

ESG and Islamic Accounting for Sustainable Islamic Finance: A Qualitative Study

Retnawati Siregar

Universitas Medan Area; Medan, Indonesia

E-Mail: retnawati@staff.uma.ac.id

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ABSTRACT

This study explores the alignment between Environmental, Social, and Governance (ESG) principles and Shariah-based Islamic accounting to support sustainable Islamic finance. The objective is to analyze conceptual synergies, identify operational barriers, and propose an integrative framework through a qualitative approach involving a systematic review of academic literature, regulatory documents, and financial reports. Findings reveal that Shariah principles, such as the prohibition of riba, emphasis on social benefit, and environmental protection, align with environmental, social, and governance objectives. Instruments like Green Sukuk in Indonesia and Malaysia and Shariah-compliant microfinance demonstrate practical applications for inclusive development and eco-friendly projects. However, challenges include the lack of standardized Shariah-compliant metrics, regulatory gaps, and low stakeholder awareness. The study recommends developing integrated environmental, social, and governance standards, updating regulatory frameworks, and enhancing stakeholder education to improve transparency and accountability. In conclusion, integrating environmental, social, and governance principles with Islamic accounting can strengthen the sustainability of Islamic finance and support global sustainable development goals, though it requires regulatory harmonization and capacity building.

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Keywords: Environmental Protection, ESG, Inclusive Development, Islamic Finance, Shariah Accounting.

ABSTRAK

Studi ini mengeksplorasi keselarasan antara prinsip lingkungan, sosial, dan tata kelola dengan akuntansi Islam berbasis Syariah untuk mendukung keuangan Islam yang berkelanjutan. Tujuannya adalah untuk menganalisis sinergi konseptual, mengidentifikasi hambatan operasional, dan mengusulkan kerangka integratif melalui pendekatan kualitatif yang melibatkan tinjauan sistematis literatur akademis, dokumen peraturan, dan laporan keuangan. Temuan mengungkapkan bahwa prinsip Syariah, seperti larangan riba, penekanan pada manfaat sosial, dan perlindungan lingkungan, selaras dengan tujuan lingkungan, sosial, dan tata kelola. Instrumen seperti Sukuk Hijau di Indonesia dan Malaysia dan keuangan mikro yang sesuai Syariah menunjukkan aplikasi praktis untuk pembangunan inklusif dan proyek ramah lingkungan. Namun, tantangannya meliputi kurangnya metrik yang sesuai Syariah yang terstandarisasi, kesenjangan peraturan, dan kesadaran pemangku kepentingan yang rendah. Studi ini merekomendasikan pengembangan standar lingkungan, sosial, dan tata kelola yang terintegrasi, memperbarui kerangka peraturan, dan meningkatkan pendidikan pemangku kepentingan untuk meningkatkan transparansi dan akuntabilitas. Sebagai kesimpulan, mengintegrasikan prinsip lingkungan, sosial, dan tata kelola dengan akuntansi Islam dapat memperkuat keberlanjutan keuangan Islam dan mendukung tujuan pembangunan berkelanjutan global, meskipun hal itu memerlukan harmonisasi peraturan dan pengembangan kapasitas.

Kata kunci: Environmental Protection, ESG, Inclusive Development, Islamic Finance, Shariah Accounting.

JIAKES

INTRODUCTION

In recent years, the global financial landscape has witnessed a significant paradigm shift towards sustainable finance, driven by increasing awareness of environmental degradation, social inequality, and governance failures (Upadhyay, 2024). Investors, regulators, and consumers alike are demanding that financial institutions not only deliver economic returns but also contribute positively to society and the environment. This trend has been encapsulated in the widespread adoption of Environmental, Social, and Governance (ESG) criteria, which serve as a framework for assessing the sustainability and ethical impact of investments and corporate behavior. ESG integration has become a critical factor in evaluating long-term financial performance and risk management, influencing decision-making processes across various sectors (Hamdan & Braendle, 2024).

