 24 governance standards outline how Shari'ah principles should be embedded into institutional processes, while the Code of Ethics promotes trust and professionalism. All these together ensure Islamic values are upheld throughout the operations of Islamic financial institutions (IFIs). This system can be compared to a universal socket with adjustable prongs and built-in surge protection. Just as the same accommodates British, American and European plug types while ensuring safety, AAOIFI's standards offer a harmonized yet adaptable framework for Islamic finance. If everyone designed their own plugs and sockets, none would work seamlessly together.

Similarly, without a unified approach, Islamic banks face the risk of inconsistencies and regulatory short-circuits (e.g., instability). AAOIFI mitigates this by standardizing key Islamic finance products like Murabahah and Ijarah across jurisdictions, promoting systemic coherence. Its flexibility also allows for the integration of local Shari'ah interpretations, much like how a universal socket adapts to regional plugs. In such a structure, accepting a central authority becomes crucial for consistency, interoperability, and Shari'ah compliance.

Mr. Omar Mustafa Ansari

Secretary General, Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)

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This empowers Islamic banks to align their transactions, follow shared protocols, and uphold quality standards, which helps build trust among stakeholders. In Islamic finance, which is distinct by design, such alignment is vital. If it is not different (from conventional finance), then it may not be termed as Islamic. Adopting a full set of AAOIFI standards will enable Pakistan to strengthen its Islamic finance ecosystem, improve global compatibility, and ensure authenticity in both structure and spirit.

Interview session on Zoom

ICMA: What specific challenges do Pakistan's Islamic financial institutions face in adopting AAOIFI standards, and how can these be addressed?

Omar Mustafa: Islamic financial institutions in Pakistan encounter certain challenges in adopting AAOIFI standards, as although voluntary adoption allows them to apply selected standards at their discretion, mandatory adoption of accounting and auditing standards only becomes effective once the relevant regulatory authority formally endorses them. The SECP currently mandates the use of the IFRS framework (in addition to certain local Islamic finance standards), which complicates the adoption of AAOIFI's accounting and auditing standards. SBP has made 41 AAOIFI standards mandatory for the banking sector, whereas review of the remaining standards is underway. Moreover, SBP has issued different guidelines and instructions based on broader parameters defined in AAOIFI standards. Since Islamic finance requires unique accounting standards, the absence of comprehensive adoption of AAOIFI standards creates a significant challenge for accurate financial reporting in the sector. SECP has also initiated a gradual process of adoption of various AAOIFI standards.

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In contrast, AAOIFI governance standards and code of ethics can be voluntarily adopted. For instance, in non-Muslim countries like the UK, USA, and Australia, although AAOIFI standards are not legally required, many institutions voluntarily follow them to demonstrate alignment with global best practices and ensure stakeholder confidence. Similarly, in Saudi Arabia, while AAOIFI standards are not mandated, many institutions follow them for reputational and compliance reasons. The main challenge in Pakistan remains the lack of consensus among regulators. The State Bank of Pakistan (SBP), Securities and Exchange Commission of Pakistan (SECP) and Institute of Chartered Accountants of Pakistan (ICAP) adopt AAOIFI standards in different ways, which may allow room for inconsistencies. A unified regulatory approach is necessary for a consistent and comprehensive adoption of AAOIFI standards in Pakistan's Islamic finance sector.

ICMA: How do AAOIFI's Shari'ah, financial accounting, and governance standards support the development of a more inclusive and ethical financial system in Pakistan?

Omar Mustafa: AAOIFI's Shari'ah, accounting and governance standards provide a comprehensive ethical framework for Pakistan's financial system by ensuring that financial activities align with (objectives of Shari'ah) Maqasid al-Shari'ah. These standards prohibit exploitative practices such as misrepresentation, unjust gain and speculative or impulsive transactions, thereby promoting transparency and justice. They also restrict investments in unethical industries, directing capital toward ventures that reflect social responsibility and equity. This ethical discipline strengthens trust and integrity within the financial ecosystem.

Islamic commercial banking, guided by AAOIFI, operates through profit and loss sharing, risk-sharing contracts and asset-backed transactions allowing faith-based participation without relying on interest. It ensures the financial inclusion for the individuals affected by religious prohibitions in conventional financial models. However, as profit-oriented institutions, these banks are not structured to fulfill broader social welfare role, which underscores the importance of developing complementary financial models such as Islamic social finance. Islamic social finance focuses on equitable development and financial access for underserved communities. It utilizes instruments like Zakat, Waqf, and Qard-e-Hasan (benevolent loans) to support the poor and unbanked. In Pakistan, the Akhuwat Foundation is a prominent example, providing interest-free microfinance to low-income individuals.

AAOIFI is working to further institutionalize such models within its standards, aiming to integrate social finance more systematically with the existing Islamic commercial banking structure to enhance financial inclusion.

Sustainability is deeply embedded in AAOIFI's ethical and governance principles. Islamic teachings emphasize on care for the environment, including guidance on conserving natural resources and avoiding ecological harm even during the wars. These values are incorporated into AAOIFI's Shari'ah Decision-Making and Corporate Social Responsibility standards, which also align with the United Nation's Sustainable Development Goals (SDGs). In a nutshell, AAOIFI's standards offer a unique and multidimensional approach to financial development in Pakistan. By distinguishing between the roles of Islamic commercial banking and Islamic social finance, and embedding sustainability in its ethical framework, AAOIFI supports the growth of a principled, inclusive, and socially responsive financial system.

ICMA: What opportunities exist for Islamic finance to support key sectors of Pakistan's economy, such as agriculture, SMEs, and infrastructure, and how can AAOIFI contribute to these efforts?

