Dafa International Journal of Economic: International Journal
Vol.02, No. 01 Year 2025

Islamic Financial Instruments: Social Accounting

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Keywords: Islamic financial, social accounting.

Received : 2 June 2022
Revised : 4 june 2022
Accepted: 4june 2022

ABSTRACT
Social-based financial systems are essential, particularly in developing nations, to promote shared development. Islamic finance principles such as takaful and waqf involve specific operational structures, Shariah compliance requirements, and distinct accounting treatments. Adherence to Shariah principles is fundamental in determining the appropriate accounting treatment for these two charitable instruments.

I. INTRODUCTION

Social-based finance is very much needed, especially in developing countries to support mutual progress and economic empowerment. OJK also strongly supports various forms of social-based finance, Chairman of the OJK Board of Commissioners Muliaman D Hadad in his remarks at the opening of the Workshop on Social Finance and Social Enterprises in collaboration with the United Nation Development Program (UNDP) in Jakarta March 2017 said "Social finance programs that rely on empowerment Economically, socially oriented and maintaining the carrying capacity of the environment is very in line with the conditions of Indonesia, where the majority of the people are still very dependent on the agricultural, plantation, livestock and fishery sectors” (ojk.go.id, 2017).

In the concept of Islamic economics, Islamic finance is contained in takaful and waqf. Where both have the same goal, namely the economic empowerment of the people. Financial concepts like this are needed, especially in a pandemic, so that the principle of ta'awun will be realized in takaful and waqf.

ISSN-E: : 2808-1714 (media online)
https://jurnal.stiedarulfalahmojokerto.ac.id/ index.php/jurnal_IJE

II. METODOLOGY

This research method uses qualitative methods by studying literature from various sources and several fundamental theories to gain an understanding of the problems studied in more depth.

III. RESULTS

Takaful

Takaful, commonly known as Shariah-compliant insurance, represents a financial arrangement based on mutual cooperation among multiple parties, aimed at offering financial protection against unexpected material risks. Within this system, participants collectively contribute to a common fund designed to provide mutual indemnity and protection to any member who encounters a defined risk. In this model, every participant simultaneously assumes the role of both insurer and insured(Alamad, 2019).

According to the Big Indonesian Dictionary, insurance is defined as "a form of protection, namely an agreement between two parties, where one party is obligated to pay contributions, and the other is obliged to provide full compensation should an incident occur to the first party or their property, in accordance with the agreed terms." From an Arabic etymological perspective, Sharia insurance is derived from the word kafala, which means guarantee or responsibility. As stated in Fatwa No.21/DSN-MUI/X/2001 issued by the National Sharia Council (DSN) of the Indonesian Ulema Council (MUI), takaful is defined as "a mutual effort to protect and support one another among a group of individuals or parties through investments in the form of assets and tabarru' (donation) funds, which incorporate a system of returns to address certain risks, based on contracts that comply with Sharia principles"(Habibi, et al., 2017).

Risk refers to the potential for loss arising from uncertain events. It is an inherent aspect of life, as nearly all human activities involve some degree of risk. Such uncertainty may pertain to events like accidents, theft, natural disasters, or death, which can lead to financial loss, damage, or hardship. Insurance serves as a vital mechanism for managing these risks. While Islamic law does not reject the concept of risk management, it imposes specific conditions to ensure ethical compliance. For instance, risk management must not involve speculative elements aimed at profit, nor should it result in one party benefiting at the expense of another. Within this framework, the Islamic approach to addressing risk has led to the development of takaful, a cooperative system of mutual protection grounded in Shariah principles(Alamad, 2019).

Takaful, which is founded on the principles of mutual contribution and shared responsibility, has been practiced for centuries. It serves a significant function in risk mitigation and management within the framework of Shariah-compliant finance. Unlike conventional insurance, where risk is transferred to an insurance company, the concept of takaful emphasizes the collective sharing of potential losses among all participants, thereby fostering a spirit of mutual assistance and cooperation.

According to AAOIFI Shariah Standard No. 26, takaful is defined as a contractual arrangement among a group of individuals who mutually agree to collectively address harm or loss arising from specific risks to which they are all exposed.