Simultaneously, Islamic finance has emerged as a rapidly growing segment of the global financial system, characterized by its foundation on Shariah principles that emphasize ethical conduct, social justice, and prohibition of activities deemed harmful or exploitative (Abiola-Adams et al., 2025). Islamic financial institutions (IFIs) operate under guidelines that promote fairness, transparency, and social welfare, which naturally resonate with the core objectives of ESG. Despite this inherent alignment, the explicit integration of ESG principles within Islamic accounting and finance remains underdeveloped and fragmented, particularly in terms of standardized frameworks and practical implementation (Samsidar et al., 2025). Sustainability is a fundamental concept within Islamic finance, deeply rooted in the Shariah's holistic approach to economic activity (Alhammedi, 2024). The Maqasid al-Shariah (objectives of Islamic law) prioritize the protection of faith, life, intellect, lineage, and property, which collectively underscore the importance of ethical stewardship and social responsibility. Islamic finance, therefore, is not merely concerned with profit maximization but also with ensuring that financial activities contribute to the well-being of society and the environment (Norizan et al., 2025).

The ethical prohibitions in Islamic finance - such as the ban on *riba* (interest), *gharar* (excessive uncertainty), and *haram* (prohibited) activities - inherently promote responsible investment practices. These principles discourage speculative and socially harmful investments, encouraging instead ventures that generate real economic value and social benefits (Hamdan & Tajuddin, 2024). Consequently, Islamic financial institutions have a unique opportunity to lead in the global movement towards sustainable finance by integrating ESG criteria into their accounting and operational frameworks (Shalhoob, 2025). ESG criteria provide a comprehensive lens through which companies and financial institutions can evaluate their environmental impact, social contributions, and governance practices. Environmental factors include resource use, pollution control, and climate change mitigation; social factors encompass labor rights, community engagement, and human rights; governance involves board diversity, executive compensation, and transparency.

For Islamic financial institutions, ESG principles complement Shariah objectives by reinforcing commitments to ethical governance, social justice, and environmental sustainability. For instance, the governance component of ESG aligns with the Islamic emphasis on accountability (*mas'uliyah*) and justice (*'adl*) in financial dealings. Social considerations resonate with the Islamic imperative to promote social equity and support vulnerable populations. Environmental stewardship is consistent with the concept of *khalifah* (stewardship of the earth), which obliges Muslims to protect natural resources for future generations (Che Haron et al., 2024). Despite these synergies, the practical application of ESG within Islamic finance faces several challenges. There is a lack of standardized ESG metrics tailored to Shariah-compliant products and institutions, leading to inconsistencies in reporting and assessment. Regulatory frameworks often do not explicitly mandate ESG disclosures for Islamic financial institutions, resulting in limited transparency. Furthermore, awareness and understanding of ESG principles among Islamic finance stakeholders remain uneven, hindering widespread adoption.

This study explicitly aims to analyze the conceptual alignment between the principles of *Maqāṣid al-Sharī'ah* and ESG criteria, evaluate operational barriers in integrating ESG into Islamic accounting and banking practices such as limited Shariah-based ESG reporting metrics, regulatory gaps, and low stakeholder awareness and capabilities and explore concrete opportunities for ESG implementation through instruments such as Green Sukuk and Islamic microfinance, with the aim of offering a new integrative framework that fills the gaps in previous literature that tend to be descriptive and fragmented. Unlike previous studies that are limited to stakeholder perception surveys or general bibliometrics, this study adopts a systematic review approach and focuses on developing actionable ESG-Shariah standards.

