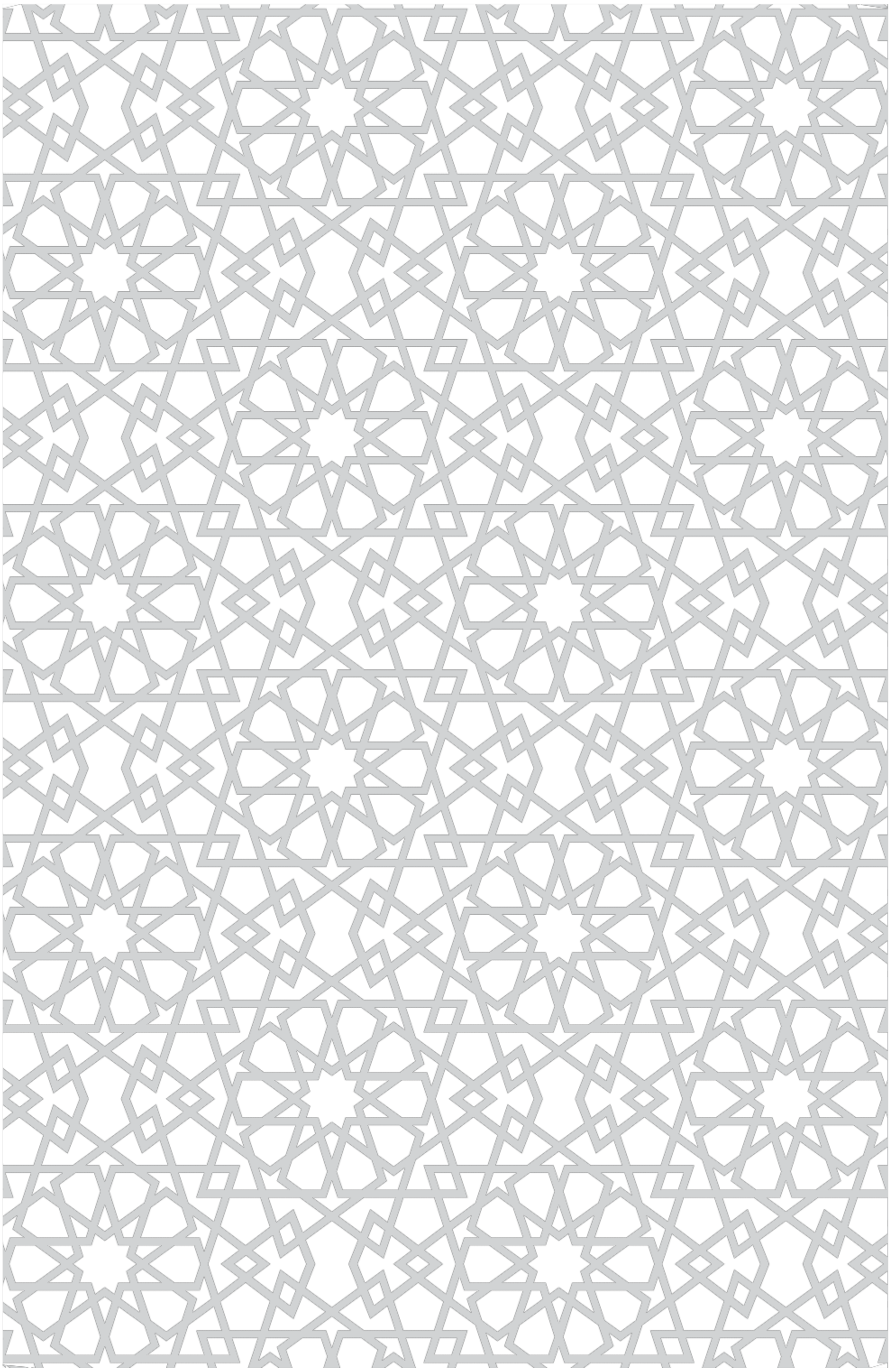
Governance Standard No. (1)

Shari'a Supervisory Board:
Appointment, Composition and Report



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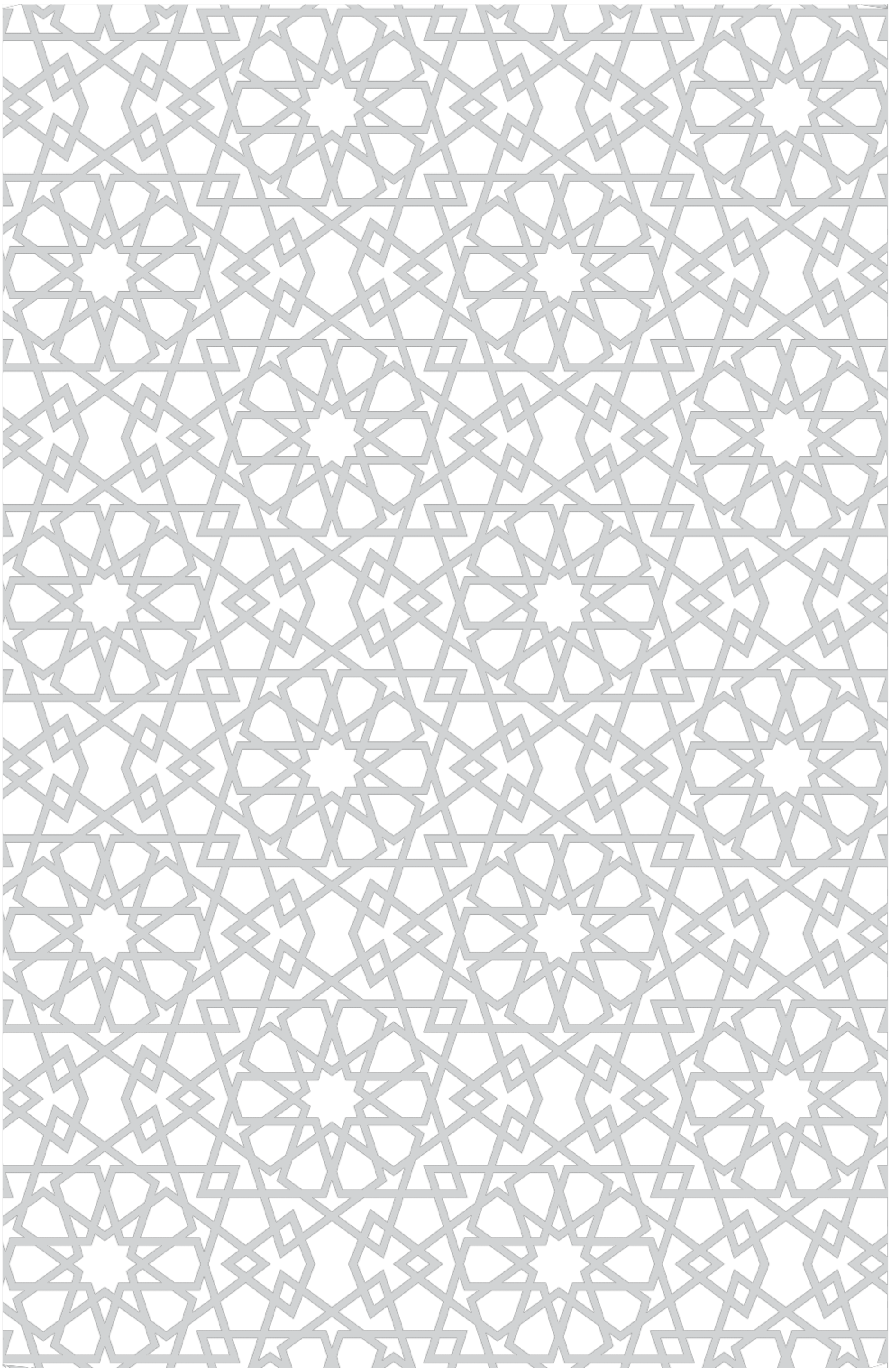


Shari'a Supervisory Board: Appointment, Composition and Report

Introduction

1. The purpose of this Governance Standard for Islamic Financial In- stitutions (GSIFI) is to establish standards and provide guidance on the definition, appointment, composition, and report of the Shari'a supervisory board for ensuring compliance of the Islamic financial institution in all its dealings and transactions with Shari'a Rules and Principles. The main points are:

Definition of Shari'a Supervisory Board

2. A Shari'a supervisory board is an independent body of specialised jurists in Fiqh Al-Mua'malat (Islamic commercial jurisprudence). However, the Shari'a supervisory board may include a member other than those specialised in Fiqh Al-Mua'malat, but who should be an expert in the field of Islamic financial institutions and with knowledge of Fiqh Al- Mua'malat. The Shari'a supervisory board is entrusted with the duty of directing, reviewing and supervising the activities of the Islamic financial institution in order to ensure that they are in compliance with Shari'a Rules and Principles. The fatwas, and rulings of the Shari'a supervisory board shall be binding on the Islamic financial institution.

Appointment of Shari'a Supervisory Board and Fixing of Its Remuneration

3. Every Islamic financial institution shall have a Shari'a supervisory board to be appointed by the shareholders in their annual general meeting upon the recommendation of the board of directors taking into consideration the local legislation and regulations. Shareholders may authorise the board of directors to fix the remuneration of the Shari'a supervisory board.

4. The Shari'a supervisory board and the Islamic financial institution should agree on the terms of the engagement. The agreed terms would need to be recorded in an appointment letter.

5. The Shari'a supervisory board should ensure that the Islamic financial institution documents and confirms the Shari'a supervisory board's acceptance of appointment. The letter of appointment of Shari'a supervisory boards should generally include reference to the compliance of the Islamic financial institution with Shari'a Rules and Principles.

6. The Shari'a supervisory board shall appoint from among its members or any other person a supervisor(s) to help it in performing its duties.

Composition, Selection and Dismissal of Shari'a Supervisory Board

7. The Shari'a supervisory board shall consist of at least three members.

The Shari'a supervisory board may seek the service of consultants who have expertise in business, economics, law, accounting and/or others. The Shari'a supervisory board should not include directors or significant shareholders of the Islamic financial institution.

8. The dismissal of a member of the Shari'a supervisory board shall require a recommendation by the board of directors and be subject to the approval of the shareholders in a general meeting.

Basic Elements of the Shari'a Supervisory Board's Report

9. The Shari'a supervisory board's report should contain the following basic elements:

a) Title;
b) Addressee;
c) Opening or introductory paragraph;
d) Scope paragraph describing the nature of the work performed;
e) Opinion paragraph containing an expression of opinion on the compliance of the Islamic financial institution with Shari'a Rules and Principles;
f) Date of report; and
g) Shari'a supervisory board's signature.

A measure of uniformity in the form and content of the Shari'a supervisory board's report is desirable because it helps to promote the reader's understanding and to identify unusual circumstances when they occur.

Title

10. The Shari'a supervisory board's report should have an appropriate title.

The addressee of the Shari'a supervisory board's report

11. The Shari'a supervisory board's report should be appropriately addressed as required by the circumstances of the engagement and local laws and regulations.

Opening or introductory paragraph

12. The Shari'a supervisory board's report should identify the purpose of the engagement.

    Illustrative wording for an opening (introductory) paragraph is shown below:

    "In compliance with the letter of appointment, we are required to submit the following report:

13. A scope paragraph should describe the nature of the work performed.

    Illustrative wording for a scope paragraph is shown below:

    "We have reviewed the principles and the contracts relating to the transactions and applications introduced by the Example Islamic Fi- nancial Institution during the period ended. We have also conduct- ed our review to form an opinion as to whether the Example Islamic Financial Institution has complied with Shari'a Rules and Principles and also with the specific fatwas, rulings and guidelines issued by us."

Management's responsibility

14. A clear statement that the management of the Islamic financial in- stitution is responsible for properly complying with Shari'a Rules and Principles.

Illustrative wording for Shari'a statement is shown below:

"The Example Islamic Financial Institution's management is responsible for ensuring that the financial institution conducts its business in accor- dance with Shari'a Rules and Principles. It is our responsibility to form an independent opinion, based on our review of the operations of the Example Islamic Financial Institution, and to report to you."

Scope paragraph

15. Confirmation that the Shari'a supervisory board has performed ap- propriate tests, procedures and review work as appropriate.

16. Where appropriate, examining, on a test basis of each type of transaction, evidence to support that the transaction and dealings entered into by the respective Islamic financial institution are in compliance with the Shari'a Rules and Principles.

Illustrative wording to explain the review process is shown below: "We conducted our review which included examining, on a test basis of each type of transaction, the relevant documentation and procedures adopted by the Example Islamic Financial Institution.

We planned and performed our review so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Example Islamic Financial Institution has not violated Shari'a Rules and Principles."

17. Where appropriate, the report of the Shari'a supervisory board should include a clear statement that the financial statements have been examined for the appropriateness of the Shari'a basis of allocation of profit between the equity holders and the investment accountholders.

18. Where appropriate, the report of the Shari'a supervisory board should include a clear statement that all earnings that have been realized from sources or by means prohibited by Shari'a Rules

and Principles have been disposed of to charitable causes.

19. Where an Islamic financial institution prepares a Statement of Sources and Uses of Zakah and Charity Funds, the Shari'a supervisory board's report should state whether the calculation of the Zakah is in compli- ance with Shari'a Rules and Principles.

Opinion paragraph

20. The Shari'a supervisory board's report should state whether the Example Islamic Financial Institution's contracts and related documentation are in compliance with the Shari'a Rules and Principles.

An illustration of these matters in the opinion paragraph is shown below:

In our opinion:

a) The contracts, transactions and dealings entered into by the Ex- ample Islamic Financial Institution during the year ended ... that we have reviewed are in compliance with the Shari'a Rules and Principles;

b) The allocation of profit and charging of losses relating to investment accounts conform to the basis that had been approved by us in accordance with Shari'a Rules and Principles;

(where appropriate, the opinion paragraph shall also include the following matters:)

c) All earnings that have been realized from sources or by means prohibited by Shari'a Rules and Principles have been disposed of to charitable causes; and

d) The calculation of Zakah is in compliance with Shari'a Rules and Principles.

21. If the Shari'a supervisory board has ascertained that the management of the Islamic financial institution has violated Shari'a Rules and Principles or the fatwas, ruling and guidelines issued by its Shari'a supervisory board, then the Shari'a supervisory board has to report the violations in the opinion paragraph of its report.

Date of report

22. The Shari'a supervisory board should state the period covered by its report and date the report as of the completion date of the

review.

23. The Shari'a supervisory board should not date the report earlier than the date on which the financial statements are signed or approved by management.

Shari'a supervisory board's signature

24. The Shari'a supervisory board's report should be signed by all members of the Board.

Publication of the Report of the Shari'a Supervisory Board

25. The report of the Shari'a supervisory board shall be published in the annual report of the Islamic financial institution.

Publication of Fatwas, Rulings and Guidelines of the Shari'a Supervisory Board

26. It is recommended that the Islamic financial institution publishes the fatwas, rulings and guidelines issued by its Shari'a supervisory board during the year.

Effective Date

27. This standard shall be effective for the financial statements for the financial periods beginning 1 Muharram 1419 A.H. or 1 January
1999 A.D.

Adoption of the standard

The standard of Shari'a Supervisory Board: Appointment, Composition and Report was adopted by the Accounting and Auditing Standards Board in its meeting No. (13) held on 10-11 Safar 1418 A.H., corresponding to
15-16 June 1997 A.D.

Appendix
Example Report of Shari'a Supervisory Board

In the Name of Allah, The Beneficent, The Merciful

To the Shareholders of the Example Islamic Financial Institution

Assalamu Alaykum Wa Rahmatu Allah Wa Barakatuh

In compliance with the letter of appointment, we are required to submit the following report:

We have reviewed the principles and the contracts relating to the transactions and applications introduced by the Example Islamic Financial Institution during the period ended. We have also conducted our review to form an opinion as to whether the Example Islamic Financial Institution has complied with Shari'a Rules and Principles and also with the specific fatwas, rulings and guidelines issued by us.

The Example Islamic Financial Institution's management is re- sponsible for ensuring that the financial institution conducts its business in accordance with Shari'a Rules and Principles. It is our responsibility to form an independent opinion, based on our review of the operations of the Example Islamic Financial Institution, and to report to you.

We conducted our review which included examining, on a test basis of each type of transaction, the relevant documentation and procedures adopted by the Example Islamic Financial Institution.

We planned and performed our review so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Example Islamic Financial Institution has not violated Shari'a Rules and Principles.

In our opinion:

a) The contracts, transactions and dealings entered into by the Example Islamic Financial Institution during the year ended ... that we have reviewed are in compliance with the Shari'a Rules and Principles;

b) The allocation of profit and charging of losses relating to investment accounts conform to the basis that had been approved by us in accordance with Shari'a Rules and Principles;

(where appropriate, the opinion paragraph shall also include the following matters:)

c) All earnings that have been realized from sources or by means prohibited by Shari'a Rules and Principles have been disposed of to charitable causes; and

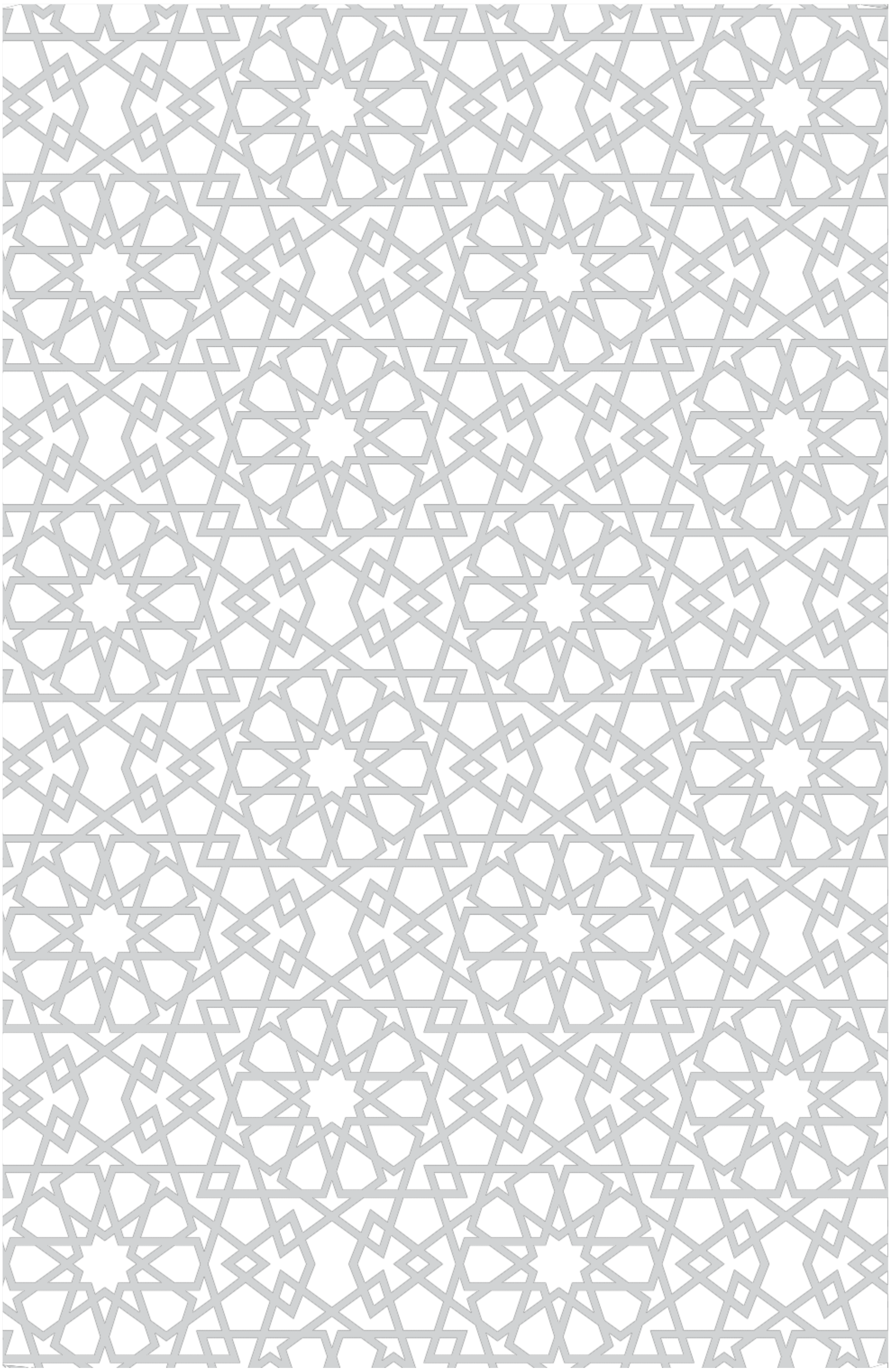
d) The calculation of Zakah is in compliance with Shari'a Rules and Principles.

We beg Allah the Almighty to grant us all the success and straight- forwardness.