The Main Aspect of Takaful

In Islam, taking precautionary measures to reduce risk is permissible. This principle is reflected in a hadith in which the Prophet Muhammad (SAW) advised a man to tie his camel and trust in God, emphasizing the importance of both faith and practical action. However, Islam prohibits contracts that involve the sale or purchase of guarantees or compensation, as such agreements often contain elements of maysir (speculation) and gharar (excessive uncertainty), both of which are forbidden in Shariah. In conventional insurance, particularly within proprietary (non-mutual) models, the insurer collects premiums from the insured with the intention of generating profit, which may involve unjust enrichment and contractual uncertainty contrary to Islamic principles.

In conventional insurance, the insurer typically expects that the total claims made by the insured during the coverage period will be less than the total premiums collected—an arrangement that reflects maysir (speculation). Additionally, the insured faces uncertainty regarding the benefits they will receive, which may be nothing if no claim is made, or significantly more than the premium paid if a major loss occurs—this constitutes gharar (excessive uncertainty). To eliminate maysir and gharar, Islamic insurance adopts a cooperative or mutual structure known as takaful, derived from the Arabic term for solidarity or mutual responsibility. The charitable and cooperative nature of takaful, along with the mutual commitment of participants to support one another, permits a degree of uncertainty or risk. This tolerance is justified by the voluntary and non-commercial essence of the arrangement, distinguishing it from profit-driven insurance contracts.

The concept of takaful is rooted in the traditional Arab practice of al-'Aqilah, a system of collective financial responsibility that was endorsed by the Prophet Muhammad (peace be upon him) during his lifetime. This principle is illustrated in a narration by Abu Huraira (RA), in which two women from the tribe of Hudhail were involved in a dispute, and one struck the other with a stone, causing the death of her unborn child. When the case was brought before the Prophet (SAW), he ruled that compensation (diyyah) was to be paid by the offender's relatives for the loss of the unborn child. The compensation was in the form of male or female slaves of the highest quality, which reflected the social norms and practices of that era. This ruling exemplifies the foundational idea of mutual responsibility and collective compensation that later evolved into the modern takaful system.

Hamal ibn Nagigha once asked the Messenger of God, "Will I be held accountable for a being that neither drinks, eats, makes a sound, nor even comes into existence?" The Prophet responded, "It is the sibling of those who predict." The practice of Aqilah among the ancient Arabs mandated that the tribe collectively bear the financial responsibility on behalf of a killer by providing compensation, known as diyyah, to the victim's heirs. Furthermore, the concept of takaful is closely linked to the traditional practice of asabiyya, which denotes tribal solidarity and collective mutual support.

In his Muqaddimah (Prolegomena), Ibn Khaldun references some of the earliest forms of cooperative insurance practiced by pre-Islamic Arab societies. He explains that Arabs engaged in various forms of property insurance, notably during seasonal trade caravans in winter and summer. Caravan members mutually agreed to compensate any individual who lost a camel during the journey, funding these compensations from the collective earnings of the expedition. Contributions were made proportionally based on each member's wealth or capital involved in the trade. Additionally, they agreed to reimburse those whose merchandise remained unsold or was destroyed due to the loss of their camels, demonstrating an early practice of mutual risk sharing.

Sharia insurance offers an alternative for those who consider interest-based transactions (usury) as forbidden. The sector of Sharia insurance in Indonesia is experiencing rapid and substantial growth. Although it is relatively new compared to conventional insurance, Sharia insurance has demonstrated the ability to compete effectively within the industry. This trend is reflected in the increasing number of conventional insurers establishing Sharia-compliant branches. According to the 2014 Insurance Statistics, by the end of 2014, there were 49 companies operating under Sharia principles in Indonesia, consisting of 5 fully Sharia insurance companies, 41 insurance companies with dedicated Sharia units, and 3 reinsurance companies with Sharia units (Habibi, et al, 2017)

Waqf

Waqf generally refers to the act of dedicating or restricting the use of an asset for a specific purpose. The term originates from the Arabic word habs, which literally means to withhold or prevent something from being transferred. From a Shariah perspective, Islamic scholars (ulama) have varying definitions of waqf based on their respective schools of thought. The key differences concern whether waqf is considered legally binding, whether waqf can be directed to the relatives of the wakif (the individual who endows the waqf from their own wealth), the ownership status of the assets after the waqf contract is established, and whether an offer and acceptance are required for the waqf's validity (Al-Baghawi, 1983). Scholars from the Shafi'i school, such as Al-Ramli and Ibn Hajar al-Haythamy, define waqf as any form of wealth (maal) that can provide ongoing benefits without being depleted or destroyed, with the benefits utilized for purposes consistent with Shariah law(Anggadini and Komala, 2017).