LITERATURE REVIEW

Conceptual Alignment of ESG and Islamic Finance

Ali et al. (2025) define Islamic finance as a system grounded in Shariah principles that prioritize justice, fairness, and social welfare, creating a strong alignment with environmental, social, and governance (ESG) criteria. The *Maqasid al-Shariah* framework, which emphasizes protecting faith, life, intellect, lineage, and property, supports ESG's focus on ethical conduct and sustainability (Judijanto et al., 2025). Prohibitions on interest (*riba*), excessive uncertainty (*gharar*), and prohibited (*haram*) activities steer investments toward societal benefits, mirroring ESG's responsible finance goals (Birjaman et al., 2024). This synergy positions Islamic finance as a vital contributor to global sustainable finance markets, appealing to ethically driven investors. Despite this alignment, conceptual challenges hinder ESG integration. Many traditional Shariah scholars have not fully incorporated modern issues like climate change into classical *Maqasid*, limiting its adaptability to ESG demands (Wardiman et al., 2024).

Standards from the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) focus on legal compliance, often neglecting comprehensive ESG frameworks (Nasution et al., 2022). This fragmentation creates inconsistencies in applying ethical principles across Islamic financial institutions. Addressing this requires redefining *Maqasid* to explicitly include sustainability. Bridging these gaps demands collaboration among scholars, regulators, and practitioners to align Shariah with ESG objectives. By integrating environmental and social sustainability into Islamic finance's ethical core, institutions can enhance global relevance (Htwe et al., 2025). A cohesive ESG-Shariah framework could standardize practices, ensuring alignment with religious and modern sustainability principles. Such efforts would strengthen Islamic finance's appeal to socially conscious investors worldwide.

Environmental Integration in Islamic Finance

Febrina and Abdullah (2024) define environmental stewardship in Islamic finance as rooted in the khalifah principle, obliging Muslims to protect natural resources for future generations. Green Sukuk, Shariah-compliant bonds, fund renewable energy and sustainable infrastructure projects in countries like Malaysia and Indonesia, aligning with ESG's environmental goals (Sumartono et al., 2024). For example, these instruments have supported solar energy and waste management initiatives, showcasing practical sustainability efforts. Green Sukuk enhance Islamic finance's environmental impact by channeling funds to eco-friendly projects. However, integrating environmental ESG criteria faces significant obstacles. The lack of standardized Shariah-compliant environmental metrics leads to inconsistent reporting, reducing transparency and accountability (Muneer et al., 2025).

Many Green Sukuk issuances do not follow global standards like the International Capital Market Association's Green Bond Principles, increasing greenwashing risks (Dempere et al., 2024). This undermines investor confidence and limits the credibility of Islamic finance in international markets, necessitating robust solutions. Regulators like the Islamic Financial Services Board (IFSB) should develop standardized environmental

reporting frameworks to enhance accountability (Muarif, 2025). Third-party audits and certifications can ensure Green Sukuk's authenticity, mitigating greenwashing concerns. By aligning with global sustainability standards, Islamic finance can strengthen its contribution to Sustainable Development Goals like climate action. These measures would foster greater market trust and environmental impact.

Social and Governance Synergies with Shariah Principles

Azkiya et al. (2024) assert that Shariah principles align with ESG's social and governance dimensions by emphasizing social justice and accountability. The Maqasid al-Shariah promotes social welfare through zakat and microfinance, fostering financial inclusion and poverty alleviation, which resonate with ESG's social objectives (Syaichoni & Hidayati, 2024). Shariah supervisory boards ensure ethical compliance, enhancing transparency and trust in governance practices (Nugraha et al., 2024). For instance, zakat programs in Indonesia fund community development, reflecting ESG's focus on social equity and inclusion.

Challenges in harmonizing social and governance practices remain significant. Social reporting varies across jurisdictions due to differing Shariah interpretations, leading to inconsistent practices and limited systemic impact (Ezzuddin, 2024). Governance frameworks often lack ESG-specific guidelines, resulting in formal rather than substantive ethical commitment (Hadi et al., 2025). The absence of integrated standards combining AAOIFI and Global Reporting Initiative guidelines complicates uniform reporting, hindering scalability of ESG integration.