Wassalamu Alaykum Wa Rahmatu Allah Wa Barakatuh

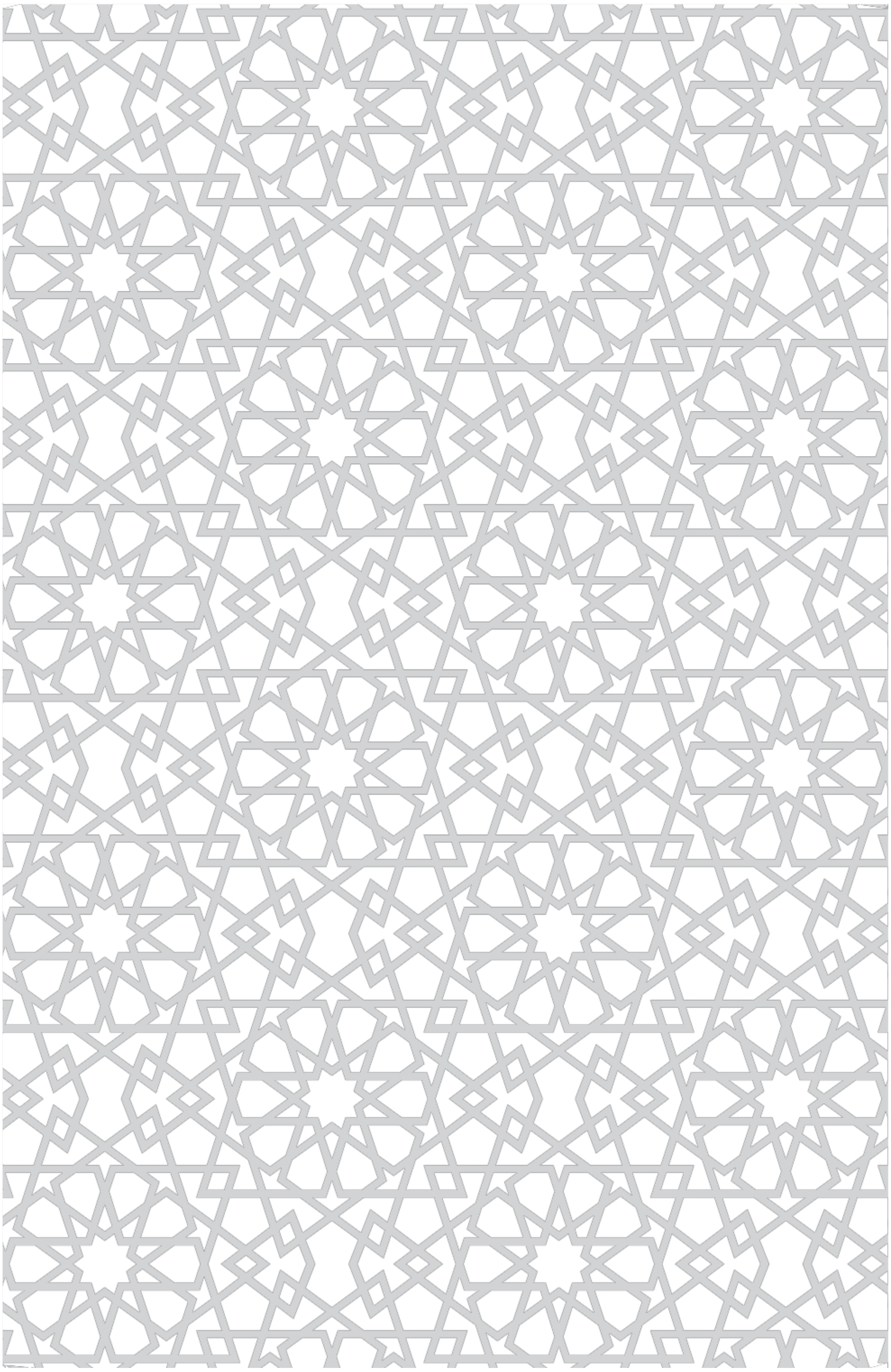
(Names and signature of the members of the Shari'a supervisory board)

Place and Date



Governance Standards No. (2)

Shari’a Review



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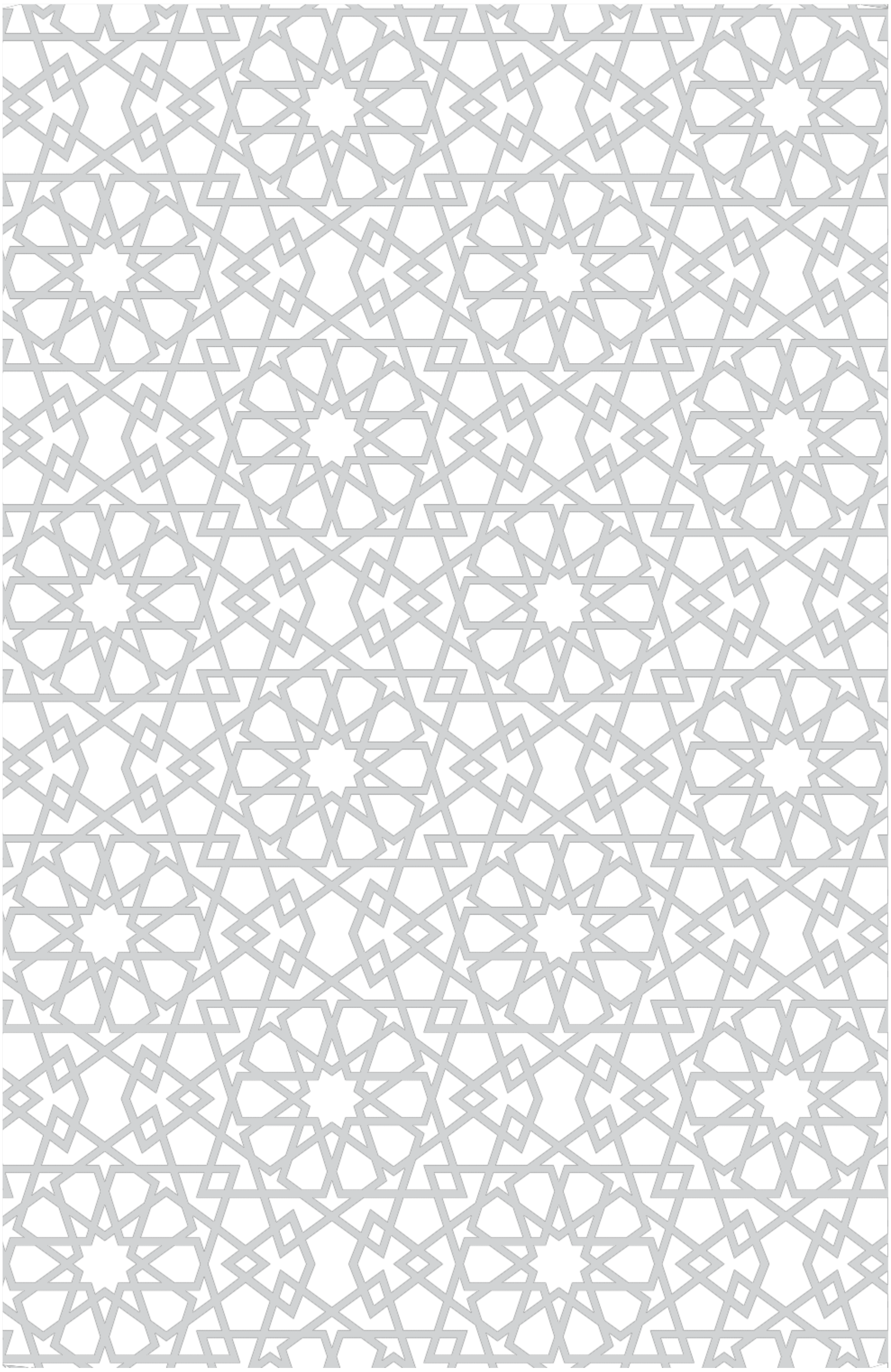

Shari’a Review

Introduction

1. The purpose of this Governance Standard for Islamic Financial Insti- tutions (GSIFI) is to establish standards and provide guidance to assist Shari’a Supervisory Boards (SSB) of Islamic Financial Institutions (IFIs) in performing Shari’a reviews to ensure compliance with Shari’a Rules and Principles as reflected in the fatwas, rulings and guidelines issued by them (hereinafter, the Shari’a).[1] The appointment, composition and report of the SSB is dealt with in AAOIFI Governance Standard for Is- lamic Financial Institutions No. (1): Shari’a Supervisory Board: Appoint- ment, Composition and Report.

2. This standard should be read in conjunction with ASIFI No. (1): Ob- jective and Principles of Auditing with particular reference to para- graph 7, and ASIFI No. (2): The Auditor’s Report with particular ref- erence to paragraph 17. It follows that the objective of this standard as well as those of ASIFIs No. (1) and No. (2) requires close coordination between the SSB and the external auditor.

Definition and Principles of Shari’a Review

3. Shari’a review is an examination of the extent of an IFI’s compliance, in all its activities, with the Shari’a. This examination includes contracts, agreements, policies, products, transactions, memorandum and articles of association, financial statements, reports (especially internal audit and central bank inspection), circulars, etc.

   The SSB shall have complete and unhindered access to all records, transactions, and information from all sources including professional advisers and the IFI employees.

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(1) Where applicable, the fatwas, rulings and guidelines of a Higher Shari’a Supervisory

Board shall also apply.

Objective of the Review

4. The objective of a Shari'a review is to ensure that the activities carried out by an IFI do not contravene the Shari'a. The achievement of this objective requires that the Shari'a as defined in (para. 1) above is mandatory.

Responsibility for Compliance with the Shari'a

5. While the SSB is responsible for forming and expressing an opinion on the extent of an IFI's compliance with the Shari'a, the responsibility for compliance therewith rests with the management of an IFI. (Consideration should be given to the definition of management in relevant national legislation and regulations). To enable management to carry out this responsibility effectively, the SSB of the IFI shall assist by providing guidance, advise and training relating to compliance with the Shari'a. The Shari'a review of an IFI's does not relieve management of their responsibility to undertake all transactions in accordance with the Shari'a. It is the management's responsibility to provide to the SSB all information relating to the IFI's compliance with the Shari'a.

6. An IFI shall not restrict the Shari'a review as noted in paragraph 3 above. In case such restrictions are imposed, these shall be included in the SSB's review report to the shareholders.

Shari'a Review Procedures

7. Shari'a review is to be carried out in the following stages:
   - Planning review procedures.
   - Executing review procedures and preparation and review of working papers.
   - Documenting conclusions and report.

Each of the above stages is explained as below:

Planning and designing Shari'a review procedures

8. The Shari'a review procedures shall be planned so that it is completed in an effective and efficient manner. The plan shall be adequately developed to include a complete understanding about the IFI's operations in terms of products, size of operation,

locations, branches, subsidiaries

and divisions. The planning shall include obtaining a list of all fatwas, rulings and guidelines issued by the SSB.

9. Understanding the activities, products and management's awareness and attitude towards compliance with the Shari'a is essential. This will have a direct effect on the nature, extent and timing of the Shari'a review procedures.

10. The plan shall be properly documented including the sample selection criteria and sizes, taking into consideration complexity, and frequency of transactions.

11. The review procedures shall be designed based on the above input.
The review procedures shall cover all activities, products and locations.
These procedures shall ascertain whether the SSB approved transactions and products have been undertaken and all related conditions have been met.

Executing Shari'a review procedures and preparation and review of working papers

12. At this stage, all the planned review procedures are executed. The SSB review procedures shall normally include:

- Obtaining an understanding of the management's awareness, com- mitment and compliance control procedures for adherence to the Shari'a;
- Reviewing of contracts, agreements, etc.;
- Reascertaining whether transactions entered into during the year were for products authorised by the SSB;
- Reviewing other information and reports such as circulars, minutes, operating and financial reports, policies and procedures, etc.;

- Consultation/co-ordination with advisors such as external auditors;
  and
- Discussing findings with an IFI's management.

The execution of the above review procedures shall be documented in work papers which shall be complete, neat and cross referenced to review procedures.

Documenting conclusions and report

13. The SSB shall document their conclusions and prepare their report to the shareholders based on the work done and discussions held. The SSB report shall be read at the annual general meeting of the IFI. A detailed report, when warranted, shall also be issued to an IFI's management.

Quality Assurance

14. The SSB shall implement adequate quality control policies and proce- dures to ensure that the review is conducted in accordance with this standard.

15. Quality control procedures may include review of all work papers to ensure that review procedures were properly understood and executed. Additional discussions may be held with the IFI's management, if required, to ensure that all significant matters were covered during the review.

Report

16. The SSB report to the shareholders of an IFI shall be based on GSIFI No. (1): Shari'a Supervisory Board: Appointment, Composition and Report.

Responsibility for Implementation of the Standard

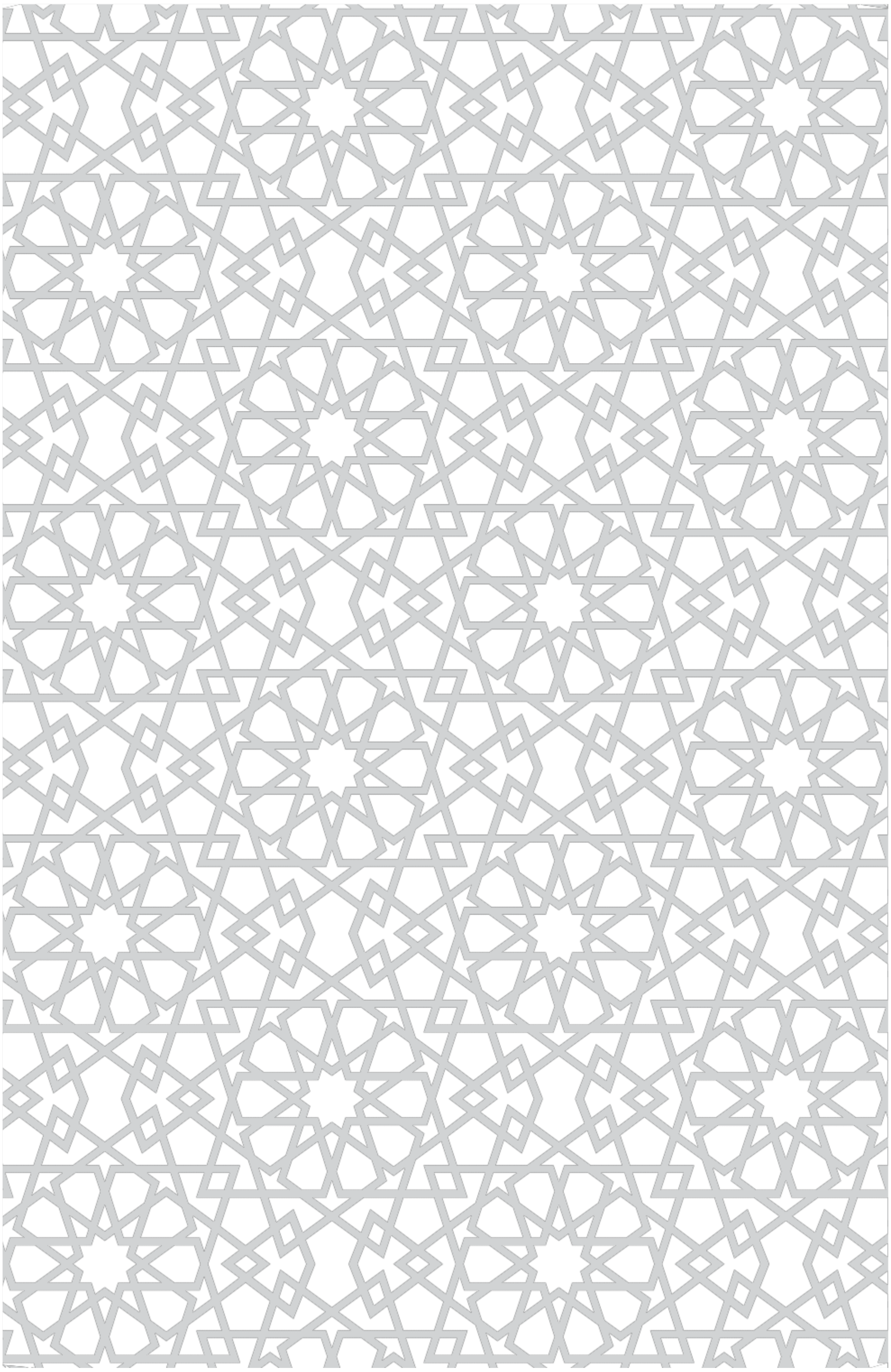
17. The responsibility for implementation of this standard, as well as that of GSIFI No. (1) Shari'a Supervisory Board: Appointment, Composition and Report, lies with the management of an IFI.

Effective Date

18. This standard shall be effective for financial statements for the financial periods beginning 1 Muharram, 1420 A.H. or 1 January 1999 A.D.

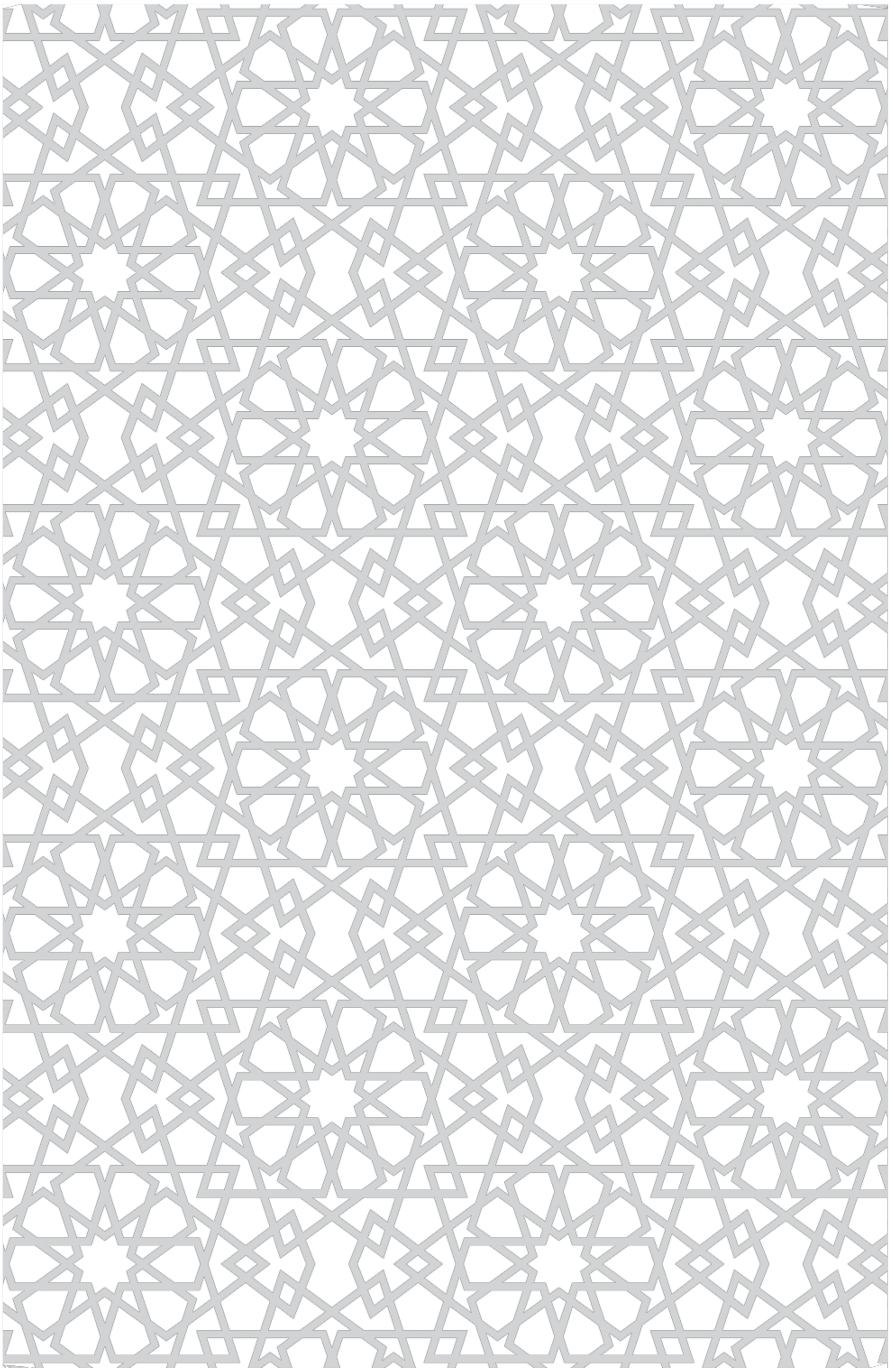
Adoption of the Standard

The standard of Shari'a Review was adopted by the Accounting and Audit- ing Standards Board in its meeting No. (15) held on 27-28 Safar 1419 A.H., corresponding to 21-22 June 1998 A.D.



Governance Standard No. (3)

Internal Shari'a Review



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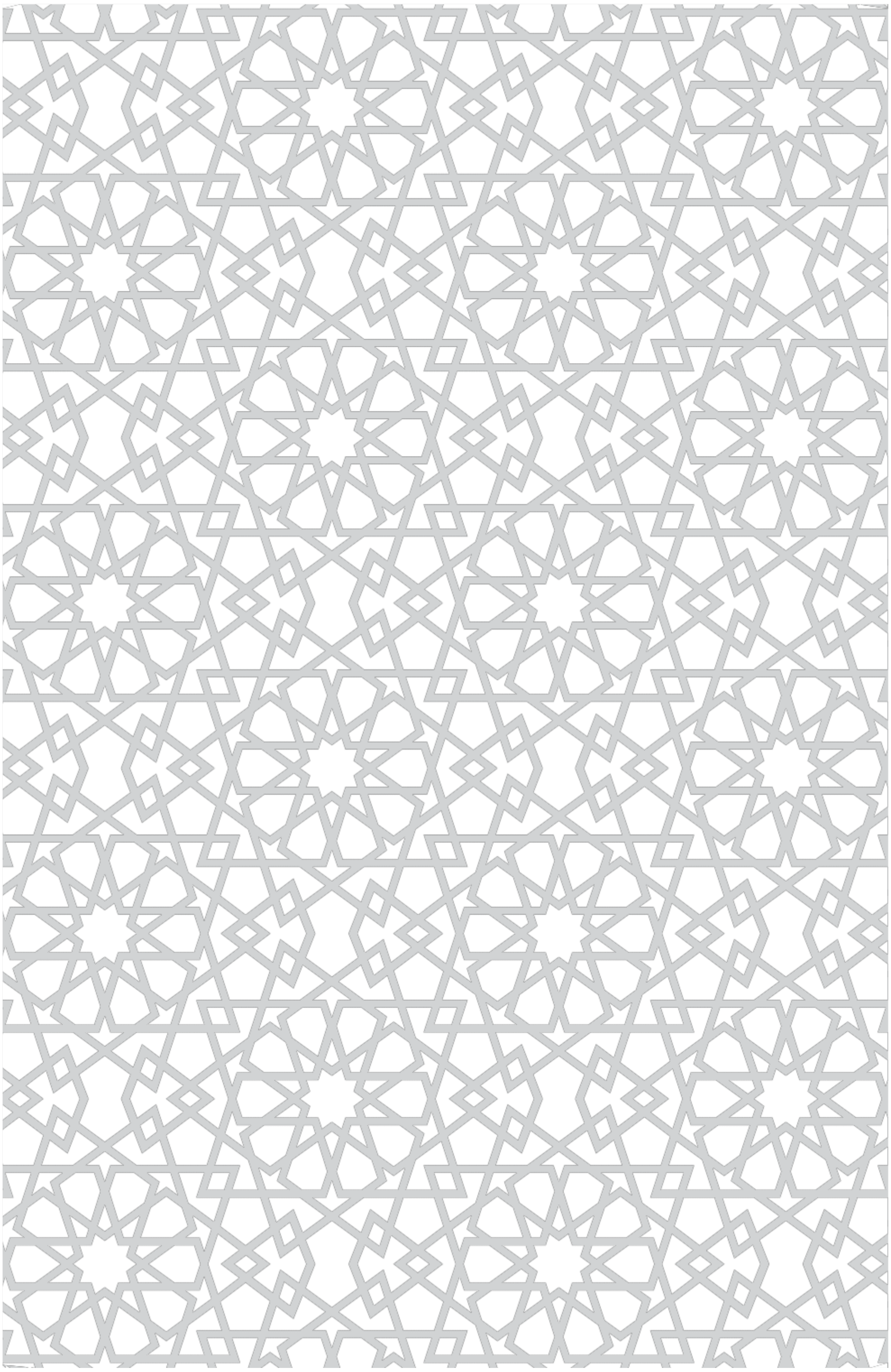


Internal Shari’a Review

Introduction

1. The purpose of this Governance Standard for Islamic Financial In- stitutions (GSIFI) is to establish standards and provide guidance on the internal Shari’a review in institutions which conduct business in conformity with Shari’a rules and principles. The standard covers the following:
   - Objectives;
   - Internal Shari’a review ;
   - Independence and objectivity;
   - Professional proficiency;
   - Scope of work;
   - Performance of the internal Shari’a review work;
   - Management of the internal Shari’a review ;
   - Quality assurance and
   - Elements of an effective internal Shari’a review control system.