Omar Mustafa: Islamic finance presents substantial opportunities to strengthen Pakistan's key economic sectors including agriculture, SMEs, and infrastructure through Shari'ah-compliant instruments and ethical financial models. In the agricultural sector, Islamic finance can offer targeted investment and financing solutions, particularly in light of post-COVID disruptions in global supply chains and heightened food security concerns. Although agriculture contributes modestly to the GDP, it remains a critical livelihood source for a significant portion of the population.

Islamic financial tools such as Salam and Istisna contracts can support pre-harvest financing, while Waqf-based models and Islamic social finance have the potential to significantly improve farmer education, facilitate access to agricultural inputs, and accelerate the adoption of agricultural technology (agritech). These advancements will also create pathways for extending agri-finance through Shari'ah-compliant financial transactions. Furthermore, emerging opportunities like collateral management and electronic warehousing will also complement these principles by offering secure, transparent, and traceable mechanisms that align with asset-backed and risk-sharing models.

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For SMEs, which are vital engines of employment and innovation, AAOIFI's Chairman of Board of Trustees, H.E. Shaikh Ebrahim Bin Khalifa Al-Khalifa in his public speeches and in international forums has emphasized on this saying, "At AAOIFI, we want to push Islamic financial institutions to commit at least 20% funding of their total financing towards SMEs sector." Although AAOIFI is not a regulatory authority, this advocacy encourages financial institutions to prioritize underserved segments and support inclusive economic growth through Shariah-compliant microfinance models. In terms of infrastructure development, Islamic finance offers Sukuk as an instrument for long-term investment by linking financing to tangible assets, promoting fiscal discipline through productive capital expenditure, and keeping consumption low.

If utilized properly, Sukuk can discipline government borrowing and spending. Governments should prioritize asset-backed Sukuk over conventional debt, directing proceeds into energy, transport, and water projects and Public-Private Partnerships (PPP) through Islamic finance principles, such as Musharaka and Mudharaba, while Wakala, Hawala, and Kafala provide agency mandates, debt assignments, and guarantees.

AAOIFI advances these efforts and plays its role through advocacy and Shariah-audit guidelines, standardizing Sukuk recognition and measurement (FAS 33) and transparent reporting (FAS 34), and emphasizing funding allocation to marginalized sectors, thereby enhancing transparency, investor confidence, and sustainable economic growth.

ICMA: What steps can the Pakistani government and private sector take to foster a stronger Islamic financial ecosystem, and how can AAOIFI guide this process?

Omar Mustafa: Quaid-e-Azam Muhammad Ali Jinnah, in his inaugural speech at the State Bank of Pakistan, emphasized the failure of the western economic system and the need for Pakistan to follow an Islamic economic model based on justice and equity. This vision was reinforced through constitutional amendments from 1973 onwards to establish a Riba-free system rooted in Shari'ah law. Since then, economic transactions have been restructured to focus on asset-backed contracts like Murabahah and Ijara, reducing speculation and linking credit to tangible assets. Profit-and-loss sharing models, such as Mudarabah and Musharakah, have helped equitably distribute returns and align the interests of capital providers and entrepreneurs. The prohibition of interest charges has ensured that economic practices align with Quranic principles of fairness and mutual benefit, contributing to greater stability, inclusivity and ethical accountability in Pakistan's markets.

A major attempt was made to Islamize the economy in the 1980s, which unfortunately failed due to the lack of standardized practices, effective governance, and structured capacity-building. To develop an Islamic financial ecosystem, Pakistan must ensure the implementation of standardized Shari'ah-compliant products, governance frameworks, and human resource development. Islamic finance, as it is directly focused on assets and transactions, encompasses diverse business activities such as sales, purchases, goods, services, commodities, and entrepreneurship, where money is exchanged for economic value rather than interest-based money-to-money transactions.

These principles promote ethically grounded economic activity. AAOIFI addresses earlier shortcomings by offering comprehensive Shari'ah standards, governance mechanisms, accounting and reporting frameworks, and specialized training and capacity building programs. It is actively working with institutions like ICMA to enhance Islamic finance education and human resource development in Pakistan. AAOIFI considers Pakistan as one of the most important destinations and a good model of Islamic finance to emulate globally. With consistent application of these standards, Pakistan is positioned to establish itself as a sustainable and a successful Islamic financial system.

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ICMA: Given the global rise in demand for Islamic finance, what can Pakistan do to become a leading hub for Shari'ah-compliant financial services?

Omar Mustafa: Pakistan has an opportunity to establish itself as a global knowledge base and infrastructure hub for Shari'ah-compliant financial services. By drawing on the intellectual contributions of early thinkers like Prof. Khurshid Ahmed, Dr. Muhammad Umer Chapra, and Sh. Muhammad Taqi Usmani, Pakistan has cultivated a skilled workforce, with professionals serving important positions in global Islamic finance institutions boards such as AAOIFI.

Despite challenges like adverse economic conditions and developing regulatory framework, significant potential exists. Pakistan is still one of the largest Islamic finance markets in terms of the number of branches, employees, and customers, with a good number of its banking sector already dedicated to Islamic finance, particularly with the planned conversion of conventional banks to Islamic finance by 2027. To enhance its position, Pakistan should focus on human resource development and expand capabilities in outsourced services, consultancy, and back-end operations. With the right resources and trainers, ICMA can drive transformation, empowering students and its members to enhance their skills in Islamic finance and remain competitive in the global market.

The Editorial Board thanks ***Mr. Omar Mustafa Ansari, Secretary General, Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)*** *for sparing from his precious time to give exclusive interview for Chartered Management Accountant Journal.*