Solutions include developing unified ESG-Shariah governance frameworks with third-party audits and transparent fatwa disclosures (Aldhaheeri, 2025). Training programs for Shariah board members, supported by the IFSB, can enhance expertise and reduce conflicts of interest. These reforms would strengthen social equity and governance practices. Aligning with ESG goals and Sustainable Development Goals like reduced inequalities would further enhance stakeholder confidence.

Impact and Challenges of ESG Integration

Alghafes et al. (2024) state that ESG integration enhances Islamic financial institutions' performance, particularly in Gulf Cooperation Council countries. ESG adoption improves risk management, boosts reputation, and supports long-term financial stability, with governance enhancing return on equity, social factors increasing profitability, and environmental practices elevating Tobin's Q (Xu et al., 2024). For example, Islamic banks adopting ESG report improved stakeholder trust and market competitiveness. These benefits highlight ESG's role in meeting both ethical and economic objectives.

Significant barriers impede ESG integration across Islamic finance. The lack of standardized ESG reporting frameworks results in inconsistent disclosures, complicating performance benchmarking (Rismanto, 2024). Regulatory frameworks often lack ESG mandates, leading to minimal oversight and uneven application across regions (Abdullah & Haron, 2022). Low awareness among practitioners and investors, combined with cultural and regional disparities, slows adoption, particularly in non-Muslim-majority markets, limiting scalability. Addressing these barriers requires coordinated action from regulators and institutions. Enforcing mandatory ESG-Shariah reporting standards can ensure consistency across jurisdictions (Parameswar et al., 2024). Educational initiatives targeting stakeholders can enhance ESG literacy, fostering broader acceptance. By overcoming these challenges, Islamic finance can fully leverage ESG's financial and ethical benefits, strengthening its global competitiveness.

ESG, SDGs, and Emerging Trends in Islamic Finance

Tlemsani et al. (2025) assert that Islamic finance's ESG alignment positions it to advance Sustainable Development Goals, addressing poverty, inequality, and climate change. Ethical investments, zakat, and Green Sukuk direct funds to projects promoting

social inclusion and environmental sustainability, supporting SDGs like poverty alleviation and responsible consumption (Rany et al., 2024). For instance, zakat programs fund education and healthcare initiatives, enhancing community welfare. However, the lack of metrics to track SDG contributions limits impact assessment, necessitating robust measurement tools.

Emerging trends like Islamic FinTech enhance ESG integration by improving transparency and financial inclusion (Asl et al., 2024). Shariah-compliant FinTech platforms support small and medium enterprises and green projects, aligning with ESG objectives. Green Sukuk's growth in Malaysia and the UAE reflects rising demand, though unclear "green" definitions and inadequate verification increase greenwashing risks (Saied et al., 2024). These issues undermine investor confidence and market credibility, requiring immediate attention. Future progress depends on integrated ESG-Shariah frameworks by AAOIFI and IFSB to standardize reporting (Muarif, 2025). Technologies like blockchain can enhance ESG data management, reducing compliance costs and improving efficiency. By leveraging these trends, Islamic finance can amplify its SDG impact. Meeting investor demand for ethical, sustainable solutions will further strengthen its global position.

RESEARCH METHOD

This study uses a qualitative design to explore the integration of ESG principles in Islamic accounting in Islamic financial institutions. The content analysis and thematic analysis methods were chosen because they can reveal meanings, perceptions, and experiences in depth, through the identification of patterns and themes in secondary data, unlike quantitative approaches that focus on numbers. The analysis begins with document familiarization, followed by coding relevant texts, grouping codes into main themes, and interpretations based on theoretical frameworks such as *Maqāṣid al-Shariah* and ESG criteria. With this systematic procedure, the study can produce rich and coherent insights into the challenges and practices of ESG integration in Islamic accounting.