   The standard also covers responsibility for its implementation.

Objectives

2. The internal Shari’a review shall be carried out by an independent division/department or part of the internal audit department, depending on the size of an Islamic financial institution (IFI). It shall be established within an IFI to examine and evaluate

the extent of compliance with Shari'a rules and principles, fatwas, guidelines, and instructions issued by the IFI's Shari'a supervisory board (SSB), hereafter referred to as Shari'a rules and principles.

The primary objective of the internal Shari'a review is to ensure that the management of an IFI discharge their responsibilities in relation to the implementation of the Shari'a rules and principles as determined by the IFI's SSB.

Internal Shari'a Review

3. The internal Shari'a review is an integral part of the organs of governance of the IFI and operates under the policies established by the IFI. It shall have a statement of purpose, authority, and responsibility (charter). The charter shall be prepared by management and shall be consistent with Shari'a rules and principles. The charter shall be approved by the SSB of the IFI and issued by the board of directors. The charter shall be regularly reviewed.

4. The charter shall make clear that internal Shari'a reviewers are to have no executive authority or responsibility for the activities they review.

5. The internal Shari'a review may be carried out by the internal audit department/internal control department if properly qualified and independent. However, if separate unit is set up it shall have authority equivalent to the authority of the internal audit department/internal control department.

Independence and Objectivity

6. The organizational status of the internal Shari'a review shall be suf- ficient to accomplish its responsibilities. The organizational status of the internal Shari'a review shall not be lower than that of the internal audit department/internal control department.

7. The internal Shari'a reviewers shall have full and continuous support of the management and the board of directors. They shall have direct and regular communications with all levels of management, SSB and external auditors, which shall enhance the organizational status of the internal Shari'a reviewers. No scope limitation and restriction of access to documents, reports, etc., shall be placed on the internal Shari'a reviewers. The head of the internal Shari'a review shall be responsible to the board of directors. He shall ensure full Shari'a review coverage, adequate consideration of the internal Shari'a review reports, and appropriate action on the internal Shari'a review recommendations. The internal Shari'a reviewers shall be objective in performing their internal Shari'a review.

8. Objectivity includes independent attitude, which the internal Shari'a reviewers shall maintain in performing the internal Shari'a reviews. The internal Shari'a reviewers shall reach objective conclusions based on work performed and its results thereof.

Professional Proficiency

Staffing and supervision

9. The staff of the internal Shari'a review shall be proficient and shall have appropriate educational background and training relevant to internal Shari'a review. The head of the internal Shari'a review shall establish suitable criteria to meet the above.

10. Supervision is a continuous process, beginning with planning and ending with the conclusion of the internal Shari'a review assignment. The head of the internal Shari'a review shall be responsible for providing appropriate internal Shari'a review supervision and he shall ensure that internal Shari'a reviews are properly supervised. Appropriate evidence of the supervision shall be documented and retained.

Compliance with code of ethics

11. The internal Shari'a reviewers shall comply with the Code of Ethics for Accountants and Auditors of Islamic Financial Institutions issued by the Accounting and Auditing Organization for Islamic Financial Institutions.

Knowledge, skills and disciplines

12. The internal Shari'a reviewers shall possess the disciplines, knowledge and skills essential to the performance of internal Shari'a reviews. Proficiency in Shari'a rules and principles in general, and Fiqh Al- Mu'amalat in particular, is required in performing internal Shari'a reviews.

Continuing education and training

13. The internal Shari'a reviewers shall maintain their technical competence through continuing education.

14. The internal Shari'a reviewers are responsible for continuing their education in order to maintain their proficiency and keep informed about improvements and current developments.

15. The internal Shari'a reviewers shall participate in training their IFI's employees and other interested members of the public by holding regular meetings, courses and seminars. They may also disseminate knowledge by publishing and distributing pamphlets, brochures, etc., explaining principles of Fiqh Al-Mu'amalat in general, and in particular the fatwas, guidelines and instructions issued by SSB about the products and services offered by their IFI.

Due professional care

16. Internal Shari'a reviewers shall exercise due professional care in performing internal Shari'a reviews. Professional care shall be appropriate to the complexities of the internal Shari'a review being performed. In exercising due professional care, internal Shari'a reviewers shall be alert to the possibility of intentional wrongdoing.

Scope of Work

17. The scope of work of the internal Shari'a review shall encompass the examination and evaluation of the adequacy and effectiveness of the IFI's system of internal Shari'a control and the quality of performance in carrying out assigned responsibilities.

    Shari'a rules and principles provide the direction as to the scope of work and the activities to be reviewed.

    The purpose of the examination of the adequacy of the system of internal Shari'a control is to ascertain whether the established system provides reasonable assurance that the IFI objectives of compliance with the Shari'a rules and principles will be met efficiently and effectively. Also, the purpose of the examination for effectiveness of the system of Shari'a internal control is to ascertain whether the system was functioning as intended. The internal Shari'a reviewers are responsible for planning, organising and directing processes to determine whether reasonable assurance exists that Shari'a compliance objective as well as other objectives and goals are being achieved.

Performance of the Internal Shari'a Review Work

General

18. The internal Shari'a reviewers shall plan each internal Shari'a review assignment. Planning documentation shall include, but not limited to, the following:

- Obtaining background information about the activities to be re- viewed, such as locations, products/services, branches, divisions, etc.
- Establishing internal Shari'a review objectives and scope of work.
- Obtaining SSB fatwas, guidelines, instructions, prior year internal and external Shari'a review results and relevant correspondence including supervisory and regulatory agencies.
- Determining the resources necessary to perform the internal Shari'a review.
- Communicating with all individuals in the IFI who need to know about the internal Shari'a review.
- Performing, as appropriate, a survey to become familiar with activities, risks, and controls to identify areas of the internal Shari'a review emphasis, and to invite reviewees' comments and suggestions.
- Writing the internal Shari'a review programmes.
- Determining how and when the internal Shari'a review results shall be communicated.
- Obtaining approval on the internal Shari'a review work plan from the concerned authorities including the SSB of the IFI.

Examining and evaluating internal Shari'a review information

19. The internal Shari'a reviewers shall collect, analyse, interpret and document information to support their internal Shari'a review results. Information shall be collected on all matters related to the internal Shari'a review objectives and scope of work. Information collection shall include examination of documentation, analytical reviews, inquiries, discussions with management, and observations. Information shall be sufficient, reliable, relevant and useful to provide a sound basis for internal Shari'a review findings and recommendations. Working papers that document the internal Shari'a review shall be prepared by an internal Shari'a reviewer and reviewed by the head of internal

Shari'a review. These working papers shall support the internal
Shari'a review findings and recommendations. Working papers shall be appropriately prepared, completed, organised, reviewed and retained.

Reporting

20. The head of the internal Shari'a review shall discuss conclusions and recommendations with appropriate levels of management before issuing final written report. On completion of the internal Shari'a review, at least a quarterly written report shall be prepared which must be signed by the head of the internal Shari'a review, addressed to the board of directors and copied to the SSB and man- agement.

21. The report shall be objective, clear, constructive and timely. The report shall present the purpose, scope and results of the internal Shari'a re- view, and it shall contain an expression of the internal Shari'a reviewer's opinion. The report shall also include recommendations for potential improvements and corrective action, and acknowledge satisfactory performance, when appropriate. The reviewees' views about the inter- nal Shari'a review conclusions or recommendations shall be included in the internal Shari'a review report.

    All disputes between management and internal Shari'a reviewers on matters relating to Shari'a interpretation shall be referred to the SSB for ruling.

Follow up

22. The internal Shari'a reviewers shall follow up to ascertain that appropriate action is taken on their reported internal Shari'a review findings. In addition, any other recommendations relating to Shari'a matters made by the SSB, external auditors, and regulatory agencies shall also be followed up. The management is responsible for rectification of non-compliance, prevention of non-recurrence of non-compliances, and ensuring that the agreed upon actions were carried out including their timing and extent of follow up.

Management of the Internal Shari'a Review

23. The head of the internal Shari'a review shall properly manage the internal Shari'a review. He shall also perform the following:
    - Establish plans to carry out the responsibilities of the internal Sha- ri'a review;
    - Provide written policies and procedures to guide the members of the internal Shari'a review; and
    - Establish a programme for selecting and developing the performance of the internal Shari'a review staff.
24. The head of the internal Shari'a review shall ensure that the inter- nal and external Shari'a review efforts are properly co-ordinated to ensure adequate Shari'a review coverage and to avoid duplicate efforts.

Quality Assurance of Shari'a Review

25. The head of the internal Shari'a review shall establish and maintain an effective and efficient quality assurance programme to evaluate the operations of the internal Shari'a review.

Elements of an Effective Internal Shari'a Review Control System

The following are the main components of an effective system of internal Shari'a control:

Employees

26. An IFI shall have a system in place which ensures that only qualified, experienced, and committed employees are recruited and retained. The system shall ensure that employees are continuously trained and developed in related disciplines, especially Fiqh Al-Mu'amalat. Their performance shall be regularly assessed and appropriate action shall be taken. Employees shall be honest and loyal to their IFI. In all cases, prior consent of the IFI's SSB shall be secured before any employee is appointed in the internal Shari'a review (in accordance with the by- laws of the IFI) in order to ascertain the employee's positive attitude towards compliance with Shari'a rules and principles.

Segregation of duties

27. The internal Shari'a reviewers shall not undertake any operational activities of the IFI.

Control procedures

28. An IFI's management shall establish controls, policies and procedures, to achieve the IFI's objective of compliance with Shari'a rules and principles.

Responsibility for Implementation of the Standard

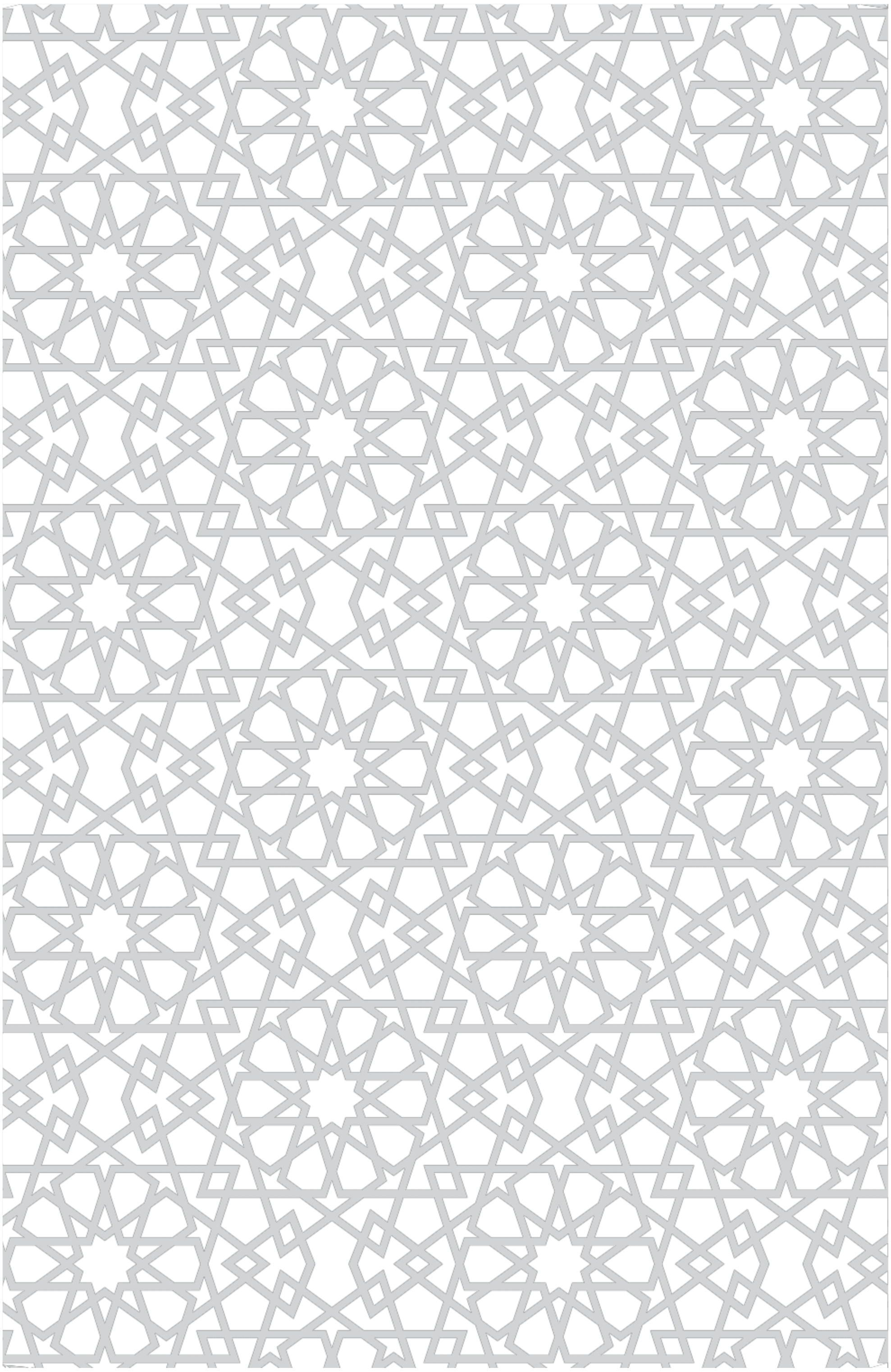
29. The responsibility for implementation of this standard lies with the management of an IFI.

Effective Date

30. This Standard shall be effective for financial periods beginning 1 Mu- harram, 1421 A.H., or 1 January, 2000 A.D.

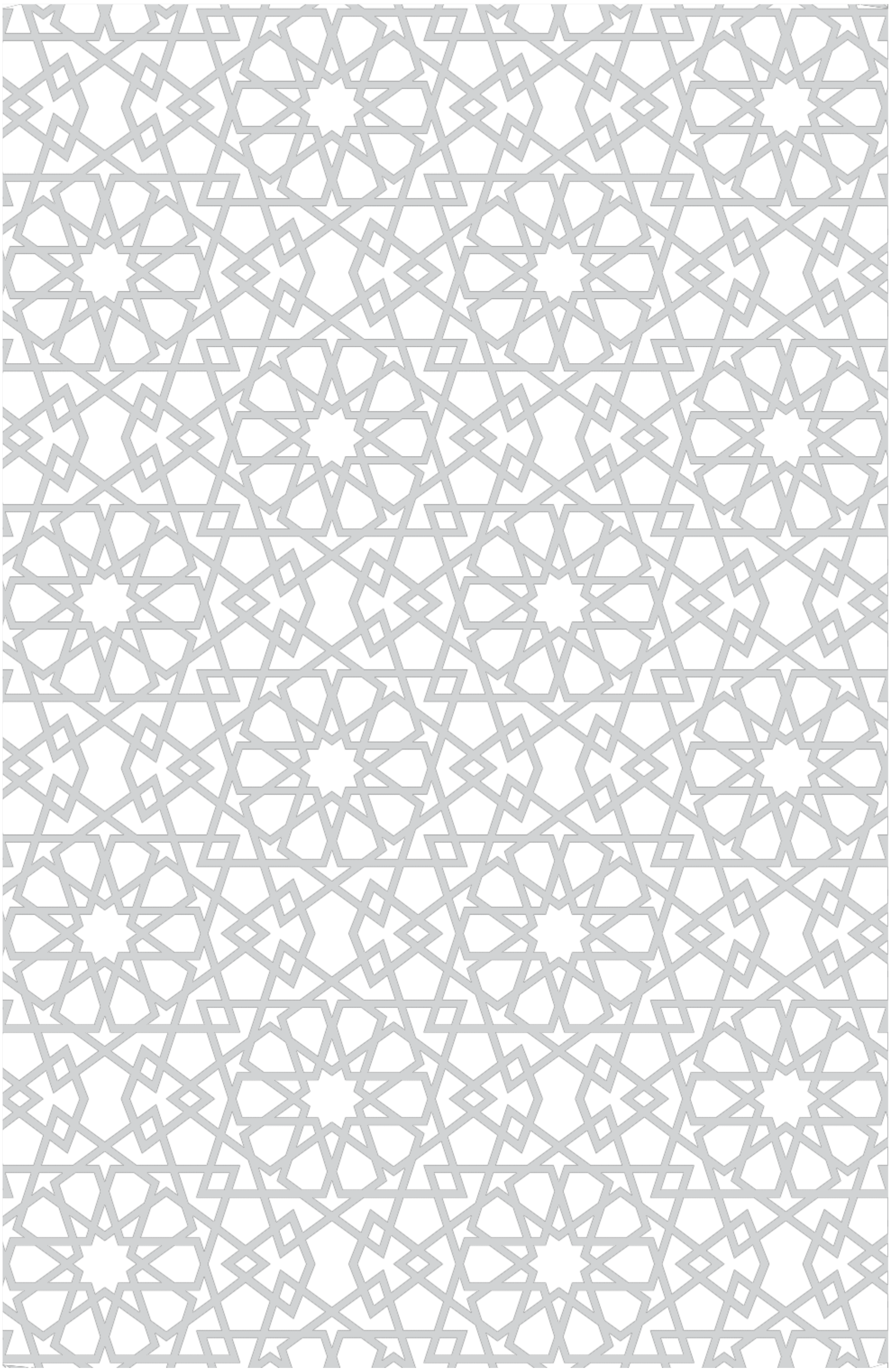
Adoption of the standard

The Internal Shari'a Review standard was adopted by the Accounting and Auditing Standards Board in its meeting No. (17) held on 29 Safar - 1
Rabi' I, 1420 A.H., corresponding to 13-14 June 1999 A.D.



Governance Standard No. (4)

Audit and Governance Committee for Islamic Financial Institutions



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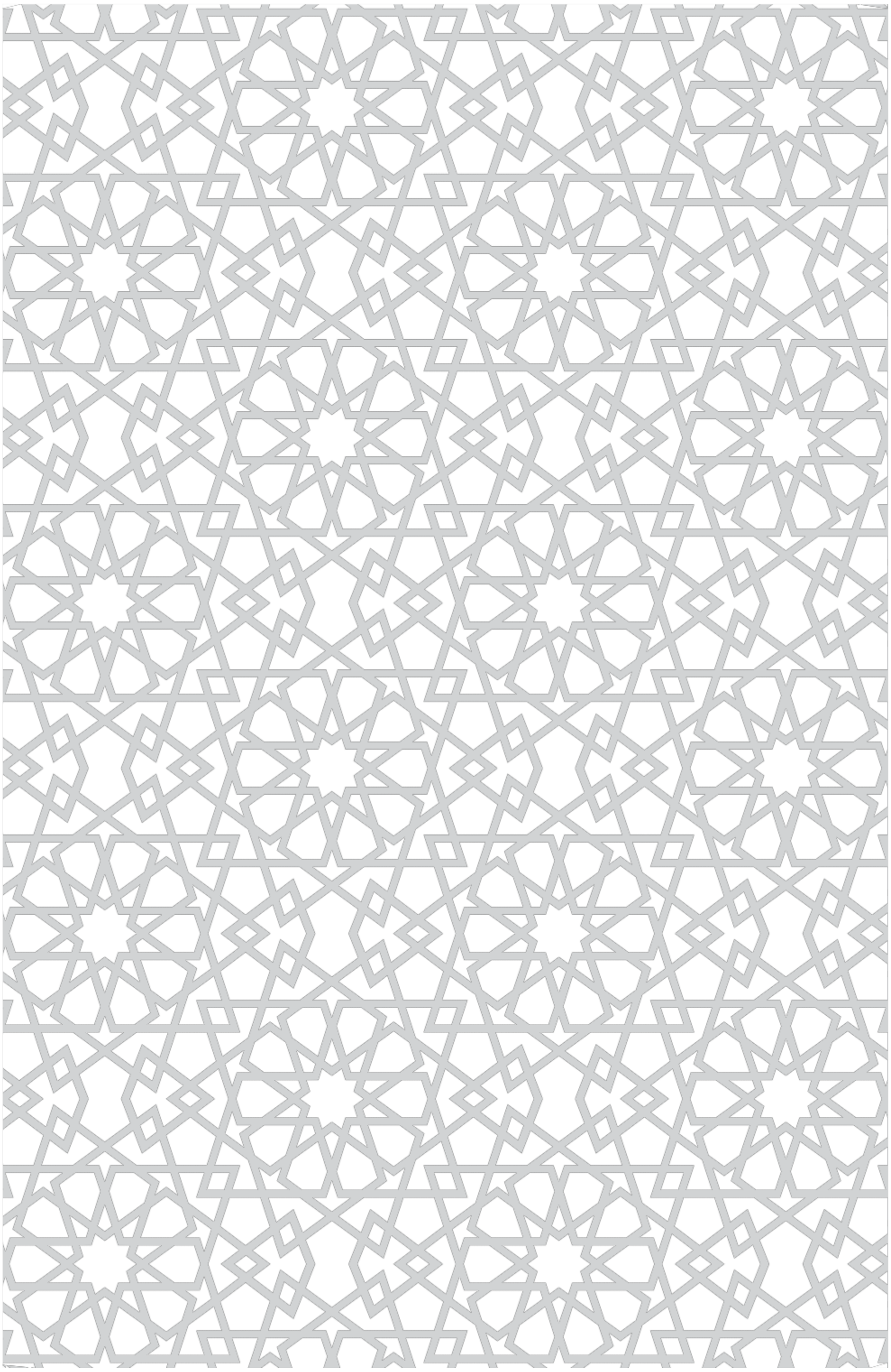


Audit and Governance Committee for Islamic Financial Institutions

Introduction

1. The purpose of this Governance Standard for Islamic Financial Institutions (GSIFI) is to define the role and responsibilities of an Audit and Governance Committee (AGC) for an Islamic financial institution (IFI). The standard also highlights the requirements for establishing such a committee for an IFI and specifies the prerequisites for an effective AGC.

Importance of AGC

2. The importance of the AGC (known internationally as the Audit Committee) for an IFI emanates from its role in:

a) Achieving the fundamental objectives of an IFI, by enhancing greater transparency and disclosure in financial reporting; and

b) Enhancing the public's confidence of the IFI as genuine in its application of Shari'a rules and principles.