عَلِيْمٌ بِهِ اللهَ فَاِنَّ شَيْءٍ مِنْ تُنْفِقُوْا وَمَا ۗ تُحِبُّوْنَ مِمَّا تُنْفِقُوْا حَتّٰى الْبِرَّ تَنَالُوا لَنْ

Meaning: "*You will never reach the (perfect) virtue, before you spend part of the wealth you love. and whatever you spend, then verily Allah knows it*."

(Surat Ali Imron (3): 92)

The verse above conveys that a person cannot attain complete virtue without spending from the wealth they cherish, such as through acts of waqf. This understanding is supported by the historical account of Abu Talhah, who, upon hearing the verse, immediately endowed a garden known for its fertility. The Prophet (SAW) then advised him to dedicate the plantation as an endowment, which Abu Talhah promptly did. Furthermore, Abu Ubaid explained that although the term infaq in the verse typically implies a voluntary or recommended act (sunnah), Muslims are encouraged to embody this practice to fulfill its intended purpose. Consequently, this verse serves as a foundational proof for the legitimacy and recommendation of waqf in Islam (Latifa and Jamal, 2019).

The Key of Waqf

There are three key aspects of waqf as described by Islamic jurists (Al-Baghawi 1983; Ibn Qadi 1989; Burhan al-Deen 1981). as follows:

1. Endowments are irrevocable: There is a general agreement among Muslim jurists that once a founder (wakif) designates an asset as waqf, this designation is irrevocable. Consequently, the waqf cannot be revoked or withdrawn by the wakif, nor can the heirs alter its status. This ensures that the waqf property continues to benefit the designated beneficiaries indefinitely, while the wakif continues to receive divine rewards even after death. However, Imam Abu Hanifah presents a differing opinion, maintaining that the wakif retains the right to reclaim or sell the waqf property, meaning the asset can be withdrawn from the waqf by its original owner.
2. The immutability of waqf: The majority of Islamic jurists hold the view that once an asset is designated as waqf, it must remain perpetual and inalienable. This principle is intended to safeguard waqf properties from confiscation by either the government or private parties. Through this enduring dedication, public and communal facilities such as mosques, hospitals, orphanages, and schools are preserved for the benefit of the Muslim community indefinitely.
3. The waqf cannot be revoked: The ownership of waqf property is considered to be transferred from the wakif to God, although the benefits generated by the property are allocated to designated beneficiaries. The majority of Islamic jurists concur that no individual can claim ownership of the waqf asset. Consequently, it functions essentially as a "frozen asset," which cannot be subjected to sale, transfer, mortgage, gift, inheritance, or any form of alienation. These conditions collectively ensure the perpetual utility of the waqf property for both present and future generations, while allowing the wakif to continue receiving divine rewards until the Day of Resurrection.

Type of Waqf

There are various types of waqf identified in Islamic literature (Al-Baghawi 1983; Ibn Qadi 1989; Burhan al-Deen 1981). Which will be explained briefly below:

1. Waqf 'ala al-nafs (self-dedicated waqf): In the context of a self-dedicated waqf, the donor (wakif) retains the right to benefit from the income or use of the waqf property throughout their lifetime, while also specifying the charitable purpose and the beneficiaries who will receive the income or benefits after their death.
2. Expert waqf (family waqf): A family waqf refers to an endowment in which the income or benefits derived from the waqf property are

allocated to specifically designated individuals, typically including family members, such as children, grandchildren, or other relatives. In the absence of any eligible beneficiaries for whom the waqf was originally established, the income or benefits are redirected toward charitable purposes.

3. Waqf al-khair (charity waqf): When a waqf's profits or gains are allocated to charitable causes, it is considered charitable. It is a donation from Waqf to promote the welfare of the underprivileged and destitute in society. Waqf typically establishes the waqf through the construction of structures like schools, hospitals, orphanages, and guesthouses, or by offering fundamental services like allocating books for study purposes, donating land for graves, digging wells, etc.
4. Al-waqf al-Mushtarak (joint waqf): Joint waqf is waqf in which the revenue or advantages from the waqf assets are distributed in accordance with the donation of the property to family and charity causes. It is a waqf established by a wakif to aid a specific person or family as well as a public charity cause. He can therefore allocate a portion of his money to his family and a portion to public charity causes.