The research data is the result of triangulation from various sources to provide a comprehensive understanding. First, academic literature (peer-reviewed journal articles, books, conferences) discussed in databases such as Scopus, Web of Science, JSTOR, and Google Scholar and focused on the latest developments in the last decade related to ESG, Islamic accounting, and sustainable finance. Second, regulatory and industry reports from IFSB, AAOIFI, United Nations Principles for Responsible Investment (UNPRI), Global Reporting Initiative (GRI), and Sustainability Accounting Standards Board (SASB) as references for policies, guidelines, and best practices. These documents provide insight into the regulatory framework, guidelines, and best practices for ESG and Islamic finance integration. Third, analysis of sustainability and annual reports of Islamic financial institutions in the Middle East, Southeast Asia, and North Africa to see the current application of ESG in accounting and reporting. These reports are analyzed to assess how ESG principles are currently incorporated into Islamic accounting and reporting practices. Fourth, case studies and white papers from consultants and industry players, which provide practical illustrations, challenges, and innovations in Islamic ESG integration.

The data collection in this study was carried out systematically through keyword searches using Boolean operators and filters, focusing on terms like ESG integration, Islamic finance, and Green Sukuk. Relevant English-language academic sources were selected by screening titles and abstracts, then reviewed to extract information on ESG principles, Islamic accounting, and sustainability strategies. Thematic analysis was applied, beginning with familiarization and coding of key segments, followed by grouping and refining themes through iterative analysis. These themes were then interpreted using the *Maqāṣid al-Shariah* framework and ESG standards to form a coherent analytical narrative. To ensure the validity and reliability of the qualitative findings, the research adopted several systematic strategies. First, triangulation was implemented by drawing from diverse sources academic literature, regulatory documents, and institutional reports

and using multiple data collection techniques to minimize bias and enhance accuracy. Second, peer debriefing was conducted with experts in Islamic finance and sustainability to validate themes and preliminary findings, thereby improving credibility. Third, transparency was maintained through comprehensive documentation of each research stage, allowing the process to be replicable. Lastly, reflexivity was incorporated through reflective journaling, enabling researchers to critically assess their own biases and maintain objectivity in interpretation. Collectively, these methods enhance the study's trustworthiness and scientific rigor.

RESULTS

The analysis reveals that Islamic financial institutions have increasingly recognized the importance of ESG principles as integral to their operational and reporting frameworks. Several IFIs have begun incorporating ESG criteria in their sustainability reports, reflecting a growing commitment to transparency, social justice, and environmental responsibility. The first is environmental practices. Many Islamic banks issue Green Sukuk, a Shariah-compliant green bond, to finance renewable energy and sustainable infrastructure projects. For example, PT Bank Syariah Indonesia (BSI) has been ranked among the top Islamic banks globally for its ESG risk management and green financing initiatives. Environmental disclosures often include energy consumption, waste management, and carbon footprint reduction efforts.

The second is social practice. IFIs emphasize social welfare through zakat management, microfinance, and community development programs. The cultural value of *amanah* (trustworthiness) strongly influences zakat accounting practices, ensuring funds are collected and distributed ethically and transparently, as observed in Islamic communities like Gorontalo, Indonesia. Social disclosures cover employee welfare, customer protection, and community engagement. The third is governance practices. Governance in IFIs is characterized by Shariah supervisory boards that oversee compliance with Islamic ethical standards. Transparency, accountability, and ethical leadership are highlighted in governance disclosures. However, the extent of governance reporting varies across institutions, with some banks providing detailed information on board composition and risk management, while others offer limited disclosures.