Functions of AGC

3. The AGC has gained widespread acceptance as a prerequisite for organizations seeking to demonstrate a commitment to higher standards of corporate governance. The AGC assists the board of directors in exercising independent and objective monitoring through the following functions:

a) Preserving the integrity of the financial reporting process.

b) Safeguarding the interests of shareholders, investors and other corporate stakeholders.

c) Providing additional assurance on the reliability of financial information presented to the board of directors, if the AGC is to be considered effective.

d) Acting as an independent link between the IFI's management and its stakeholders.

Responsibilities of AGC

The responsibilities of the AGC shall comprise the following:

Review of internal controls (including internal audit)

4. The AGC's role with regard to internal controls is to ensure that the IFI has the appropriate controls in place and that these controls are functioning properly, as well as to monitor the implementation of management's strategy. The AGC shall have a sufficient understanding of the IFI's business and its control environment to make pertinent inquiries concerning systems of internal control. Implicit in such a function is extensive interaction with the IFI's management, its internal and external auditors and the ability to gauge the significance of problems and issues raised by these parties.

   The specific responsibilities associated with this function include:

   a) Comprehending the major risks to which the business is exposed.
   b) Monitoring management's control consciousness as it relates to the significance attached to controlling the IFI's policies, procedures, methods, and organizational structure.
   c) Reviewing the pressures on management to achieve results (e.g., remuneration arrangements, and market expectations).
   d) Monitoring the adequacy of management reporting processes.
   e) Reviewing resources and skills, scope of responsibilities, overall work programme and reporting lines of internal audit.
   f) Reviewing the effectiveness of internal control systems, particularly focusing on major findings of internal audit, the external auditor's management letters and of any other reports from regulatory bodies together with management responses.
   g) Reviewing the findings of central bank inspections and other regulatory bodies together with management responses and ensuring that appropriate actions have been taken to comply with the central bank inspectors' requirements.
   h) Reviewing the IFI code of ethics and the effectiveness with which it is implemented.
   i) Reviewing the effectiveness of the IFI's system for monitoring compliance with Shari'a rules and principles and legal requirements as

well as considering the adequacy of controls over significant areas where loss or embarrassment could be caused to the IFI.

j) Ensuring that the management of IFI has implemented the proce- dures that govern its relationship with the related parties.

Review of accounting practices and audit plan

5. Financial reporting of transactions, projects and other activities in progress at a particular point in time includes recognition, measurement and disclosure of such activities. The outcome of such activities is subject to uncertainty and their measurement involves the use of accounting assumptions and judgment.

   The specific responsibilities associated with this function include:

   a) Understanding areas in the IFI exposed to high degrees of risk and uncertainty, with particular reference to judgmental areas involv- ing estimates, contingent liabilities and significant claims.
   b) Reviewing the IFI's accounting policies and practices and reporting requirements, with particular emphasis on the implications of new accounting standards and proposed changes in the IFI's accounting policies and on areas in which choices exist between accounting methods or policies.
   c) Reviewing the nature and scope of the audit with particular reference to high-risk areas or locations and the resources and skills of the auditors.
   d) Ensuring coordination between internal and external auditors and ensuring that the independence and professional integrity of auditors is not compromised.
   e) Considering any issues related to the appointment, resignation or dismissal of members of the Shari'a Supervisory Board (SSB), chief internal auditor and/or the external auditors and reviewing proposals to appoint new members of the SSB, external auditors and/or chief internal auditor.

Review of interim and annual accounts and financial reports (inclusive of matters arising from the audit)

6. The over-riding principle with respect to the AGC's review of all the above-mentioned reports is to ensure their completeness, fairness

and accuracy. The AGC shall review these reports (interim and annual accounts and financial reports) before their submission to the IFI's board of directors. The review shall satisfy the AGC as to the fair presentation of reported earnings and the completeness of disclosures in the annual report and accounts. In addition, the AGC shall be briefed by the management on the latter's methodology with respect to developing and summarizing interim financial information. Also, the AGC shall be aware of any review procedures performed by the external auditors on interim financial statements.

The specific responsibilities associated with this function include:

a) Ensuring compliance with Shari'a, legal and regulatory requirements.
b) Ensuring compliance with all Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) standards and determining the appropriateness and effect of any changes in accounting policies and practices.
c) Reviewing the treatment of significant areas of judgment, accounting estimates and unusual transactions.
d) Reviewing significant adjustments arising from the audit.
e) Determining the appropriateness of the going concern assumption as the basis on which the accounts are prepared and if applicable, of the proposed statement by the directors that the company is a going concern.
f) Presenting a balanced and comprehensible assessment of the company's position that relate to the responsibilities of the AGC.

Ethics

7. The fundamental principles governing the operation of an IFI have been enunciated in AAOIFI's Code of Ethics for Accountants and Auditors of Islamic Financial Institutions.[1] The AGC shall be governed by the principles listed below and shall endeavor to ensure that the IFI adheres to the same set of ethical values:

a) Faith-driven conduct.
b) Professional competence and diligence.
c) Trustworthiness.

(1) AAOIFI's Code of Ethics for Accountants and Auditors of Islamic Financial Institutions, Sections 2 and 3.

d) Religious legitimacy.
e) Objectivity.
f) Professional conduct and technical standards.

In order to ensure adherence to these fundamental values, it is imperative that the AGC of an IFI should work to facilitate Shari'a reviews by the SSB and the internal audit function of the IFI.

Reviewing the compliance with Shari'a rules and principles

8. The duties of the AGC also include the review of the reports produced by the internal Shari'a review and the SSB to ensure that appropriate actions have been taken. The AGC may invite a member of the IFI's SSB to attend its meeting, as and when required.

Reviewing the use of restricted investment accounts' funds

9. In the case of Islamic banks, funds are mobilized from investors based on Mudaraba contract or agency for both unrestricted and restricted investment accounts. The latter represents off-balance sheet accounts, and this places a greater responsibility on the Islamic bank's management to ensure that the funds are invested in accordance with the terms of the agreement and that profits are allocated according to the agreed terms between the Islamic bank and holders of investment accounts which should be in compliance with Shari'a rules and principles. Co-ordination between the AGC, internal Shari'a reviewers and external auditors is imperative for the effective monitoring of restricted investment accounts.

Establishing the AGC

10. The specific structure of the AGC shall vary according to the IFI and the country in which it is established. However, certain features in terms of establishing the AGC and practicing its responsibilities include:

11. ***Constitution***

a) The AGC shall be formally established by the board of directors from its non-executive members. The board of directors shall also appoint the chairman of the AGC. The AGC shall be vested with sufficient authority to carry out its responsibilities with independence and integrity.

b) The Terms Of Reference (TOR) of the AGC shall be set out in writing and state clearly the AGC's powers and responsibilities and empower it to investigate any matters within its jurisdiction.

c) The TOR will be used by the board of directors, AGC members, management, outside legal counsel, SSB, internal Shari'a reviewers and external auditors.
The Standard provides a sample TOR of the AGC applicable to an IFI as an Appendix.

12. Membership

a) Attributes
AGC members shall be knowledgeable about the business of the institution and applicable regulations and laws to deal adequately with the accounting and auditing matters the AGC will face. They shall understand the related Shari'a rules and principles, and their application to various products and services offered by the IFI and shall have sufficient knowledge of AAOIFI's standards.

b) Term of office and size
The term of office of an AGC shall match the term of the members of the board of directors. The AGC shall not have less than three members, and these should represent a balance of views and experience.

c) Remuneration
The AGC members' remuneration may be based on a recommendation by the board of directors to the general assembly meeting or on the prevailing laws and regulations applicable in the country.

13. AGC planning and meetings

The AGC shall –with the consent of the board of directors– prepare internal by-laws to govern the AGC meetings and who should attend the meetings without the right to vote.

Reporting

14. The reports of the AGC shall be submitted to the board of directors through the chairman of the board and copied at the same time to the chief executive officer. The names of the AGC may be mentioned in the annual reports. It is also recommended that the AGC's chairman shall report to the chairman of the board of directors any significant matters of concern that arose at the last meeting to the AGC. The board of directors shall also discuss the work of the AGC based on its quarterly report.

Effective Date

15. This Standard shall be effective for financial periods beginning 1 Muharram, 1423 A.H. or 1 January 2002 A.D.

Adoption of the Standard

The standard of the Audit and Governance Committee for Islamic Fi- nancial Institutions was adopted by the Accounting and Auditing Standards Board in its meeting No. (21) held on 8 Safar 1422 A.H., corresponding to
2 May 2001 A.D.

Appendix
Specimen Terms of Reference

Constitution

The board of directors hereby resolves to establish a committee of the board to be known as the Audit and Governance Committee (AGC).

Membership

The board of directors shall appoint the AGC members from the non- executive members of the board. The AGC shall not have less than three members. A quorum shall consist of a majority of the members.

The chairman of the AGC shall be appointed by the board of directors. (All other requirements with respect to membership of the AGC are explained in more detail in item 12 (a-c) of the Standard.)

Attendance at Meetings

The Terms Of Reference (TOR) shall state the persons who shall be invited to attend the meetings of AGC; for example, the finance director, the head of internal audit and representatives from other technical departments, external auditor, representative from the SSB and the internal Shari'a review. It shall also be stated whether the AGC shall meet at least once a year with the external auditors in the absence of any management executive.

The head of internal audit shall be the secretary of the committee.

Frequency of Meetings

The TOR shall state the number of meetings which must be held by the AGC annually.

Authority

The AGC is authorized by the board of directors to investigate any activity within its terms of reference. It is authorized to seek any information

it requires from any employee and all employees are directed to cooperate with any request by the AGC.

The AGC is authorized by the board of directors to obtain outside legal or other independent professional advice and to secure the attendance of outsiders with relevant experience and expertise if it considers this necessary.

Responsibilities

The responsibilities of the AGC shall be:

a) To consider the appointment of the Shari'a supervisory board, ex- ternal auditor, and/or the chief internal auditor, the audit fee, and any questions of resignation or dismissal. This will include reviewing skills and resources of the external auditor.

b) To discuss with the external auditors before the audit commences the nature and scope of the audit, and ensure co-ordination where more than one audit firm is involved

c) To review the interim and annual financial statements before submission to the board of directors, focusing particularly on:

- Any changes in accounting policies and practices;
- Major judgmental areas;
- Significant accounting adjustments resulting from the audit;
- The going concern assumption;
- Compliance with the accounting standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions;
- Compliance with regulatory bodies, stock exchange and legal requi- rements; and
- Compliance with the procedures that govern the relationship between management and related parties.

d) To discuss problems and concerns arising from the external and internal audits, and any matters the external and internal auditors may wish to discuss (in the absence of management where necessary)

e) To review the reports of regulatory bodies together with management responses f) To review the internal audit programme, consider the major findings of internal audit investigations and management's response, and ensure co-ordination between the external and internal auditors

g) To keep under review the effectiveness of internal control systems, and in particular to review the external auditor's management letter and management's response

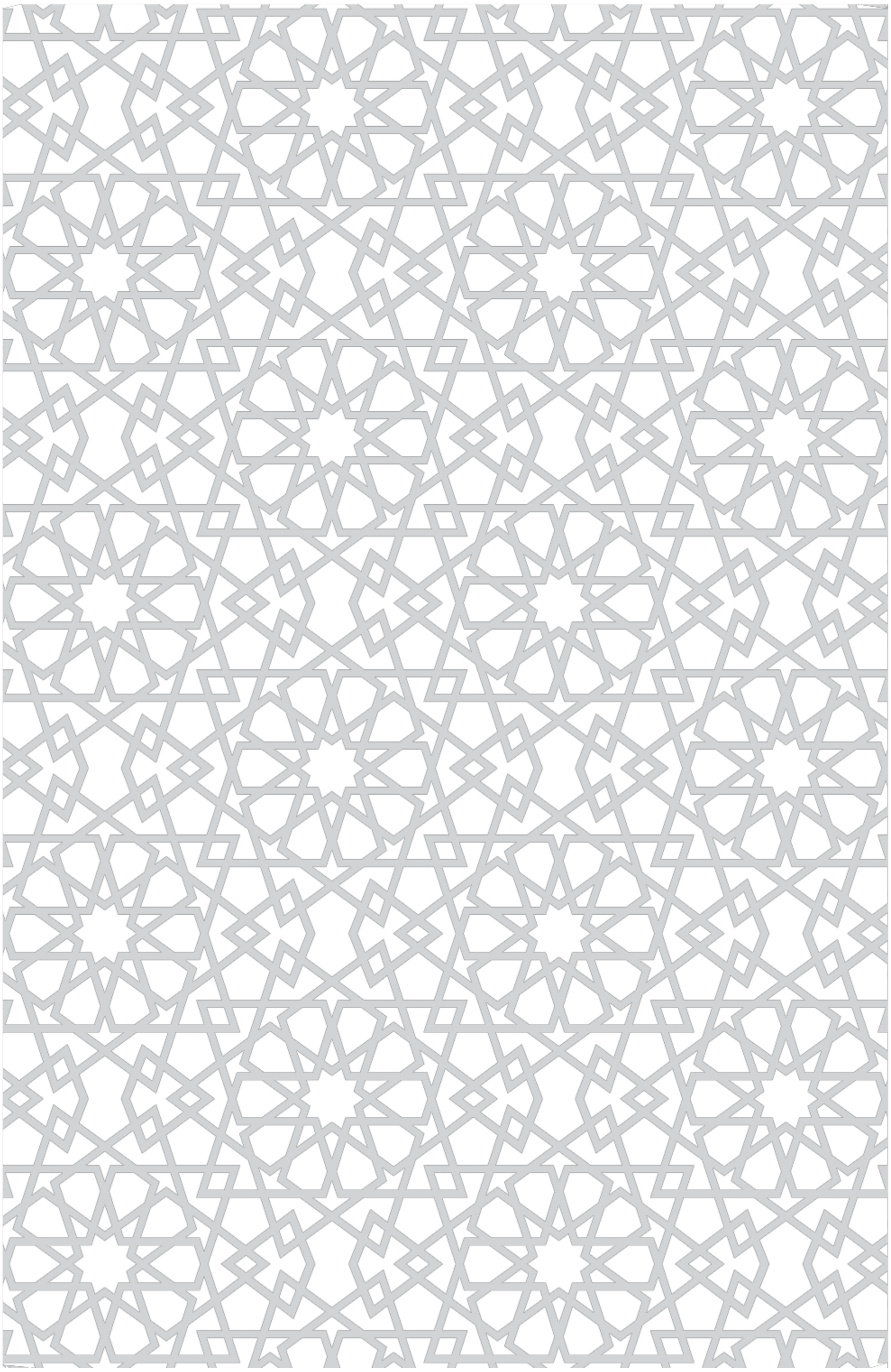
h) To ensure compliance with Shari'a rules and principles by implementing recommendations contained in reports produced by the SSB and the internal Shari'a reviewers

i) To coordinate with the internal Shari'a reviewers, internal and external auditors to ensure that restricted investment accounts are managed according to Shari'a rules and principles

j) To consider other topics, as defined by the board of directors

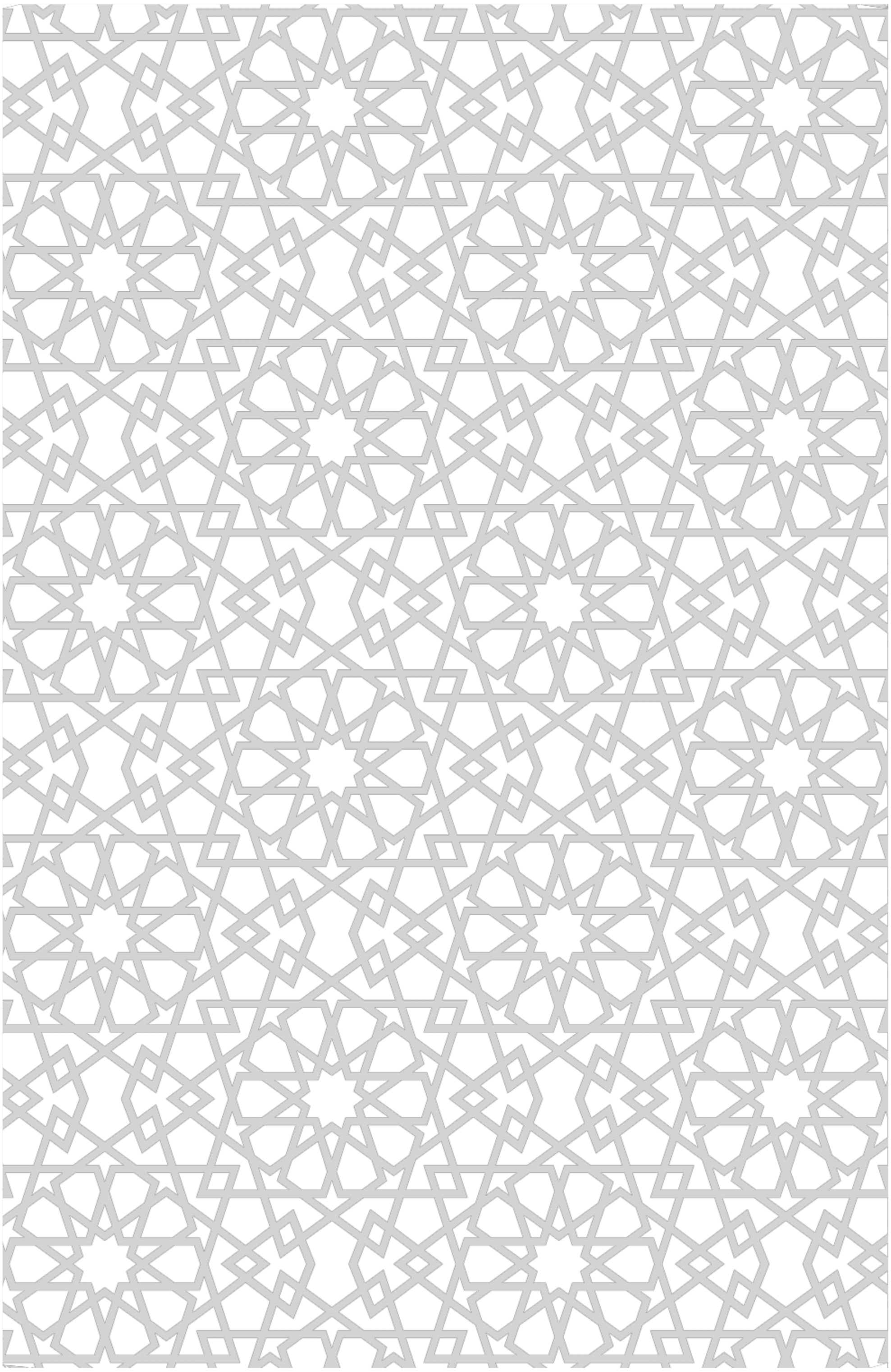
Reporting Procedures

The secretary shall circulate the minutes of meetings of the AGC to the board of directors.



Governance Standard No. (5)

Independence of Shari’a Supervisory Board



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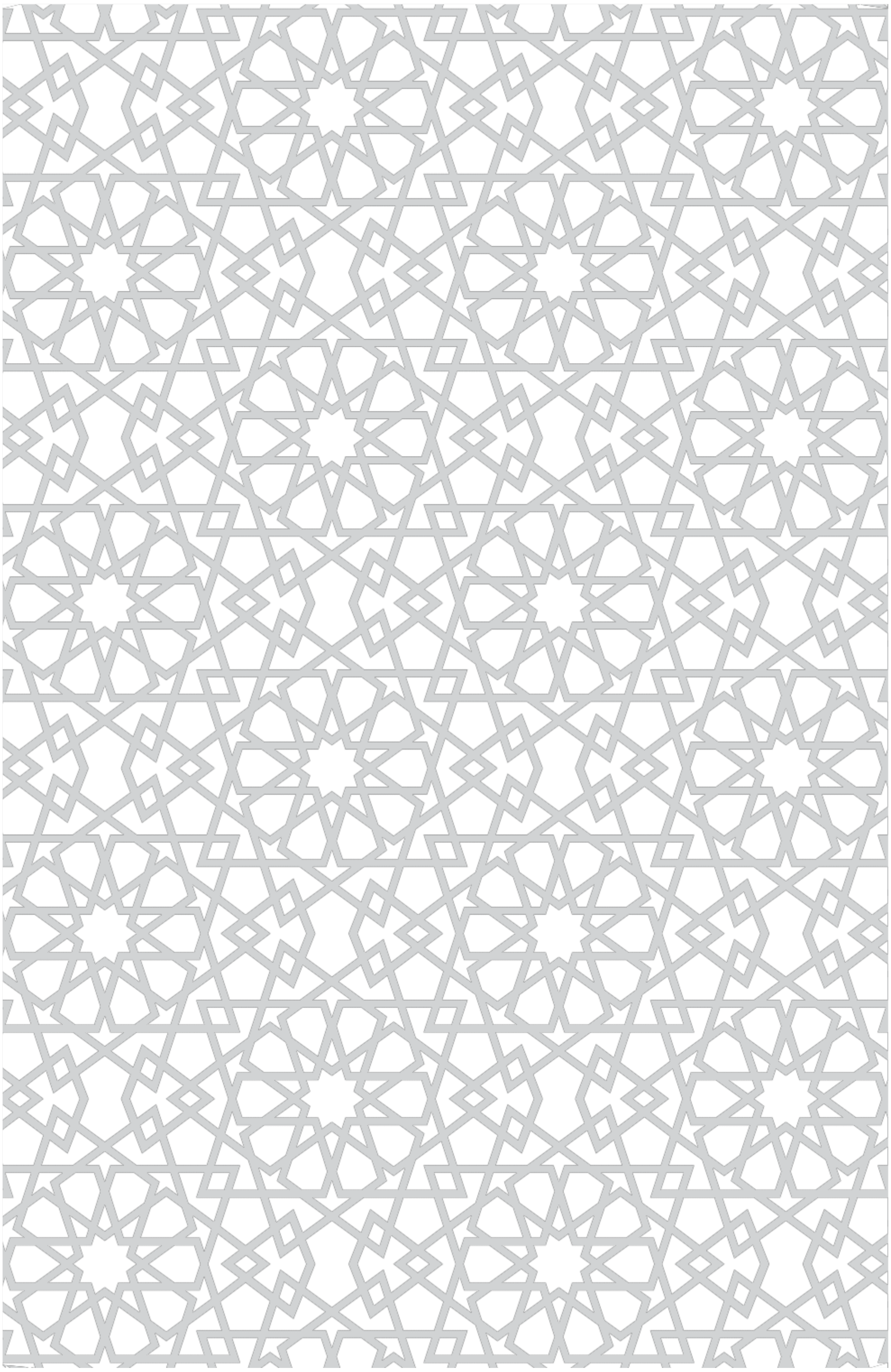


Independence of Shari'a Supervisory Board

1. Introduction

The purpose of this standard is to provide guidance for members of Shari'a Supervisory Boards (SSBs) of Islamic Financial Institutions (IFIs) pertaining to its independence, monitoring of such independence and ways to resolve issues of independence. (para. 1)

2. Independence

Independence, for the purpose of this standard, is "An attitude of mind which does not allow the viewpoints and conclusions of its possessor to become reliant on or subordinate to the influences and pressures of conflicting interests. It is achieved through organizational status and in an objective way". The principle of objectivity imposes obligations on SSB members to be fair, intellectually honest and free of conflict of interests (neutral). (para. 2)

3. Importance of Independence of SSBs

The importance of the independence of SSB members for an IFI emanates from its role in:

a) Enhancing the public confidence in the IFI as compliant in its appli- cation of Shari'a rules and principles.

b) Achieving the fundamental objectives of an IFI by enhancing inde- pendence and objectivity of its SSB. (para. 3)

SSB Members have a responsibility to the public who rely on the services provided by them that require independence. The public includes clients, credit grantors, governments, employers, employees, investors and others who rely on the objectivity and integrity of SSB members to ensure Shari'a compliance with regard to activities of IFI. (para. 4)

4. Objectivity

Objectivity is an independent mental attitude which SSB members should maintain in performing Shari'a supervision. SSB members are not to subordinate their judgment on Shari'a supervision matters to that of others. (para. 5)

Objectivity requires SSB to perform Shari'a supervision in such a manner that they have an honest belief in their work. SSBs should avoid potential and actual situations that impair their ability to make objective professional judgments. (para. 6)

SSB members should not be employee of the same IFI. (para. 7)

SSB and its members should not be involved in any manner with regard to managerial decisions and operational responsibilities of the IFI. (para. 8)

When SSB members are or were within the engagement or immediately preceding an engagement period, an officer of a client or partner/ employee of an IFI, the preceding period should be not less than three years. (para. 9)

5. Continuous Assessment

SSB members should continuously assess their relationships with their IFIs to identify any situations that may impair independence and resolve it or report to the SSB such situations in which an issue of independence impairment is present or may reasonably be inferred, and how to resolve it. (para. 10)

6. Basis of SSB Independence

Similar to AAOIFI Code of Ethics for Accountants and Auditors of IFIs and the Code of Ethics for the Employees of IFIs, SSB independence standards and rules are derived from the Shari'a rules and principles. Accordingly, this standard should be read in conjunction with these two codes. (para. 11)

7. Resolution of Issues of Independence Impairment

When faced with potential and/or actual issue of independence impairment

SSB members should follow the following to resolve the issue:

a) Document the issue.
b) Review the issue internally within the SSB.
c) If the issue still exists after the internal review by the SSB, the SSB member with the issue of independence impairment must resign and General Assembly of the IFI must be notified.
d) In all above levels of conflict resolution, consideration must be given to local laws and regulations. (para. 12)

8. Responsibility for Implementation of This Standard

Responsibility for implementation of this standard lies with the manage- ment of an IFI. (para. 13)

9. Effective Date

This Standard shall be effective for financial periods beginning 1 Muharram, 1429 A.H., or 1 January 2008 A.D. (para. 14)

Adoption of the Standard

The Standard on Independence of Shari’a Supervisory Board was adopted by the Accounting and Auditing Standards Board in its meeting No. (29) held on 29 Rabi’ II, and 1 Jumada I, 1426 A.H., corresponding to 7 and 8
June 2005 A.D.