Journal study: the relationship between waqf in Indonesia and religiosity

Achmad Nurdany, "Ensuring the determinant of waqf in Indonesia: does religiosity matter?" Journal of Islamic Economics & Finance, Vol. 5 No. 1, January 2019: 18-24. In this essay, I aim to investigate the connection between Indonesia's waqf land amounts, which are determined by the country's Muslim population, mosques, and ulama.

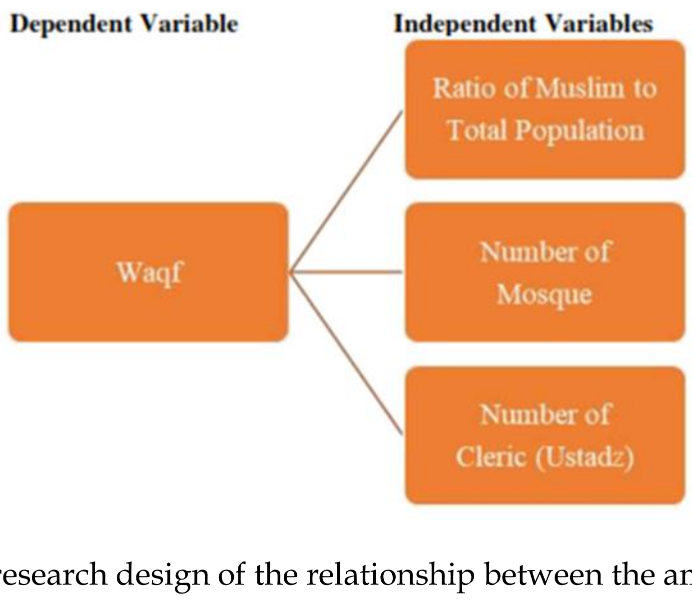

figure 1. The research design of the relationship between the amount of waqf land in Indonesia will be measured by the number of Muslim population, the number of mosques and the number of ulama

Cross-sectional data analysis from 33 Indonesian provinces is used in this study. The Ministry of Religion provided the secondary data in 2016. The ministry is a public entity, religious institution, religious education, and religious affairs in Indonesia, according to the ministry's report, which includes quantitative data. The ministry's report also includes the total number of waqf, Muslim population, buildings of worship, and kiai paa for each region based on this study variable.

This study found that the MR variable (the ratio of Muslims to the total population) did not exhibit a statistically significant relationship with the dependent variable LW (waqf land), although the correlation was positive. This outcome is likely due to the annual increase in the Muslim population in Indonesia outpacing their level of awareness and engagement in waqf contributions. Interestingly, the NM variable (number of mosques) demonstrated a significant negative effect on waqf land. This negative impact may be attributed to the tendency of Muslims to allocate waqf donations specifically for mosque construction, rather than for other productive or income-generating purposes. Among the variables examined, only the NC variable (number of kiai or Islamic scholars) aligned with the study's hypothesis, showing a positive and significant influence on waqf land. The author posits that Islamic scholars in Indonesia play a vital role in encouraging the Muslim community to adhere to divine commands, including the practice of waqf, which is regarded as a virtuous charitable act in Islam.

In light of this, a number of policy suggestions were also examined. In the first place, the government should prioritize building more kiai rather than mosques. Second, supporting programs that pay monthly salaries based on certificates of competency recognition or provide direct incentives for better performance are necessary to increase their quality. Third, the waqf provided by the Muslim community for use in other profitable economic applications needs to be controlled or even regulated by the government.

CONCLUSION

This discussion addresses charity-based social accounting, commonly referred to as non-commutative contracts in Islamic finance, with a focus on takaful and waqf. Both are rooted in Islamic financial principles and governed by specific operational structures, Shariah compliance requirements, and accounting treatments. It is evident that adherence to Shariah principles—particularly the charitable foundations of these contracts—is crucial for establishing appropriate accounting standards.

As outlined in this chapter, while IFRS and IAS 4 provide a foundational framework for the accounting treatment of takaful insurance products, there are unique features inherent to takaful that require special consideration in its financial reporting and compliance requirements. Similarly, the Islamic concept of waqf, which is based on a trust-like mandate, necessitates a comparable accounting approach. An analogy is drawn to the accounting treatment of takaful, given that the responsibility for financial reporting lies with the entity managing the assets in both cases.

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