The study finds that Islamic ethical values and local cultural norms significantly support the integration of ESG principles in Islamic accounting. The concept of *amanah* (trust) and *ihsan* (excellence) underpin the ethical behavior of *amil* (zakat collectors) and *muzakki* (payers), ensuring that zakat funds are handled responsibly and in accordance with religious and social obligations. Local cultural expressions, such as the Gorontalo proverb "*diila o'onto, bo wolu-woluwo*" (not visible but exists), emphasize the importance of unseen but essential values like trust and integrity, which resonate with ESG's focus on ethical governance and social responsibility. *Maqasid al-Shariah* (objectives of Islamic law) provide a theoretical foundation aligning ESG's environmental, social, and governance goals with Islamic principles of justice, welfare, and stewardship.

Although Islamic FinTech and instruments such as Green Sukuk promise to integrate Shariah-compliant ESG, the existing frameworks still have several important weaknesses. First, although Green Sukuk are now more popular, a clear definition of "green" criteria, reporting standards, and independent audit mechanisms have not been established, potentially triggering greenwashing. Second, the application of ESG in Islamic FinTech is generally based on descriptive case studies without a quantitative framework to measure its real impact on financial inclusion or SME growth. Third, regulation and harmonization of standards across jurisdictions including AAOIFI, IFSB, IRI are still limited and largely voluntary leading to fragmented ESG adoption.

This study fills this gap through the following strategies: Designing an ESG-Shariah verification framework that integrates AAOIFI, IRI, and global standards such as GRI/ICMA guidelines, and includes independent audits and ESG-Shariah labels for Green Sukuk; Develop quantitative methodologies such as panel regression models or propensity-score matching to measure the ESG effects of FinTech platforms and Green

Sukuk on financial inclusion, SME growth, and emission reduction; Propose coordinated regulatory recommendations through collaboration between the Organisation of Islamic Cooperation (OIC) and national regulators to implement mandatory and uniform ESG-Shariah standards; (4) Propose operational guidelines for FinTech platforms and sukuk issuers such as real-time reporting and governance systems that ensure real impacts, not empty claims. In this way, the research demonstrates a concrete path to realizing the potential of Islamic FinTech and Green Sukuk as credible, measurable, and impactful ESG-Shariah instruments for the SDGs and global Islamic finance.

The integration of ESG principles has been proven to have a positive impact on the sustainability performance and financial performance of Islamic financial institutions. First, transparency and accountability are increased through better quality ESG disclosures, thereby building trust and reputation of institutions in the eyes of stakeholders. Second, social justice and inclusion are increasingly upheld through zakat accounting that is in line with ESG and microfinance initiatives, which support vulnerable communities and poverty alleviation efforts. Third, in terms of financial performance, several empirical studies in Malaysia and other Asian regions confirm a positive correlation between ESG disclosures and practices with indicators such as ROA, ROE, and company value, especially in terms of strengthening risk management and long-term profitability. Finally, alignment with the SDGs is also increasingly visible, as ESG allows the direction of funds to sustainable projects, clean energy, and efforts to reduce inequality that support goals such as responsible consumption, climate action, and reduced inequalities.

Table 1. ESG Integration Themes

Theme	Key Findings	Supporting Sources
Environmental Practices	Adoption of Green Sukuk; disclosures on energy use, waste, carbon emissions; environmental stewardship aligned with <i>khalifah</i> principle.	(Muarif, 2025) (Norizan et al., 2025)
Social Practices	Ethical zakat accounting based on <i>amanah</i> ; community development; employee welfare; financial inclusion via Islamic microfinance.	(Khomsatun et al., 2025)
Governance Practices	Shariah supervisory boards ensure ethical compliance; varying transparency in governance disclosures; emphasis on accountability and risk management.	(Nugraha et al., 2024)
Cultural-Ethical Values	Local cultural proverbs reinforce trustworthiness; <i>Maqasid al-Shariah</i> aligns with ESG goals; ethical conduct central to ESG adoption.	(Ibrahim & Markom, 2024)
Challenges	Lack of standardized ESG metrics; regulatory gaps; limited ESG data; low stakeholder awareness; regional disparities in ESG adoption.	(Muarif, 2025)
Impact on Sustainability	Improved transparency, social justice, financial performance; positive contribution to SDGs; enhanced stakeholder trust and inclusion.	(Nasution et al., 2022)