Appendix
Examples of Possible Issue of Independence Impairment

SSB members, during their engagement period, should be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with independence, objectivity and integrity. Examples of situations or conditions or circumstances that may indicate actual or apparent lack of independence are as follows:

- **Financial involvement with, or in the affairs of, clients**

  Financial involvement with an IFI affects independence and may lead a reasonable observer to conclude that it has been impaired. Such involvement, which may be direct or indirect, can arise in a number of ways. Examples are shares ownership, guarantees, etc.

- **Personal and family relationships**

  Personal and family relationships to a third degree of relationship with an SSB member can affect independence. There is a particular need to ensure that an independent approach to any assignment is not endangered as a consequence of any personal or family relationship. The kind of relationship that may impair independence is between the SSB member and a member of the Board of Directors, CEO or any other member of the executive/management team of the IFI.

- **Fees**

  When the receipt of recurring fees from an IFI or group of connected IFIs represents a large proportion of the total gross fees of an SSB member, the dependence on that IFI or group of IFIs should inevitably come under scrutiny and could raise doubts as to independence. Additionally, when there is a large proportion of unpaid fees for prior periods, this could be seen as an impairment of independence.

- **Contingency fees**

  Shari'a supervision services should not be offered or rendered to an IFI under an arrangement whereby no fee will be charged unless a specified finding or result is obtained or when the fee is otherwise contingent upon the findings or results of such services.

- **Performance-related bonus**

  Shari'a supervision services should not be offered or rendered to an IFI under an arrangement whereby the SSB benefits from bonus payment related to the performance of the IFI.

- **Goods and services**

  Acceptance of goods and services from an IFI may be a threat to independence. Acceptance of undue hospitality poses a similar threat. Acceptable goods or services are those that are within the normal courtesies of social life.

- **Actual or threatened litigation**

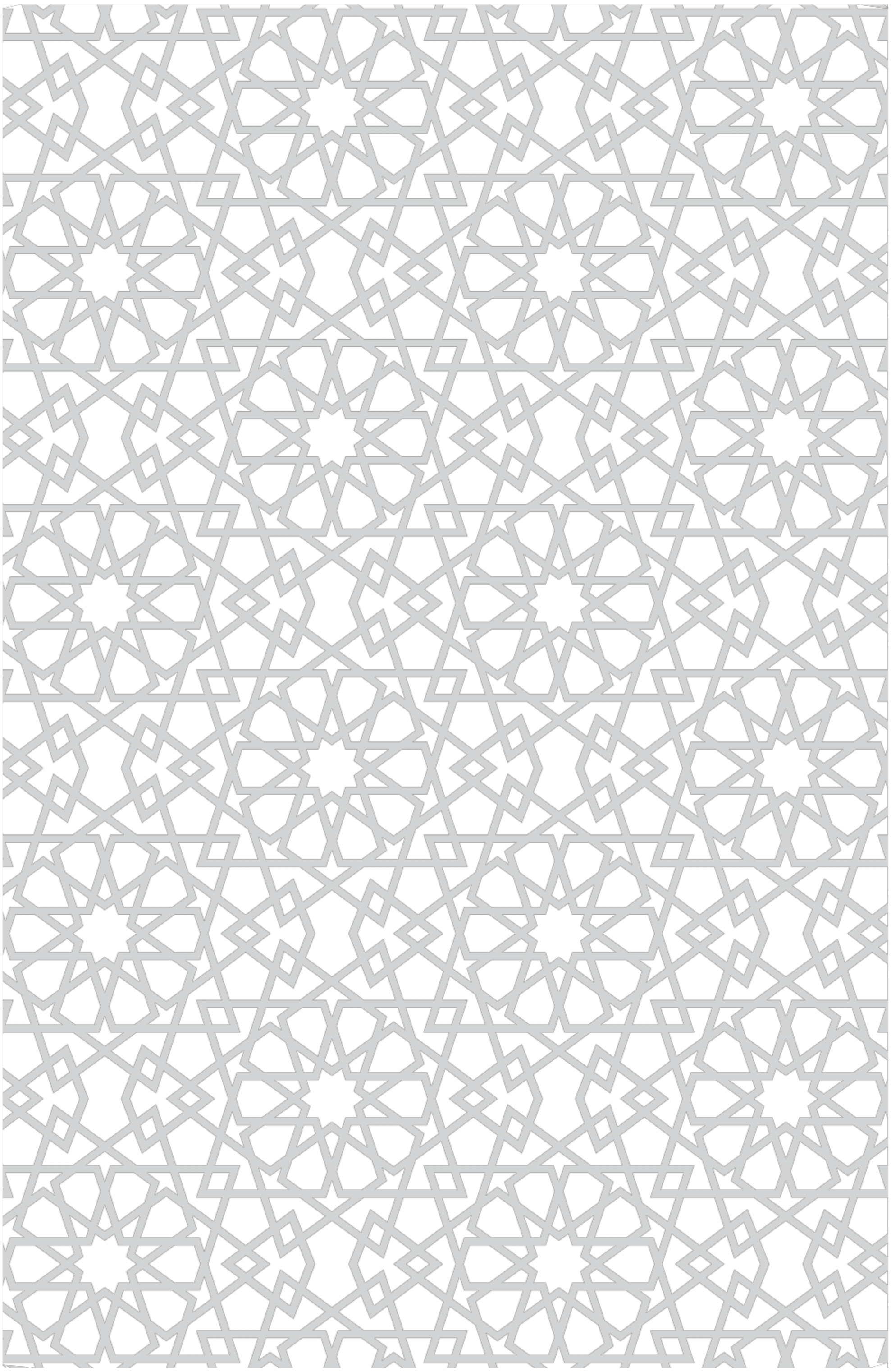
  Litigation involving an SSB member and an IFI may cause concern that the normal relationship with the client is affected to the extent that an SSB's independence and objectivity may be impaired.

- **Long association of SSBs with IFIs**

  The continuation of the same SSB member on a Shari'a supervision engagement over a prolonged period of time may pose a threat to independence. The SSB member should take steps to ensure that independence and objectivity are maintained on the engagement. There is a concern that a long involvement by an SSB member with a client could lead to a close relationship which could be perceived to be a threat to independence and objectivity. An IFI should take steps to provide for an orderly rotation of SSB servicing on the engagement, so as to ensure that at least one SSB member should be rotated every five years.

Governance Standard (No. 6)

Statement on Governance Principles for Islamic Financial Institutions



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Statement on Governance Principles for Islamic Financial Institutions

1. Introduction

Governance practices play a vital role in ensuring that businesses are run in a prudent and sound manner. A loss of confidence in financial institutions has the potential to create severe economic dysfunction, adversely affecting the general community in which they operate. (para. 1)

Financial institutions are different from other types of businesses due to their public purpose. There are more stakeholders in banks and other financial services institutions than in other businesses. Indeed, in an Islamic financial institution (IFI), the list of stakeholders is even wider. The interest of *Rab Al-Mal* and providers of other forms of capital are exposed to the risk of being prejudiced if governance practices are focused on benefits to owners or equity-holders. (para. 2)

Those charged with governance of IFIs are held to the highest fiduciary standards since they are accountable not to the equityholders who appointed them only but also for the safety of all key stakeholders as well as the community the IFI serves. (para. 3)

Financial institutions that develop strong governance practices win public confidence and, thereby, promote trust amongst their equity- holders, investors and other parties dealing with them. In IFIs, governance practices are also expected to lead to enhanced Shari'a compliance structures. (para. 4)

2. Rationale for Establishment of the Framework

A Statement on Governance Principles for Islamic financial institutions is necessary in order to support the development of sound governance practices within IFIs as well as establish the basis for standards setting by AAOIFI on individual aspects of governance.

(para. 5)

This Statement on Governance principles (the “Statement”) represents the framework for governance in IFIs and form part of the pronouncement of the AAOIFI. (para. 6)

The purpose of the Statement is as follows:

a) To lay down the key principles and concepts relevant to governance in IFIs.

b) To assist IFIs as well as their stakeholders to appreciate the respective roles of those charged with governance.

c) To establish the foundation upon which the development of future governance or compliance standards will take place.

d) To provide the necessary inter-linkage between the various current and future standards applicable to IFIs. (para. 7)

The Statement recognizes the complexity of the concept of governance structures and, therefore, focuses on the principles on which it should be based. (para. 8)

The governance principles are founded on the need for structures leading to enhance compliance, transparency, accountability, fairness and equitable treatment of stakeholders. (para. 9)

3. Objectives of the Statement

The overall aim of the Statement is to encourage the efficient use of economic resources by IFIs and equally to require accountability for the stewardship of those resources. (para. 10)

More specifically, the Statement seeks to ensure that those charged with governance and those employed by an IFI, as well as those associated with an IFI in any important functional capacity shall perform their respective roles effectively and in a manner that is consistent with Shari’a. (para. 11)

The Statement is intended to serve as the minimum standard in the establishment of governance structures in an IFI. The principles set forth will also provide the foundation for AAOIFI in its effort to set governance standards in relation to some or all of the individual principles or aspects of the principles framework set out herein in future. (para. 12)

4. Basis for Governance

Governance has to do with a wide range of aspects including those relating to social responsibility, business ethics and culture, board and management accountability as well as the respective roles of other parties carrying out a functional role in relation to an IFI's business. These roles have a bearing on how the IFI's business strategies, policies, operations or control frameworks are designed, implemented and monitored. (para. 13)

Governance practices are defined and practiced differently depending upon the relative national regulatory approaches, legal systems, cultural influences, powers of owners, boards of directors, management, etc. (para. 14)

For the governance structure to be effective, an IFI would need to consider its unique business model characteristics. (para. 15)

4/1 Enhancing confidence

The financial services industry (whether conventional or Islamic) is one in which 'trust' is vital. Trust is the cornerstone upon which an IFI operates. (para. 16)

The interest of those who have effective control over an institution can differ from the interests of those who supply equity and other funding, making sound governance structures necessary. In an IFI, this aspect is accentuated since a significant portion of the risk bearing funds mobilized is derived from parties other than equity holders. (para. 17)

Sound governance practices serve to enhance public confidence and therefore, it is necessary that those charged with governance as well as those having an influence on them pay appropriate attention. (para. 18)

Confidence in an IFI cannot be developed without several import- ant measures, one of which is a transparent governance structure. (para. 19)

The Board of Directors (BOD), Shari'a Supervisory Board (SSB), management, employees and other parties dealing with or working for an IFI have to strive to enhance confidence and trust which are vital to the survival and growth of its business. (para. 20)

4/2 Shari'a compliance

Governance in the context of an IFI, therefore, goes well beyond the boundaries of 'corporate governance' in the conventional context since it has social and religious connotations to it as well. As a matter of fact, an IFI exists due to its ability to conduct its commercial activity in accordance with Shari'a. (para. 21)

An IFI has been established to assist investors in using the funds in a beneficial manner consistent with Shari'a. The choice of investing in or dealing with one IFI versus the other is predicated on the evaluation of and the institution's ability to operate strictly in accordance with Shari'a in the absence of which there can be a lack of confidence in the IFI. Therefore, an IFI must have mechanisms to comply with Shari'a in all their financial and other dealings. (para. 22)

4/3 Business model

The business model of an IFI is characterized by contracts that are designed to be compliant with Shari'a, making it unique. The risks associated with such contracts are also unique and both the IFI and its clients should recognize its distinguishing features. (para. 23)

While equityholders' capital should be protected and their interests safeguarded, risks attributable to client funds handled though restricted, unrestricted or other forms of risk bearing instruments are quite significant. (para. 24)

4/4 Stakeholders' interests

It is important for those charged with governance to understand who the key stakeholders are to allow the establishment of a gover- nance structure that is characterised by high levels of accountability. (para. 25)

Those charged with governance are accountable towards the interests of all key stakeholders of the IFI. (para. 26)

An IFI's interaction with stakeholders has much to do with dissemina- tion of timely and sufficient financial and non-financial information regarding its operations and performance.

(para. 27)

An IFI should therefore understand and respond to the transparency needs of its stakeholders. For this, BOD and management of the IFI should ensure that its stakeholders are recognized and that their information needs are addressed. (para. 28)

4/5 Social responsibility

The governance structure will aim to align, as nearly as possible, the interests of the stakeholders, of those charged with governance and of the society. (para. 29)

The principles of Shari'a strike a balance between the interest of the individual and those of the society to which he or she belongs. IFIs have been established to assist in using wealth and financial resources in a manner beneficial to investors as well as to the community at large. (para. 30)

An IFI, therefore, plays an important role in the promotion of an atmosphere in which commercial activities can be undertaken in compliance with Shari'a in the best interest of the wider societal content. (para. 31)

4/6 Business ethics and culture

Codes of ethics in an IFI comprise values that are derived from Shari'a. Such values underpin the behaviour of all persons employed by or associated with the IFI in carrying out or undertaking their respective duties or obligations to the institution. (para. 32)

5. Principles of Governance

5/1 Principle (1): Effective Shari'a compliance structures

An IFI should establish an effective structure for ensuring Shari'a compliance. Such structure should cover effectiveness of the role played by BOD, SSB, management, and auditors in so far as they relate to Shari'a compliance. (para. 33)

5/1/1 Appropriate governance structures should be in place to allow for a transparent Shari'a compliance process. (para. 34)

5/1/2 Interaction between the SSB or its members and managements should be transparent. (para. 35)

5/1/3 The responsibility for the conduct of the overall affairs of the IFI in accordance with Shari'a rests with the BOD. The SSB should report on compliance based on its review. (para. 36)

5/2 Principle (2): Fair treatment of equityholders

An IFI should provide the equityholders voting rights, adequate opportunity to have a dialogue with the institution, ability to select members of the governing BOD and SSB and also ensure fair disclosure of financial and banking practices adopted to allow them to make appropriate decisions regarding their investment in the IFI. (para. 37)

5/2/1 Necessary governance mechanisms should be in place to safeguard the interests of the equityholders who assume the risks inherent in the business of the institutions they own. (para. 38)

5/2/2 Equityholders should have access to vital corporate information about the conduct of the overall affairs of the IFI to allow them to make an informed judgment and exercise their voting rights. (para. 39)

5/2/3 The BOD and management should be accountable to the equity-holders and responsible for managing successful and productive relationships with the equity-holders. (para. 40)

5/2/4 Controlling equityholders should safeguard the interests of minority equityholders. (para. 41)

5/3 Principle (3): Equitable treatment of fund providers and other significant stakeholders

An IFI should ensure equitable and unbiased treatment of fund providers and other significant stakeholders and associated invest- ments as well as in relation provision of adequate financial and non-financial information to allow them to take appropriate deci- sions regarding their dealing with the institution. (para. 42)

5/3/1 Necessary governance mechanisms should be in place to safeguard against the risks of inequitable treatment of fund providers and other significant stakeholders. Such measures could be provision of certain rights to those parties to help in their decisions and related measures. (para. 43)

5/3/2 Fund providers and other significant stakeholders of an IFI should be provided with adequate and timely information about major changes to its business that can have material consequences to their interests in the IFI. (para. 44)

5/4 Principle (4): Fit and proper conditions for board and management

An IFI should lay down a set of criteria to govern the appointment of persons to serve on the BOD and SSB as well as for appointment of management. (para. 45)

5/4/1 Selection of members of BOD, SSB and management should be transparent and based on a predefined set of criteria. (para. 46)

5/5 Principle (5): Effective oversight

The BOD should play an effective role in leadership, direction and monitoring the implementation of its policies as well as in promoting a sound control Shari'a compliant culture within the IFI. (para. 47)

5/5/1 The primary role of the BOD is to carry out its responsibilities in the best long-term interest of the IFI and its stakeholders. The BOD should set the appropriate tone for risk, compliance, and other control activities consistent with Shari'a. (para. 48)

5/5/2 The BOD should set a clear strategic plan that sets forth the IFI's business strategy and management plans to implement it. (para. 49)

5/5/3 The BOD should establish a well-aligned management struc- ture that fosters proper segregation of duties and enhances accountability and effectiveness of management oversight. (para. 50)

5/5/4 A sound internal controls framework is comprised of an effec- tive control environment, an assessment of key risks, control activities, timely and effective information and communication processes, and an oversight/monitoring process. (para. 51)

5/5/5 Regular evaluation of effectiveness of the BOD is necessary in enhancing accountability. The BOD should set effective financial and non-financial performance measures for periodic assessment of effectiveness of governance. (para. 52)

5/6 Principle (6): Audit and governance committee

An IFI should have an audit and governance committee whose role and responsibilities should be set in appropriate terms of reference which should include, among others matters, the process for financial reporting, internal controls, internal audit oversight, external audit oversight and Shari'a compliance. (para. 53)

5/6/1 The audit and governance committee should be composed of non-executive members of the BOD and should maintain its independence from executive authority as practicable. (para. 54)

5/7 Principle (7): Risk management

The BOD of an IFI should be actively involved in setting the risk appetite and should make sure that there are appropriate policies and systems for identification, measurement, analysis, reporting and mitigation of risks. (para. 55)

5/7/1 The BOD should understand its role and that of management in the area of risk management. Management is responsible for assessing and managing the IFI's exposure to various risks. The BOD is responsible for ensuring that the IFI has a process in place to assess and manage risks and to ensure that both management and the BOD receives timely and accurate information on key risk areas. (para. 56)

5/7/2 The BOD should approve the IFI's risk strategy and set tol- erance levels for risks the IFI assumes and should establish the framework for management of the risks it takes on in its business. (para. 57)

5/7/3 The BOD should have a thorough understanding of the risks in relation to the IFI's business as well as the internal and external risks that could prevent it from achieving its strategic objectives. (para. 58)

5/7/4 The BOD should establish a programme for succession planning and leadership development that should also cover training and continuing education on subjects related to the IFI's business. (para. 59)

5/8 Principle (8): Avoidance of conflicts of interest

An IFI should set appropriate governance structures to ensure that members of BOD, members of SSBs, management and staff as well as external parties, such as external auditors, rating agencies, and other parties with substantial dealings with it avoid conflicts of interest. (para. 60)

5/8/1 The IFI should identify all situations of potential conflicts of interest and institute codes and policies to ensure situations leading to such conflicts are avoided at all times. (para. 61)

5/8/2 Those charged with governance should act in a manner that is free and objective in perspective. (para. 62)

5/9 Principle (9): Appropriate compensation policy oversight

An IFI should set appropriate governance structures in relation to remuneration policies for BOD, SSB and management. Compensation policies should be developed on an independent and transparent basis. (para. 63)

5/10 Principle (10): Public disclosures

An IFI should adopt high standards of reporting and satisfy the information needs of owners, investment accountholders, other counterparties, regulatory, Zakah and other related agencies. The IFI should maintain high standards of transparency and market discipline to build trust with shareholders and other stakeholders. Accurate, adequate, timely and fair reporting of financial and non- financial performance measures should be ensured. (para. 64)

5/11 Principle (11): Code of conduct and ethics

An IFI should adopt policies, procedures consistent with Shari'a to promote a code of ethical and responsible behaviour by members of BOD, members of SSB, management and employees. (para. 65)

5/12 Principle (12): Appropriate enforcement of governance principles and standards

An IFI should have a mechanism to ensure that the principles and standards on governance are adhered to and monitored. (para. 66)

6. Governance Structures

6/1 Those charged with governance

For the purposes of this Statement, those charged with governance are normally persons accountable for ensuring that the entity achieves its objectives with regards to effectiveness and efficiency of operation, compliance with Shari'a and applicable laws, and reporting to relevant parties. Those charged with governance include management only when it performs such functions. (para. 67)

6/2 Governance structures

It is recognized that uniform structures will not take into account the diversity of circumstances and experience among entities and within the same entity over time. (para. 68)

An IFI shall use diligence and care in translating the individual principles in laying down the enforcing policies for adoption. The BOD should provide sufficient guidelines to those affected and establish a governance structure that is effective. (para. 69)

For purposes of this statement, governance structures comprise all or some of the following that an IFI finds necessary to adopt the principles laid out herein.

a) A structure though which the governance objectives of the IFI are set, and the means of attaining those objectives and monitoring performance are determined.

b) Mechanisms in place for efficient use of resources and equally to require accountability for the stewardship of those resources.

c) The system by which the IFI is directed and managed while encouraging it to create value, provide accountability and establish control systems that commensurate with risks involved.

d) A system of checks and balances for ensuring that those charged with governance act in the best interests of the IFI's stakeholders for producing long-term value to the IFI's stakeholders while maintaining the highest standards of ethics and professional confessional conduct. (para. 70)

6/3 Limitations

Governance is concerned with a variety of interactive qualitative elements including aspects of human values and human behaviour and thinking abilities. Integrity is an important human characteristic upon which successful governance processes impinge. (para. 71)

Persons with high integrity are more likely to promote more trans- parent behaviour in their day-to-day performance of their respective roles in furtherance of the overall goals of the IFI. Thinking abilities of members of BOD and management also come to the fore in the day-to-day processes involved in relation to activities relating to stra- tegic planning and decision making, etc. (para. 72)

Accordingly, there is no one-size fits all structure that would guarantee effectiveness or soundness in governance frameworks. (para. 73)

In this sense, good governance is not just a matter of prescribing particular structures or a matter complying with pre-established rules. (para. 74)

Adoption of the Statement

The Statement on Governance Principles for Islamic Financial Insti- tutions was adopted by the Accounting and Auditing Standards Board in its meeting No. (30) held on 19 Shawwal 1426 A.H., corresponding to 21
November 2005 A.D.

Appendix (A)
Brief History of
the Preparation of the Standard

AAOIFI was established in 1991 as a standard-setting body and has thus far issued 30 Shari'a standards, 25 accounting statement/standards, 5 auditing standards, 5 governance standards, and 2 codes of ethics.

Prior to the issuance of the initial set of accounting standards, AAOIFI issued financial accounting statements entitled: "Objectives of Financial Accounting for Islamic Banks and Financial Institutions", and "Concepts of Financial Accounting for Islamic Banks and Financial Institutions".

These two financial accounting statements essentially established the 'framework' for financial accounting rules to be followed by IFIs as well as formed the basis for AAOIFI's accounting standards. The two statements provided the basic guidelines for recognition, measurement and disclosure of financial transactions for purposes of financial statements preparation.

Expanded Role of the AAOIFI

While the need for accounting and auditing standards was most felt in late 1980s leading to the establishment of AAOIFI, the need for governance standards has arisen in recent years due to the divergence in the practices followed by IFIs.

In 1998, the statute of the AAOIFI was amended to include the objective
- "to also develop banking practices thought relating to the activities of
Islamic financial institution". With this broader mandate, the AAOIFI
commenced work in areas of 'best practices' and has now issued 5

governance
standards namely:

1. Shari’a Supervisory Board: Appointment, Composition and Report.
2. Shari’a Review.

3. Internal Shari'a Review.
4. Audit and Governance Committee for Islamic Financial Institutions.
5. Independence of Shari'a Supervisory Board.

The governance standards issued thus far aimed at addressing some of specific issues affecting IFIs.

Although there exists a 'framework' of principles to guide the IFIs and AAOIFI in relation to accounting practices in the form of the two general statements specified above, no framework existed in respect of the governance practices and standards.

Therefore, the Statement on Governance Principles for Islamic Financial Institutions has been developed to provide the framework for governance practices and standards.

Appendix (B)
Basis for Development of the Statement

The Statement on Governance Principles for Islamic Financial Institutions is based upon an initial study carried out by a committee established for this purpose.

The study focussed on:

- Firstly, studying some of the current pronouncements or standards in the area of governance in various countries;
- Then, assessing whether any identified current pronouncements or standards (that might indeed be appropriate to conventional institu- tions) were relevant to governance structures in an Islamic financial institution having considered the internal and external environment within which it operates; and
- Finally, providing an illustrative set of key principles to be considered within the Framework.

Just what constitutes governance, in itself, is still a topic of wide debate in the corporate world. Corporate governance has only recently emerged as a discipline in its own right. The importance of the subject is widely recognized but the terminology and analytical tools are still emerging.

Several regulatory bodies, standard-setting or voluntary organizations have done much work on the subject of governance. The principles laid down by these authorities have been considered in developing the Statement where found appropriate.

Appendix (C)
Meeting Stakeholder Information Needs

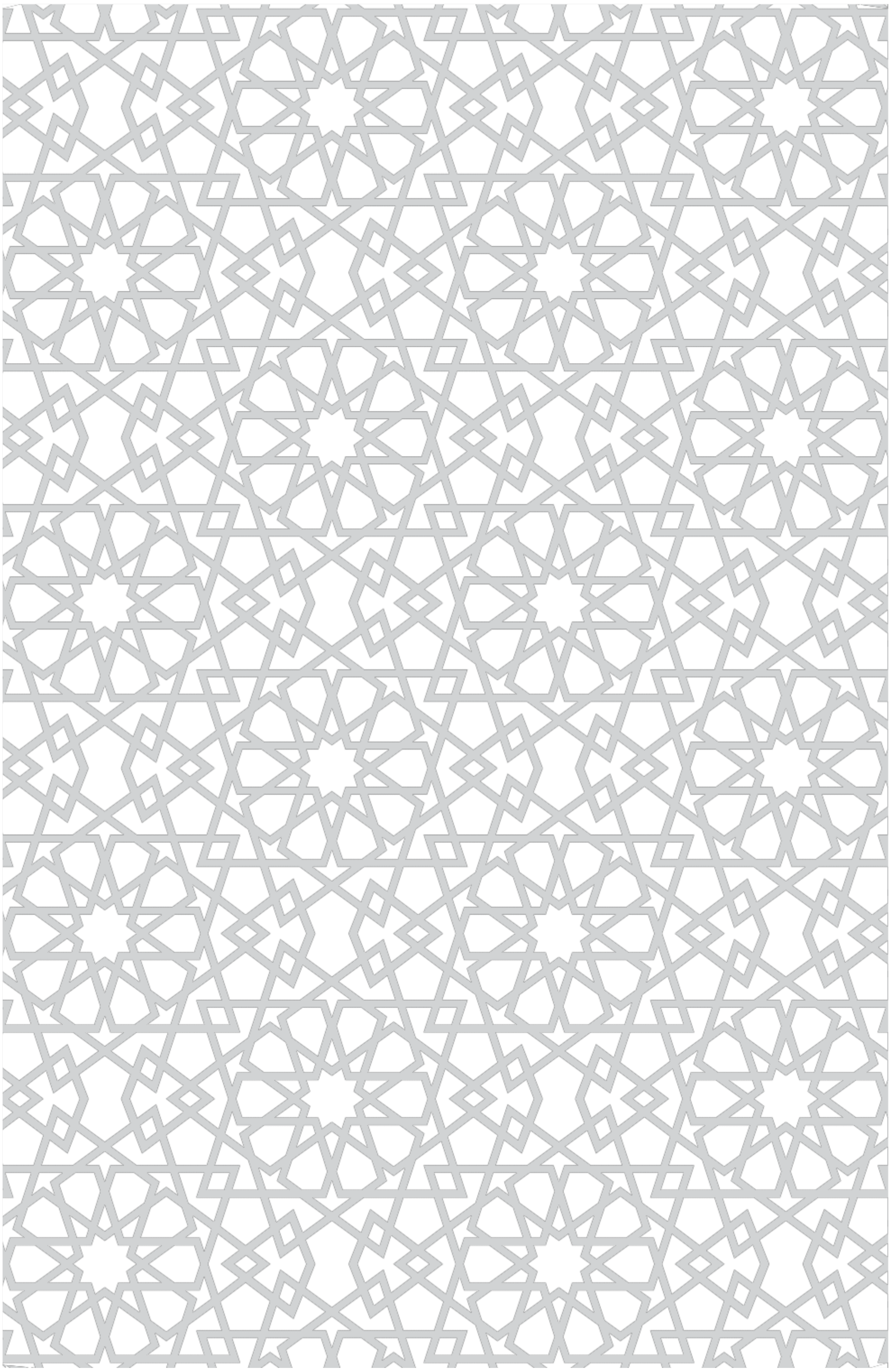
An important objective of a governance structure will be to provide accurate, adequate and timely information so as to allow the various stake- holders to make informed decisions about their ownership, rights, con- tinued association with the IFI, etc. The following table illustrates some governance issues relevant to key stakeholders.

Key stakeholders	Possible role of governance practices
Equityholders	Equityholders of an IFI are potentially interested in information concerning: a) Financial health –financial position, results and cash flows. b) Roles and responsibilities of BOD. c) Roles and responsibilities of SSB. d) Management structure. e) Risk management practices and risk mitigation measures. f) Compensation practices and remuneration paid to directors and managements.
Shari'a Supervisory Board (SSB)	Assurance that all key transactions and dealings requiring examination from a Shari'a compliance standpoint are brought to the attention of the SSB. Assurance about whether information presented by the BOD or management to the SSB is accurate and reliable.
Internal Shari'a	Appropriate information and evidence to confirm compliance with requirements of the SSB

Restricted investment accountholders	All of the above plus assurance about truth and fairness of the net assets attributable to their funds and about appropriate compliance and risk management practices in relation to
Unrestricted investment accountholders	All of the above plus the following: a) Legal implications of commingled funds and corresponding assets. b) Status of their funds in the event of failure of the Mudarib. c) BOD's and management's measures to ensure their interests are safeguarded and decisions relating to their funds are free from bias. d) Appropriate risk management measures in
Regulatory bodies and institutions that have an interest in safety and soundness of the financial sector	All of the above plus the following: a) Confirmation that the IFI is using sound principles to manage and control its operations, its risks and the compliance activity. b) Assurance that the IFI is properly safeguarding its clients. c) Assurance that the BOD and management maintain high standards of ethics and transparency and

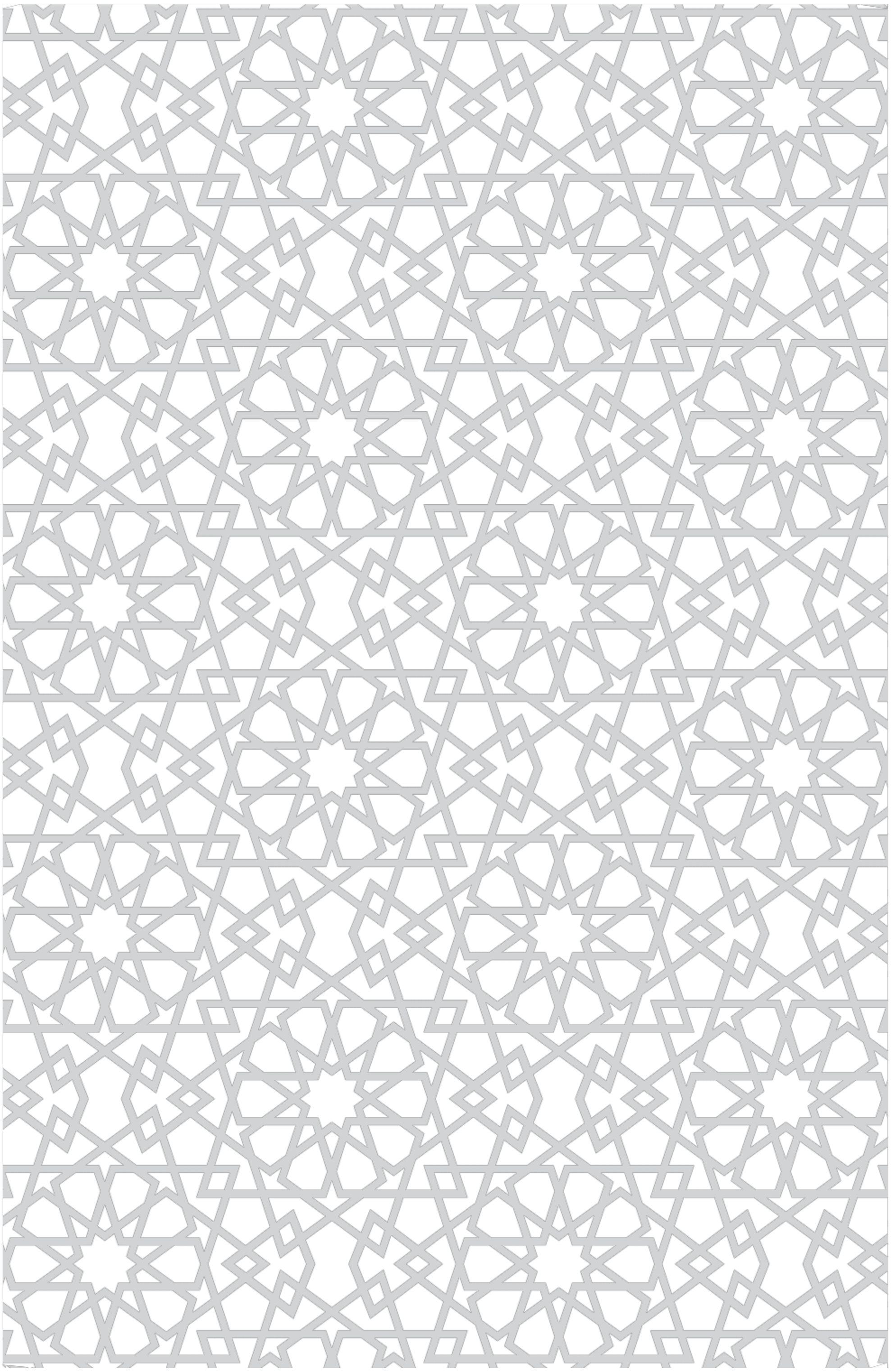
The governance structure should, therefore, be aimed at meeting the stakeholders' information needs.

If an IFI intends to disclose information it knows (or is negligent in not knowing) to be material, and non-public, to a party or shareholder, it must provide prior or simultaneous, widespread public disclosure of that information.



Governance Standard (No. 7)

Corporate Social Responsibility, Conduct and Disclosure for Islamic Financial Institutions



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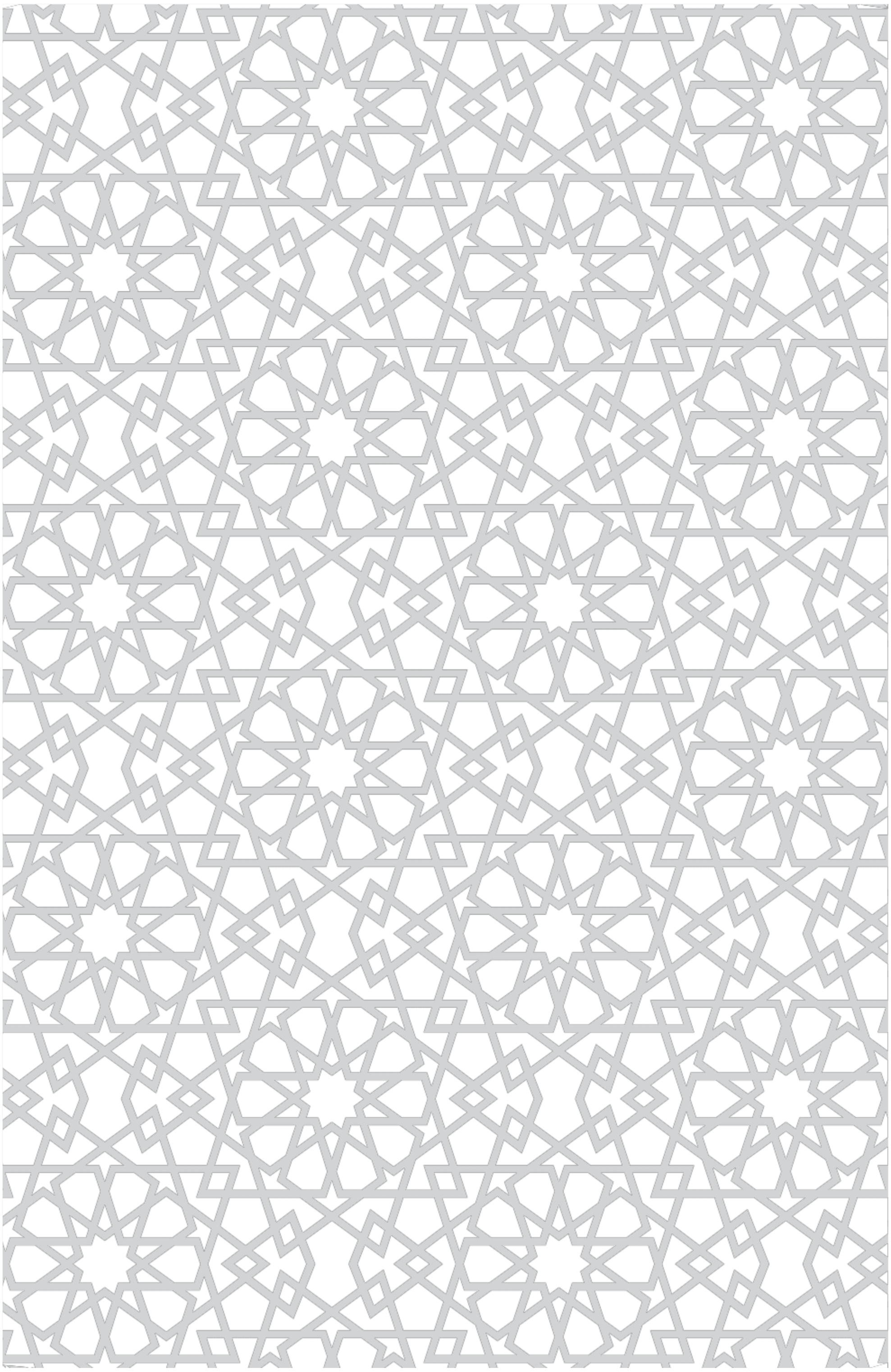

Corporate Social Responsibility Conduct and Disclosure for Islamic Financial Institutions

1. Introduction

The purpose of this Governance Standard for Islamic Financial Institutions (GSIFI) is to establish standards on the definition of Corporate Social Responsibility (CSR) for Islamic Financial Institutions, provide both mandatory and recommended standards to implement CSR in all aspects of the Islamic Financial Institution's (IFI)[(1)] activities and pro- vide guidance on disclosure of CSR information to the IFI's stakeholders. (para. 1)

2. Scope of the Standard

The principles of this standard are applicable to all IFIs, regardless of their legal form, country of incorporation or size. However, the specific rules and provisions of this standard for activities, compliance and disclosure are classified into mandatory and recommended sections. The mandatory sections are applicable to all IFIs regardless of their legal form, country of incorporation or size. The recommended sections are only applicable to IFIs which have the capacity, financial or otherwise, to carry out or comply with such activities (para. 2).

Should the requirements of this standard contradict the IFI's charter or the laws and regulations of the country in which it operates, a disclosure should be made to that effect. Islamic Insurance companies may disregard provisions that are not applicable to their operations. (para. 3)

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(1) The IFIs referred to in this standard are defined as any institution that plays the role of a financial intermediary that strictly abides by the provisions of the Shari'a. These include, but are not limited to Islamic banks and Islamic Insurance companies.

3. Definition of Corporate Social Responsibility for Islamic Financial Institutions

Corporate Social Responsibility (CSR) for IFIs refers to all activities carried out by an IFI to fulfill its religious, economic, legal, ethical and discretionary responsibilities as financial intermediaries for individuals and institutions. (para. 4)

Religious responsibility refers to the overarching obligation of IFIs to obey the laws of Islam in all its dealings and operations. Economic responsibility refers to the obligation for Islamic banks to be financially viable, profitable and efficient. Legal responsibility refers to the obligation of IFIs to respect and obey the laws and regulations of the country of operation. Ethical responsibility refers to the obligation of IFIs to respect the mass of societal, religious and customary norms which are not codified in law. Discretionary responsibility refers to the expectation from stakeholders that IFIs will perform a social role in implementing Islamic ideals over and above the religious, economic, legal and ethical responsibilities. (para. 5)

This standard does not focus on economic or legal responsibilities of IFIs as it is assumed that the management/accounting structure and other accounting and governance standards are designed to fulfill economic responsibilities, while legal responsibilities are codified and enforced by the state and its functions. (para. 6)

4. Objectives of the Standard

The primary objective of this GSIFI is to prescribe uniform standards on CSR activities and compliance for IFIs. It is not the intended objective of the standard to prescribe new principles and rules of conduct for IFIs, but to codify existing principles and rules in a comprehensive structured format. (para. 7)

The second objective of this standard is to ensure that the CSR activities and compliance of IFIs are communicated in a uniform, truthful, transparent and comprehensible manner to relevant stakeholders to whom the IFI owes a duty of accountability. (para. 8)

The objectives of this standard, as stipulated above, and the standard itself are intended to encourage IFIs to take a proactive role in applying CSR to all aspects of their operations. (para. 9)

5. Responsibilities Under This Standard

5/1 Structure of corporate social responsibility

The responsibilities under this standard are divided between man- datory and recommended conduct. Within mandatory conduct, there are specific responsibilities which an IFI must carry out, while there is guidance on the discretionary methods by which these specific responsibilities may be carried out. (para. 10)

5/2 Mandatory conduct

5/2/1 Policy for screening clients

IFIs shall implement a CSR policy for screening prospective clients. This policy must include

a) Screening criteria
b) The approval of the Shari'a Supervisory Board of the screening criteria. (para. 11)

The policy stipulating the screening criteria may include pro- visions:

i. For review of the compliance of prospective client's investments with Islamic law, among other aspects, if any, based on the discretion of the IFI,
ii. Requiring that effective screening processes are in place to prevent third parties from using the IFI to engage in criminal activities such as money laundering
iii. For review of the prospective client's compliance with prin- ciples and rules of CSR as contained within this standard, particularly mandatory core conduct as stipulated in sections 5/2 (extended to the prospective clients).
iv. For review of the impact of the prospective client's investment on the economy, society and the environment.

v. Stating that any future abrogation of the terms of financing, as stipulated under this policy, will result in violation of contractual terms (with the remedy to be decided by the IFI). (para. 12)

If these policy terms form part of the contractual agreement with clients, a policy disclosure must be made to prospective clients stipulating these policy terms prior to contractual agreement. (para. 13)