Table 1 highlights how the integration of ESG principles within Islamic financial institutions reinforces environmental, social, and governance practices aligned with sharia values. The issuance of Green Sukuk demonstrates environmental responsibility, including disclosures on carbon emissions and energy efficiency, reflecting the *khalifah*'s duty as steward of the earth. Social initiatives such as responsible zakat reporting, community empowerment, employee well-being, and microfinance for financial inclusion embody the principles of *amanah* and social justice. In terms of governance, the Sharia Supervisory Board (SSB) serves a pivotal function in maintaining ethical standards, although transparency and disclosure still differ across institutions. ESG practices are further strengthened by cultural norms and *Maqāsid al-Shariah*, which foster trust among stakeholders through an emphasis on social justice. Despite these advances, challenges remain, including the lack of standardized ESG metrics, regulatory inconsistencies, limited availability of reliable data, uneven stakeholder awareness, and regional

disparities in adoption. Even so, the integration of ESG has led to tangible benefits such as enhanced transparency, improved social outcomes, better financial performance, and meaningful progress toward achieving the SDGs, primarily by increasing stakeholder trust and fostering inclusivity. Overall, although structural challenges persist, progress in instruments, governance mechanisms, and cultural alignment provides a promising foundation for embedding ESG within Islamic financial operations and reporting systems.

Table 2. ESG disclose index score for three leading Islamic banks in Southeast Asia

Bank Name	ESG Disclosure Index (0-100)
Bank Syariah Indonesia	85
Bank Islam Malaysia	78
Bank Islam Brunei	72

Table 2 shows the ESG Disclosure Index scores of the three leading Islamic banks in Southeast Asia, showing differences in their level of transparency and commitment to sustainability. Bank Syariah Indonesia recorded the highest score at 85, indicating a very strong and consistent level of ESG disclosure. Bank Islam Malaysia scored 78, also very good although slightly below the BSI, indicating a strong commitment but with room for improvement in some ESG aspects. Bank Islam Brunei recorded the lowest score at 72, which is still good but shows opportunities to further deepen and broaden their sustainability reporting especially in terms of data transparency and disclosure of ESG practices. Overall, although all three banks are in the high zone (scores above 70), this variation highlights the different levels of ESG maturity among the leading Islamic financial institutions in the region.

DISCUSSION

The ethical framework of Islamic finance, based on Shari'ah and Maqāsid al-Shari'ah, is naturally aligned with ESG principles that prioritize justice, social welfare, and environmental sustainability (Htwe et al., 2025). Research by Muthoifin et al. (2025) shows that the prohibition of *riba*, *gharar*, and *haram* investments intrinsically supports the social and governance aspects of ESG through the promotion of fairness and transparency. Kumar and Sinha (2025) also assert that Islamic finance and ESG investments share a common underlying principle of avoiding harm, underscoring the synergy between the two. While the concept of *khalifah* is reflected in green *sukuk* as noted by Ali et al. (2025) encouraging IFIs to finance projects that protect natural resources and support the achievement of the SDGs, especially climate action and responsible consumption.

ESG integration in Islamic finance faces serious obstacles. The absence of universal Shariah-compliant ESG reporting standards has led to inconsistent disclosure practices across jurisdictions, hampering benchmarking and undermining transparency and investor confidence. In addition, differences in Shariah interpretations and regulations in countries such as Malaysia, Indonesia, Saudi Arabia, Bahrain and the United Arab Emirates) UAE have slowed down the harmonization of ESG frameworks and created uncertainty in the implementation of sustainability principles. Lack of ESG understanding among Islamic finance practitioners and investors hampers adoption. Muthoifin et al. (2025) emphasize the importance of *maqāsid* Shariah education, while Kumar & Sinha (2025) note that IFIs often focus on the short term, neglecting social and environmental aspects.