5/2/2 Policy for responsible dealing with clients

IFIs shall implement a CSR policy for responsible dealing with clients, including provisions relating to avoidance of onerous terms on clients, marketing ethics, implementing responsible financing practices in all types of transactions with clients and dealing with late repayments and insolvent clients. This policy shall stipulate:

a) That all contract forms have to be screened by the Shari'a supervisory board or its agent to avoid the imposition of onerous terms and conditions to clients who are in a weaker bargaining position relative to the IFI,

b) Provisions to ensure that all marketing campaigns and documents are ethically balanced promoting business without an exclusive focus on profits that may induce inappropriate behaviour/consumption and unsuitable products inconsistent with Islamic, social and cultural norms,

c) The obligations and rights of each party to transactions undertaken with the IFI,

d) The due process and responsible terms and conditions under which financing is extended to clients, taking into consideration the client's ability to repay and the effect on the client's financial and overall well-being, through assessment of the client's present disposable income capacity,

e) The remedies available, in the event that one or both parties violate their contractual terms,

f) The opinion of the Shari'a Supervisory Board regarding late payment charges,
g) Late payment charges to be charged to clients, if any,
h) How the IFI allocates the late payment charges in its accounts (allocation to revenue or charity),
i) The conditions under which IFIs will defer collection of debt from insolvent clients. (para. 14)

A policy disclosure shall be made to clients prior to execution of any contract. This policy disclosure shall form part of the contractual terms and conditions. (para. 15)

5/2/3 Policy for earnings and expenditure prohibited by Shari'a

IFIs shall implement a CSR policy for earnings and expenditure prohibited by Shari'a. (impermissible or haram transactions). This policy must include a due process procedure wherein the following must be documented for impermissible transactions:

a) Specific description of each material transaction and aggregate description of accumulated immaterial transactions
b) Revenue, expense, liability or asset amount of each material transaction and aggregate revenue, expense, liability or asset amount of accumulated immaterial transactions,
c) Reasons for undertaking such transactions,
d) The Shari'a Supervisory Board's verdict on the necessity of these transactions,
e) How the IFIs intends to dispose of such revenues, assets or liabilities, and
f) Recommendations for finding viable permissible or halal alternatives for similar impermissible transactions in the future. (para. 16)

The procedure above should be read in conjunction with and supplements any existing AAOIFI standards that re- late to earnings and expenditure prohibited by Shari'a. (para. 17)

5/2/4 Policy for employee welfare

IFIs shall implement a CSR policy for employee welfare. This policy shall stipulate provisions for the rights and obligations of employees, including provisions affording fair treatment of all employees, avoidance of discrimination, as well as expected behaviour of all employees. This policy may include specific provisions relating to:

a) Equal opportunity for all employees, regardless of gender, race, religion, disability or socio-economic background,

b) Merit-based salary and promotion structure for all em- ployees, regardless of gender, race, religion, disability or so- cio-economic background,

c) Establishing long term incentive schemes and further development and training incentive schemes for all em- ployees,

d) Provisions for maternity leave and flexible work hours for female employees,

e) Maximum allowable work hours under full-time, part-time and casual employment for all employees,

f) Prohibition of discrimination including, and not limited to, gender, race, religion, disability or socio-economic back- ground, penalties for such discrimination and avenues for complaints for such discrimination without any manner of recrimination (Appointment(s) should be made within the organization to deal with such discrimination; the person(s) appointed must be seen to be just and fair to all employees, regardless of the employee's gender, race, religion, disability or socio-economic background),

g) Pro-actively establishing, monitoring and acting on realizable quotas/targets for employment of staff from disadvantaged backgrounds, with disabilities, from a minority group, and/or from under-represented groups in the formal economy (in- cluding females) (affirmative action).

h) Elimination of child labour from the workforce and if not feasible, educational and familial support for children,

i) Elimination of class and race barriers between higher and lower ranking employees,

j) Expected behavior of all employees in line with the Code of Ethics for the Employees of Islamic Financial Institutions,

k) Expected behavior (humility, modesty and mutual respect) of higher ranking employees towards lower ranking employees, vice versa, and

l) Occupational health and safety measures to be taken by the IFI and by the employees (para. 18).

A policy disclosure must be made to all employees before commencement of the employment contract and preferably be disclosed in any form of media that is utilized to advertise employment vacancies. This policy disclosure should form part of the contractual terms and conditions. Efforts should be made to communicate this policy disclosure to all employees in their native language (language most frequently used by the employee). (para. 19)

5/2/5 Policy for Zakah

The terms and conditions under which a Zakah policy must be established are stated in Shari'a Standard No. (35), State- ment of Financial Accounting No. (2): Concepts of Financial Accounting for Islamic Banks and Financial Institutions sec- tion 4/6 and Financial Accounting Standard No. (9) on Zakah. (para. 20)

5/3 Recommended conduct

5/3/1 Policy for Qard Hasan

IFIs may implement a CSR policy for Qard Hasan for social reasons. The provisions of this policy may include matters pertaining to:

a) Establishing a Qard Hasan fund,

b) Maintaining a record of sources of Qard Hasan funding (depositors, shareholders and/or other parties) (sources of funds),

c) Types of allowable beneficiaries of the Qard Hasan funds as determined by the bank (allowable uses of funds),

d) Circumstances in which such loans are distributed to individuals (or to organizations),

e) Contractual enforcement measures for debtors able to repay loans,

f) Write off conditions for debtors unable to repay loans, and g) Developing a strategy to increase Qard Hasan loans from the sources referred to in 5/3/1b, which are to be used solely for charitable purposes, and pro-actively establishing, monitoring and acting on realizable quotas/targets for this particular strategy. (para. 21)

This policy may be monitored on a yearly basis. If implemented, this policy may supplement any provisions contained elsewhere in the AAOIFI standards including, Statement of Financial Accounting No. (2): Concepts of Financial Accounting for Islamic Banks and Financial Institutions section 4/7. (para. 22)

5/3/2 Policy for reduction of adverse impact on the environment

IFIs may implement a CSR policy for reducing the impact of the IFI on the environment. The provisions of this policy may include matters pertaining to:

a) Establishing organization wide guidelines on efficient and minimal usage of non-renewable resources,

b) Initiatives to educate employees to efficiently use non- renewable resources and increase use of renewable resources,

c) Incentives and initiatives to find alternatives to non-renewable sources of energy and materials for operations (e.g., e-mail bank statements instead of paper bank statements), or

d) incentives and initiatives to recycle renewable sources of materials within the organization (para. 23).

The provisions of this policy may be reviewed on a yearly basis to implement new and innovative methods by which to minimize the environmental impact of the IFI (para. 24).

5/3/3 Policy for social, development and environment based in- vestment quotas

IFIs may implement CSR policies for social, development and environment based investment quotas. This policy may include provisions for pro-actively establishing, monitoring and acting on realizable and profitable investment quotas/targets, based on the extent to which the investments directly or indirectly contribute to social, development and environmental causes. (para. 25)

Social Impact Investments: These policies may include quotas/ targets for social-impact investments, based on the role that the investments play in:

a) Assisting poor and needy individuals and families, by financing business opportunities and/or education,
b) Assisting orphans,
c) Assisting heavily indebted individuals or families with unfortunate circumstances,
d) Assisting in the provisioning of health and medical services to impoverished communities or areas,
e) Assisting in the development of research and education facilities, particularly those that utilize and empower di- sadvantaged individuals or communities,
f) Assisting the development of small and medium sized entrepreneurs and family

businesses,

g) Encouraging the development of Islamic and native societal culture, and

h) Discouraging contemporary social ills and vices. (para. 26)

Development Impact Investments: These policies may include quotas/targets for development impact investments:

a) That offer significant growth potential for the country of operation or for another developing country,

b) That significantly contribute to the development of in-frastructure in the country of operation or for another de- veloping country,
c) That have a significant proportion of small to medium size enterprises (SME) or indirectly rely on small to medium size enterprises (SME), and/or
d) That directly or indirectly assists in the alleviation of social and economic disadvantages and discrimination including, and not limited to, micro-finance industry and third-sector organizations. (para. 27)

Environmental Impact Investment: These policies may include quotas/targets for environmental impact investments, based on the role that the investments play in:

a) Protecting the environment,
b) Reducing the impact of development on the environment, c) Encouraging individuals and institutions to protect and preserve the natural environment and reduce the impact of development on the environment, and
d) Increasing the use of renewable, sustainable sources of energy and/or reducing the reliance on scarce non-renewable sources of energy. (para. 28)

This policy may be monitored on a yearly basis, with revisions being made on based on quota/target performance. (para. 29)

5/3/4 Policy for par excellence customer service

IFIs may implement a CSR policy to develop par excellence customer service skills of employees and contractors. The provisions of this policy may include matters pertaining to:

a) Establishment of a code of conduct for all employees and contractors in dealing with customers (The code of conduct for customer service may include the provisions from the Code of Ethics for the Employees of Islamic Financial Ins- titutions section 6/3),

b) Active measures to be taken by management to develop customer service skills of employees, and

c) Surveys that provide customer service feedback on perfor- mance/quality and likely areas of improvement. (para. 30)

5/3/5 Policy for micro and small business and social savings and investments

IFIs may implement a CSR policy to assist micro and small business and social savings and investments. The provisions of this policy may include matters pertaining to:

a) Encouragement of micro and small business savings through special features and terms for these types of investment depositors,

b) Encouragement of social savings for marriages, children's education, community based programs and other social welfare programs through special features and terms for these types of investment depositors,

c) Encouragement of both micro and small business savings and investment through combination features and terms for these types of investment depositors (e.g., savings deposit with higher rates of return and investment loans discounts etc), and

d) Encouragement of both family savings and investment through combination features and terms for these types of in- vestment depositors (e.g., savings deposit with higher rates of return and investment loan discounts etc). (para. 31)

5/3/6 Policy for charitable activities

IFIs may implement a CSR policy for charitable activities. The provisions of this policy may include matters pertaining to:

a) Establishing a charity fund,

b) Establishing avenues for voluntary donations by donors (e.g. from depositors, shareholders, clients, contractors and employees) for the charity,

c) Establishing fund raising drives (emergency or otherwise)
from bank's clients through existing operational means,
d) Specifying target groups, communities and institutions that
require assistance, including those described in policy for social impact based investment quota (section 5/3/4) and policy for environmental impact based investment quotas (section 5/3/5)
e) Means by which charity may be distributed to prospective
donees, and
f) Contracting an agent or establishing a trust foundation to
distribute funds to allocated charities. (para. 32)

5/3/7 Policy for Waqf management

IFIs may implement a CSR policy for managing Waqf properties on behalf of their beneficiaries. The provisions of this policy may include matters pertaining to:

a) Establishing a Waqf management department or allocating staff to a Waqf management function,
b) Establishing rules and guidelines based on Shari'a for Waqf management,
c) Establishing a fair rate structure for the provision of services by the bank, and
d) Giving discounted rates and flexible terms for Waqf investment financing. (para. 33)

6. Disclosure Requirements and Presentation Treatment Options

6/1 Mandatory disclosure requirements

Disclosure should be made, in a separate CSR report contained within the annual report, of the material policies of the IFI with respect to its mandatory CSR conduct to satisfy the information needs of the IFI's stakeholders. Disclosure may also be made in other reports specifically targeted towards the general public. (para. 34)

It should be noted that while disclosures are meant to be comprehensive, the potential user groups of CSR information are wide and hence disclosures should be designed with the intention of making them as understandable as possible for the general public.(para. 35)

6/1/1 Disclosure of policy for screening clients

Disclosure should be made, in the annual report, of the CSR policy on screening clients. This disclosure should stipulate

a) The specific provisions of the screening policy including the benchmarks and/or criterion utilized to measure compliance with Islamic law, and

b) Whether these have been approved by the Shari'a supervisory board. (para. 36)

6/1/2 Disclosure of policy for dealing with clients

Disclosure should be made, in the annual report, of the CSR policy on dealing with clients. This disclosure should stipulate the specific provisions of the CSR policy including:

a) The defined procedure of the IFI on avoiding the imposition of onerous contractual terms on clients who are in a weaker bargaining position relative to the IFI,

b) The provisions ensuring that marketing campaigns and documents are ethically balanced,

c) The obligation and rights of both parties,

d) The due process and responsible terms and conditions under which credit is extended to clients, including the process by which the client's ability to repay and the effect on the client's financial and overall well-being is assessed,

e) The remedies available in the event that one or both parties violate their contractual terms,

f) The Shari'a supervisory board's opinion on the permissibility

of charging late payment charges,
g) Late payment charges levied on clients,
h) How the IFI allocates the late payment charges in its accounts
(allocation to revenue or charity), and
i) The conditions under which the IFI will defer collection of
debt from insolvent clients. (para. 37)

6/1/3 Disclosure of earnings and expenditure prohibited by Shari'a

Disclosure should be made, in the annual report, of the earnings and expenditure prohibited by Shari'a (impermissible or haram transactions) for the financial year, if any. This disclosure should stipulate the following items for the financial year:

a) Aggregate descriptions, amounts, account classification (re- venue, expense, liability or asset) and reasons for undertaking these types of transactions,

b) The SSB's verdict on the necessity of these transactions, c) How the IFI intends to dispose of such amounts,,

d) The IFI's strategy to find viable permissible or halal alter- natives, if any, for similar impermissible transactions in the future. (para. 38)

This comprehensive disclosure supplements existing disclosure required by other AAOIFI standards (Financial Accounting Standard No. (1): General Presentation and Disclosure in the Financial Statements of Islamic Banks and Financial Institutions section 3/6). (para. 39)

6/1/4 Disclosure of policy for employee welfare

Disclosure should be made, in the annual report, of the IFI's policy for employee welfare. This disclosure should stipulate the provisions of the IFI policy and the measures taken to implement these provisions within the organization. (para. 40)

The disclosure may include the policy relating to affirmative action, including:

a) Provisions of the policy, including targeted disadvantaged groups,

b) Quotas/targets and achievements for the year, and

c) Reasons for upward and downward revisions in quotas/ target.

This disclosure may be included with the mandatory disclosure of the policy for employee welfare. (para. 41)

6/1/5 Disclosure of policy for Zakah

Disclosure should be made for Zakah, in the financial state- ments, in accordance with the provisions of Financial Account- ing Standard No. (1): General Presentation and Disclosure and Financial Accounting Standard No. (9) on Zakah. (para. 42)

6/2 Voluntary disclosure

Disclosure may be made of the material policies of the IFI with respect to its recommended CSR conduct to satisfy the information needs of the IFI's stakeholders. Disclosure may be made in other reports specifically targeted towards the general public. (para. 43)

It should be noted that while disclosures are meant to be comprehensive, the potential user groups of CSR information are wide and hence disclosures should be designed with the intention of making them as understandable as possible for the general public.(para. 44)

6/2/1 Disclosure of policy for social, development and environment based investment quotas

Disclosure may be made, in the annual report, of the CSR policy for social, development and/or environment based investments quotas and the extent of implementation of this policy for the financial year. The disclosure may include:

a) The provisions of the policy,

b) Classes of investments by ultimate purpose/beneficiary of investments (e.g., orphans, SME development, Islamic culture, reduction in tree logging, reduction in environ- mental greenhouse gases, increase in recycling, science and technology)

c) The profitability of such investments for the year,

d) Quotas/targets and achievements for the year, and

e) Reasons for upward and downward revisions in quotas/ target (para. 45).

6/2/2 Disclosure of policy for par excellence customer service

Disclosure may be made, in the annual report, of the CSR policy for par excellence customer service. The disclosure may include:

a) Provisions of the policy,

b) Measures taken by management to develop customer service skills, and

c) Aggregate results of customer surveys demonstrating ove-rall quality of customer service and areas of improvement. (para. 46)

6/2/3 Disclosure of policy for micro and small business and social savings and investments

Disclosure may be made, in the annual report, of the CSR policy for micro and small business and social savings and investments. The disclosure may include:

a) Provisions of the policy;

b) Features of the offer;

c) Measures taken by management to implement the provisions of the policy;

d) Quotas/targets and achievements for the year; and

e) Reasons for upward and downward revisions in quotas/ target (para. 47).

6/2/4 Disclosure of policy for Qard Hasan

Disclosure may be made, in the annual report, of the CSR policy for Qard Hasan. The disclosure may include:

a) Whether there is a formal scheme operated by the bank for depositors, shareholders and other parties to place their funds for the use of Qard Hasan borrowers,

b) Provisions of the policy/scheme including conditions for those unable to repay the loans,

c) Sources of funding for Qard Hasan

loans,

d) Aggregate purposes for which the Qard Hasan loans have been made,

e) Quotas/targets to increase internal and external Qard Hasan funding and achievements for the year in this regard, and

f) Reasons for upward and downward revisions in quotas/ target. (para. 48)

The disclosure requirement should be read in conjunction with and supplements any disclosure recommended by the existing AAOIFI Statement of Financial Accounting No. (2): Concepts of Financial Accounting for Islamic Banks and Financial Insti- tutions section 4/7 and Financial Accounting Standard No. (1): General Presentation and Disclosure in the Financial State- ments of Islamic Banks and Financial Institutions section 4/7. (para. 49)

6/2/5 Disclosure of policy for charitable activities

Disclosure may be made, in the annual report, of the CSR policy for charitable activities. The disclosure may include:

a) Provisions of the policy,
b) Aggregate classes of charitable activities by ultimate benefi- ciary and amounts distributed to each aggregate class,
c) Quotas/targets and achievements for the year, and
d) Reasons for upward and downward revisions in quotas/ target. (para. 50)

This disclosure will supplement any disclosure recommended by the existing AAOIFI Statement of Financial Accounting No. (2): Concepts of Financial Accounting for Islamic Banks and Financial Institutions section 4/6 and Financial Accounting Standard No. (9): Zakah (para. 51).

6/2/6 Disclosure of policy for Waqf management

Disclosure may be made, in the annual report, of the CSR policy for Waqf management. The disclosure may include:

a) Types of Waqf managed by the IFI,

b) Financial and other services offered to the Awqaf by the IFI. (para. 52)

7. Responsibility Under This Standard

7/1 Compliance and attestation function

It is the responsibility of the board of directors of the IFI to ensure compliance with the provisions of this standard. The Board of directors shall ensure that an independent compliance audit is performed prior to its attestation of CSSR conduct. (para. 53)

The compliance function will comprise testing of compliance, in form and in substance, with mandatory CSR conduct provision as well as recommended CSR conduct provisions which have been adopted by the IFI. (para. 54)

The attestation by the board of directors of the IFI will comprise a signing declaration containing:

a) A statement which stipulates that management has pro-actively engaged in the mandatory and voluntary provisions of the CSR standard in all its conduct; and/or

b) A statement which stipulates that management's representations in the annual report regarding its CSR conduct fairly represent management's actual conduct. (para. 55)

7/2 Implementation function

The responsibility for implementation of this standard lies with the management of an IFI. (para. 56)

8. Effective Date

This Standard shall be effective for financial periods beginning 1 Muharram 1431 A.H. or 1 January 2010 A.D. (para. 57)

Adoption of the Standard

The Standard on Corporate Social Responsibility Conduct and Disclosure for Islamic Financial Institutions was adopted by the Accounting and Auditing Standards Board in its meeting No. (35) held on 6 Rabi' II, 1430
A.H., corresponding to 2 April 2009 A.D.

Appendix (A) Brief History of the Preparation of the Standard

In its meeting No. (31) held in Manama, Kingdom of Bahrain on 17 Jumada I 1427 A.H., corresponding to 13 June 2006 A.D., the Accounting and Auditing Standard Board decided to develop a new standard on Corporate Social Responsibility Conduct and Disclosure for Islamic Financial Institutions.

Subsequently, a consultant was commissioned to prepare a preliminary study and exposure draft of the Standard on Investments in Associates. Preparation of the preliminary study and exposure draft was overseen by the Auditing and Governance Standards Committee.

The preliminary study and exposure draft were discussed by the Auditing and Governance Standards Committee through a series of meetings and telephone conference calls.

The preliminary study and exposure draft were also deliberated by Accounting and Auditing Standard Board in its meetings No. (33) held in Manama, Kingdom of Bahrain on 24 Jumada I, 1429 A.H., corresponding to 29 May 2008 A.D., and No. (34) held in Manama, Kingdom of Bahrain on 14 Dhul-Qa'dah 1429 AH., corresponding to 12 November 2008 A.D.

Listening session for the exposure draft was convened in Manama, Kingdom of Bahrain on 24 Safar 1430 A.H., corresponding to 19 February 2009 A.D., to gather comments from the Islamic finance industry as well as accounting and auditing professions.

The exposure draft was revised in light of the comments made in Accounting and Auditing Standards Board meeting No. (34) and the listening session.

The Accounting and Auditing Standards Board adopted the Standard on Corporate Social Responsibility Conduct and Disclosure for Islamic Financial Institutions at its meeting No. (35) held on 6 Rabi’ II, 1430 A.H., corresponding to 2 April 2009 A.D.

Appendix (B)
Reasons for the Standard

The reason for this standard is to provide specific guidance to IFIs to engage in productive CSR activities and disclose the nature of these activities to their stakeholders. Since there is no comparable standard generally and specifically for IFIs, this is an important standard to ensure the legitimacy and reputation of IFIs are preserved.

The rationale for this standard stems from the significant variation in the practice and understanding of CSR by IFIs. A number of research papers indicate that IFIs have widely varying CSR practices, with some IFIs really delivering high quality CSR initiatives and reports, whereas other IFIs are simply not interested in CSR. The papers also suggest that CSR activities are misunderstood as any activity that is not directly aligned with profit incentives. As a result, a number of IFIs engage in supporting activities that are not within the definition of social responsibility as espoused by Islamic scholars and thinkers. Rather, they are perceived to be marketing ploys to enhance the reputation of the IFI, with little direct social or environmental improvement.

The Islamic perspective on social responsibility is that the activities must directly assist individuals or societies to enhance their living or environmental conditions or assist them to better comply with religious rules and norms. Islam discourages the boasting of socially responsible activities to enhance one’s own image. However, this does not necessarily imply that institutions representing stakeholders should not be accountable. Indeed, Islam encourages accountability and therefore IFIs should be held accountable by their stakeholders for the extent of engagement in social activities.

Appendix (C)
Basis for Conclusions

CSR derives itself from core principles in the Noble Qur`an. The three major foundational principles for CSR are the vicegerency of mankind on earth, divine accountability and the duty on mankind to enjoin good and forbid evil.

Vicegerency

The principle of vicegerency denotes that mankind is the representative of Allah on earth and as such Allah has entrusted mankind with stewardship of Allah's Possession. Allah states this principle in the Qur`an: ***{"...Verily, I am going to place (mankind) generations after generations on earth..."}***;(1) and Allah further states: ***{"And it is He Who has made you generations coming after generations, replacing each other on the earth..."}***.(2)

Divine Accountability

The principle of divine accountability flows from the vicegerency principle and denotes that individuals will be accountable to Allah for all of their actions on the Day of Judgment. This principle is expounded in several verses of the Qur`an, two of which are: ***{"...Certainly, Allah is Ever a Careful Account Taker of all things"}***,(3) ***{"So whosoever does good equal to the weight of an atom (or a small ant), shall see it. And whosoever does evil equal to the weight of an atom (or a small ant), shall see it."}***(4) This divine accountability is the basis for all actions of a Muslim.(5) and in turn the representative organizations of Muslims.