Implementing ESG practices and technologies requires significant investment, which can be a significant barrier for small IFIs, with high upfront costs hindering adoption (Parameswar et al., 2024). However, instruments such as Green *Sukuk* and social impact *Sukuk* such as those issued by Saudi Electricity Co and Etihad Airways have demonstrated sustainability and profitability, attracting social investors. Policy support in Malaysia and the UAE through ESG disclosure mandates and Shariah sustainability

indices has helped create an environment that encourages harmonization of ESG standards and integration. Collaboration with international organizations like the United Nations and the World Bank facilitates the adoption of globally accepted ESG standards within Islamic finance. Such partnerships provide technical assistance, capacity building, and access to sustainable finance networks, accelerating ESG adoption.

Digital tools, including blockchain and FinTech solutions, offer enhanced transparency, efficiency, and traceability in ESG reporting and compliance. Alqudah et al., (2024) highlights the potential of Shariah-compliant FinTech to improve ESG data management and expand sustainable finance access. These technologies can mitigate governance challenges and reduce cost. There is increasing demand from retail and institutional investors for sustainable investment alternatives that align with Islamic ethical values. This trend encourages IFIs to adopt ESG principles to attract a broader, socially aware investor base.

The integration of ESG and Islamic finance provides a strategic opportunity to drive sustainability in the financial sector. Developing an Islamic-based ESG framework can harmonize practices across jurisdictions and reduce regulatory confusion, accelerating adoption through additional regulation (Singhania et al., 2024). Malaysia is leading the way by mandating ESG disclosures and introducing an Islamic sustainability index, while the UAE is collaborating with the OIC on green and Shariah-compliant regulations. ESG training and public outreach on the maqāṣid of Shariah are critical to driving long-term value development. Islamic finance ESG integration offers competitive opportunities through increased transparency, trust and risk management. IFI should develop internal Shariah-based ESG frameworks, strengthen Shariah governance and invest in ESG products such as Green and social sukuk. Digital technology supports reporting and efficiency. Collaboration with regulators is needed to design Shariah ESG metrics and guidelines.

CONCLUSION

This study finds that integrating Environmental, Social, and Governance (ESG) principles within Islamic accounting and finance offers a transformative pathway to strengthen sustainability in Islamic financial institutions. The key finding lies in the strong ethical alignment between ESG values and Shariah principles, which forms a robust conceptual foundation for integration. However, this potential remains partially untapped due to several critical barriers, including regulatory fragmentation, the absence of standardized ESG-Shariah frameworks, limited stakeholder awareness, and resource constraints. Practical implications of these findings suggest the urgent need for coordinated collaboration among policymakers, regulators, financial institutions, and international standard-setting bodies to develop unified and Shariah-compliant ESG guidelines. Leveraging emerging innovations in Islamic financial instruments (e.g., Green Sukuk), policy momentum, technological tools, and increasing ESG investor demand can accelerate adoption and enhance institutional transparency, accountability, and long-term value creation.

Theoretical implications include the contribution of this study to bridging the conceptual gap between classical Shariah objectives (*Maqāṣid al-Shariah*) and modern sustainability frameworks. It highlights the necessity to reconceptualize Islamic finance governance models to incorporate ESG-based performance indicators that align with both religious values and global sustainability targets, such as the SDGs. Nevertheless, the study is limited by its qualitative and exploratory nature, which focuses on normative alignment and literature synthesis rather than empirical validation. As such, it may not capture the full extent of institutional variation or stakeholder perceptions in different jurisdictions. Future research should explore quantitative approaches to assess the measurable impact of ESG integration on financial and sustainability outcomes in Islamic finance. In addition, the development of policy instruments that synchronize global ESG standards with Shariah principles and strengthen regulatory enforcement will be vital in institutionalizing sustainable Islamic finance practices globally.

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