(1) [Al-Baqarah (The Cow): 30]. (2) [Al-An'am (The Cattle): 165]. (3) [Al-Nisa` (The Women): 86].
(4) [Al-Zalzalah (The Earthquake): 7-8].
(5) One who submits to the Will of

Allah.

Enjoining Good and Forbidding Evil

The principle of enjoining good and forbidding evil encapsulates the responsibilities that Allah places on Muslims as trustees and vicegerents. Allah says: ***{"The believers, men and women, are Awliya` (helpers, supporters, friends, protectors) of one another, they enjoin (on the people) Al-Ma'ruf (i.e. Islamic Monotheism and all that Islam orders one to do), and forbid (people) from Al-Munkar (i.e. polytheism and disbelief of all kinds, and all that Islam has forbidden)..."}***[(1)] and in another verse, Allah states:
{"You [true believers in Islamic Monotheism, and real followers of Prophet Muhammad and his Sunnah (legal ways, etc.)] are the best of peoples ever raised up for mankind; you enjoin Al-Ma'ruf (i.e. Islamic Monotheism and all that Islam has ordained) and forbid Al-Munkar (polytheism, disbelief and all that Islam has forbidden)..."}[(2)] This responsibility is overwhelming and encompasses all aspects of a Muslim's life. It comprises a prescription towards positive (permissible and recommended) actions and a prescription against negative (impermissible and not recommended) actions. IFIs have generally ensured their operational status by avoiding negative actions. However, their approach to positive actions has been varied due to a lack of standards in the area.

The combination of these principles denotes a divine accountability for each Muslim to enjoin good and justice and forbid evil and injustice. These core principles therefore constitute the basis of individual social responsibility.

Collective Religious Duty and Islamic Financial Institutions

IFIs came into existence as a collective religious obligation (Fard Kifayah)[(3)] on the larger community (Ummah). This obligation is to operate a financial intermediary for individuals in the larger community wishing to comply with Islamic law (Shari'a). In this special position, IFIs are able to perform the obligations that individuals cannot perform themselves. The IFIs are therefore representatives for individuals who:

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(1) [Al-Tawbah (The Repentance): 71].
(2) [Al-'Imran (The Family of Imran): 110].
(3) Fard Kifayah refers to a collective religious duty which, if performed by some, would exempt others from performing it. However, if it is not performed by any, the entire

community is sinful.

i. Invest their money as shareholders or investment accountholders;
ii. Have co-operative, partnership or borrowing relations with the IFI;
iii. Are employed by the IFI;
iv. Have other explicit contractual relations with the IFI; and
v. In addition to the above, have an implicit social contract with the IFI as part of the larger community (Ummah).

Second, IFIs hold a position of significant responsibility in society as financial intermediaries which source and allocate funds. The example set by IFIs has an impact on other individuals, institutions and organizations.

These two points denote that IFIs are a *Fard Kifayah*.(1) It is therefore pertinent that IFIs play a role in encouraging the right type of behavior and activities while discouraging the wrong type of behavior and activities.

Islamic Corporate Social Responsibility

The core foundations of CSR are the same as the foundations for individual social responsibility of each Muslim; that is to enjoin right and to forbid wrong. The definition of right and wrong in Islam can be defined in various dichotomies which are overlapping. In their legal form, right refers to everything that is permissible or recommended (Halal and Mustahab respectively), while wrong refers to everything that is impermissible or not recommended (Haram and Makruh respectively). From the perspective of Islamic jurisprudence, right refers to what is just while wrong refers to what is unjust.

However, because IFIs are a collective religious obligation (Fard Kifayah), the definition of right and wrong are sometimes of a different nature than those that apply to individuals. This is because IFIs have a special religious and financial position in society.

Religiously, IFIs have a responsibility to comply with the form and substance of Islamic law in all aspects of their operations. This is because they are in an exemplary position. This means that all aspects of its operations

(1) *Fard Kifayah* refers to a collective religious duty which, if performed by some, would exempt others from performing it. However, if it is not performed by any,

the entire community is sinful.

should be conducted in a permissible or recommended manner while no aspect of its operation should be conducted in an impermissible or not recommended manner. If it is conducted in an impermissible or not recommended manner, it is an obligation to disclose to its stakeholders the reasons for that particular conduct.

Financially, IFIs are intermediaries which mobilize funds from investors and allocate funds to projects and other investments. In this context, it is the responsibility of IFIs to mobilize funds from permissible and recommended sources and invest funds in permissible and recommended projects. Further, IFIs are also in an exemplary position as financial intermediaries and hence can significantly impact the conduct of the IFIs stakeholders.

Mandatory and Recommended Conduct Classifications

The classification between mandatory and recommended conduct is based on the Qur`anic principle of not imposing responsibilities on individuals (and in extension organizations) by Allah greater than what they can endure. This is clear in Allah's Saying: ***{"Allah burdens not a person beyond his scope..."}***.[1]

(1) [Al-Baqarah (The Cow): 286].

Appendix (D)
Definitions

Clients

Clients in this standard are defined as those individuals who and corporations which execute a sale, lease, borrowing or partnership agreement with the IFI. This does not include Investment Accountholders or depositors of any type.

Contractors

Contractors in this standard are defined as businesses or corporations that provide services to the IFI in return for a contractually agreed con- sideration. Contract workers are differentiated from employees because they do not have a direct contractual relationship with the IFI.

Customers

Customers in this standard are defined as all individuals and institutions that execute any type of contract in which the Islamic bank provides a good or service in return for valuable consideration.

Deposit Customers

Deposit customers in this standard are defined as those individuals and institutions which execute a contract to place funds with the IFI for safe keeping, deposit or investment. This does not include shareholders of any type.

Employees

Employees in this standard are defined as individual who work directly for the IFI in return for valuable consideration. This includes all ordinary connotations of the word employee including full-time, part-time, casual, seasonal, contract and project based employment. Employees do not include contract workers working for a business or corporation other than the IFI.

Employees are differentiated from contract workers because employees have a direct contractual relationship with the IFI, whereas contract workers do not have a direct contractual relationship with the IFI.

Investment Deposits

Investment deposits in this standard are defined as deposits placed by customers for the purposes of gaining an investment rate of return, and not for the sole purpose of safe keeping. These include investment accountholders.

Investment Assets

Investment assets in this standard are defined as those assets that bring a future economic benefit invested in by the IFI for the direct purpose of gaining a return and not for an operational purpose (e.g. fixed assets).

Qard Hasan

Qard Hasan in this standard is defined as a non-interest bearing loan intended to allow the borrower to use the loaned funds for a period of time with the understanding that the same amount of the loaned funds would be repaid at the end of the period.

Waqf

Waqf (plural Awqaf) in this standard is defined as an inalienable religious endowment in Islam.

Zakah

Zakah is a fixed religious obligation calculated by reference to net assets (including cash) that have appreciated or have the capacity to appreciate in value over a specific period of time except for assets that have been acquired for consumption or use in the production of revenues. Zakah is a religious obligation on wealth for every Muslim, including a child or an insane person, must meet provided his net assets are liable for Zakah.

Appendix (E)
Examples of Disclosure Format and Presentation

Notes:

The purpose of this example is to illustrate the application of some of the provisions of this standard. The example is not intended to illustrate the only acceptable method for the presentation of or the disclosure of CSR activities and compliance. Furthermore, the example does not reflect all requirements of the standard.

It should be noted that while disclosures are meant to be comprehensive, the potential user groups of CSR information are wide and hence disclosures should be designed with the intention of making them as understandable as possible for lay people.

The disclosures may be supplemented, if possible, with images of the tangible benefits resulting from CSR activities and compliance.

Example of Comprehensive CSR Report

In the Name of Allah, The Beneficent, The Merciful

(Name of Institution)

Islamic Corporate Social Responsibility Report

For the year ended xxx

(Name of Institution) is engaged in implementing ideals of Islamic Social Responsibility to the best of its ability in all aspects of its operations. In line with these ideals, (Name of Institution) has applied best practice standards on Islamic Corporate Social Responsibility issued by the Accounting and Auditing Organization for Islamic Financial Institutions.

These standards stipulate mandatory and recommended forms of Islamic Corporate Social Responsibility activities and compliance. (Name of Institution) has implemented both mandatory and rec- ommended forms of Islamic Corporate Social Responsibility.

The implementation of these standards in true Islamic form and substance by the management of (Name of Institution) is attested by the board of directors in its report to shareholders. Presented below is a summary of the compliance and initiatives undertaken by (Name of Institution) during the year ended xxx.

Social Responsibility within the Organization

Employee welfare

[State policy and affirmative action initiatives for employee welfare here]

Internal environmental preservation policy

[State policy for reduction of environmental impact and initiatives, targets and achievements for the year here]

Earnings and expenditure prohibited by the Shari'a

[State policy for impermissible transactions and detailed informa- tion for the year here]

Social responsibility in its relationship with customers and clients

Par excellence customer service

[State policy for customer service, initiatives, targets, achievements and survey results for the year here]

Late repayments and insolvent clients and avoiding onerous terms

[State policy for late repayments and insolvent clients and avoiding onerous terms here]

Qard Hasan

[State policy for Qard Hasan and detailed information for the year including beneficiaries of Qard Hasan here]

Special features

[State policy on encouragement of entrepreneur and social savings and investments here and initiatives, targets and achievements for the year here]

Social Responsibility in Screening Its Investments

Screening of clients for compliance with Islamic principles and social responsibility

[State policy on screening of clients and contractors here]

Investment quotas based on industry, social impact and environmental impact

[State policy on investment quotas and initiatives, targets and achievements for the year here]

Social Responsibility in Its Relationship with Greater Society

Zakah

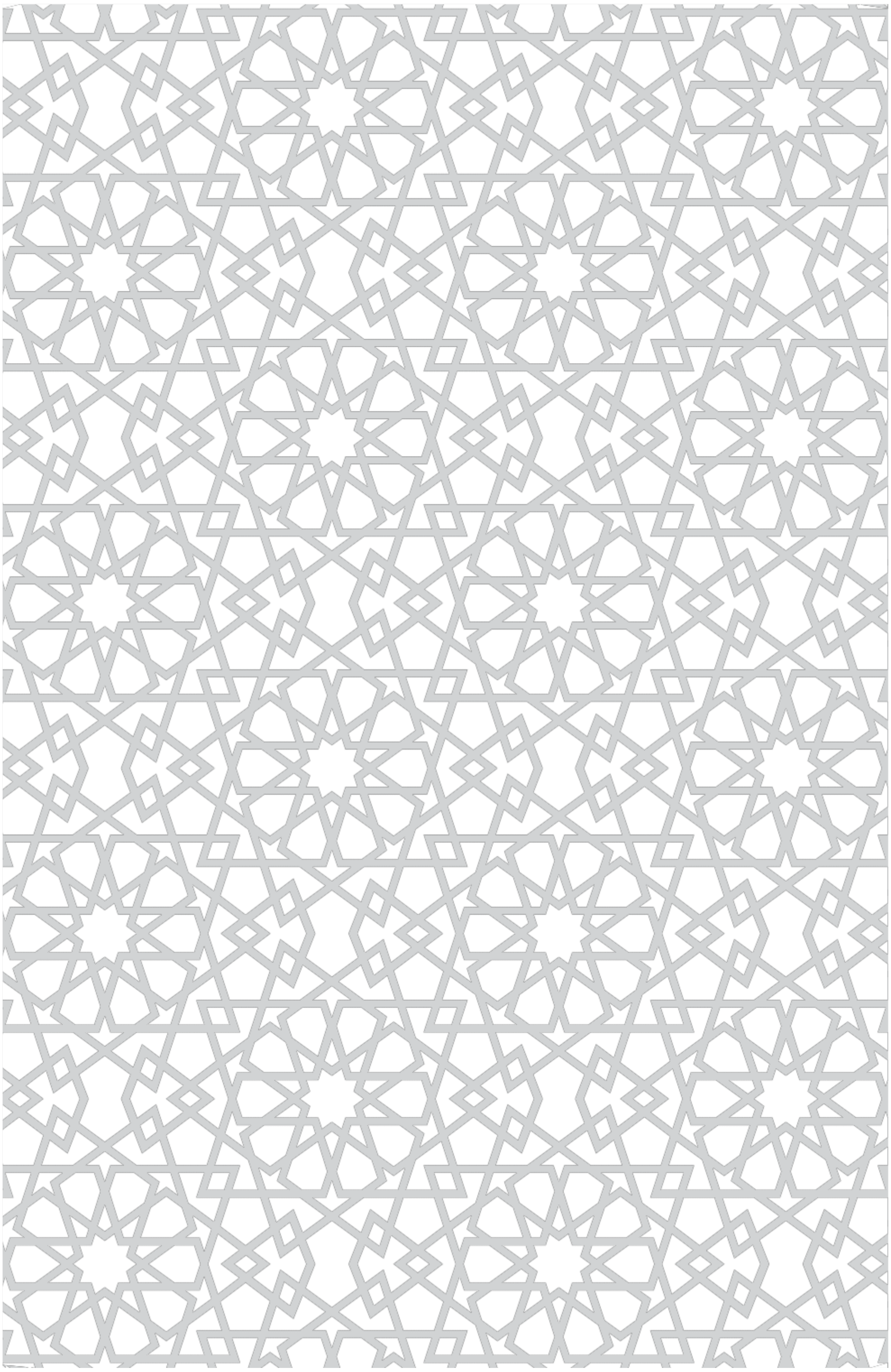
[State policy on Zakah and detailed information about Zakah for the financial year here]

Charitable activities

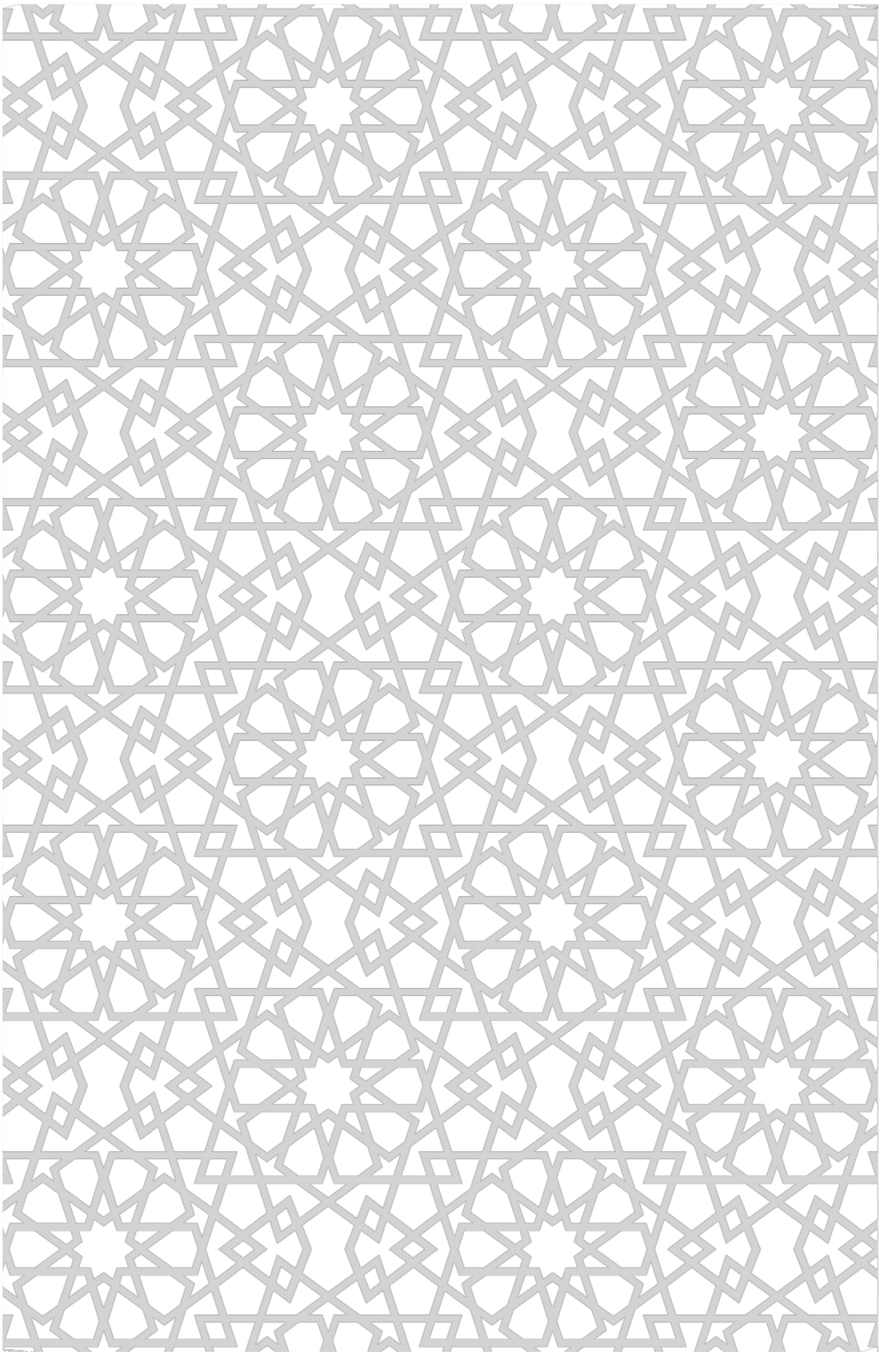
[State policy on charitable activities and detailed information on charitable activities for the financial year here]

Waqf management

[State policy on Waqf management here and detailed information on types of Awqaf managed, services offered to Awqaf, and initiatives for the financial year here]



Code of Ethics for Accountants and Auditors of Islamic Financial Institutions



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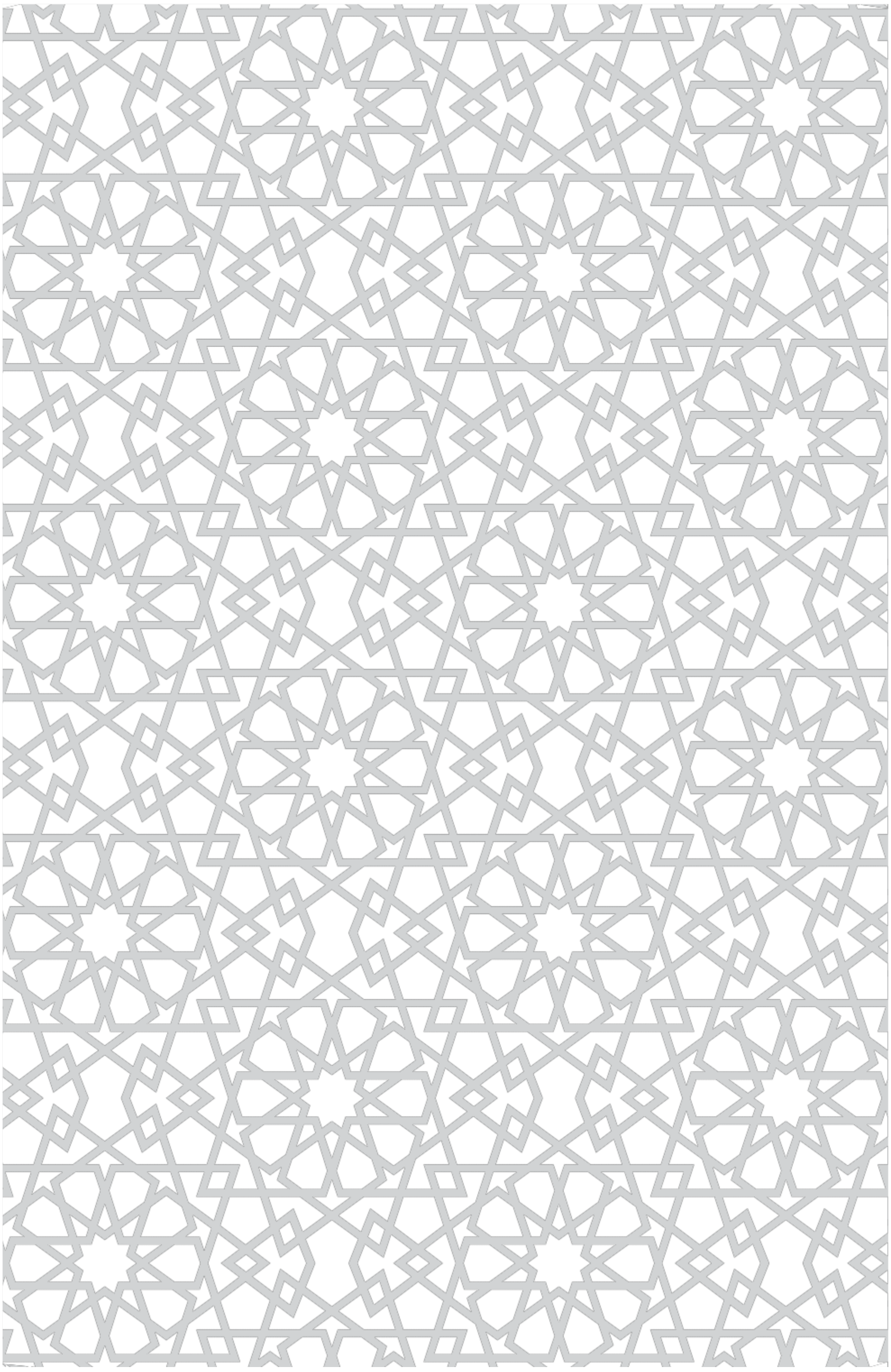

Code of Ethics for Accountants and Auditors of Islamic Financial Institutions

1. Introduction

Accounting is one of the professions that is required by Shari'a as Fard Kifayah (a collective religious duty which, if performed by some, would exempt others from performing it. However, if it is not performed by any, the entire community is sinful). In addition to its technical definition, accounting is a means to fulfil a Shari'a requirement, namely to record, measure and allocate rights fairly among claimants. The concept of fairness (justice) is mentioned in the Holy Qur`an in the following verses: ***{"Verily, Allah enjoins Al-'Adl (i.e. justice and worshiping none but Allah Alone - Islamic Monotheism) and Al-Ihsan [i.e. to be patient in performing your duties to Allah, totally for Allah's sake and in accordance with the Sunnah (legal ways) of the Prophet in a perfect manner]..."}***;[1] and ***{"Verily! Allah commands that you should render back the trusts to those, to whom they are due; and that when you judge between men, you judge with justice...".}***[2] The concept of fairness has a counterpart in accounting thought known as "freedom form bias". Though accounting and auditing standards lead, in principle, to the realisation of this concept, fairness is an ethical value and hence there is a need for a code of ethics that guides professional accountants in the performance of their professional duties and services.

In order for the code of ethics to have moral persuasion, there must be a solid and legitimate source from which its ethical foundations and

(1) [Al-Nahl (The Bee): 90].
(2) [Al-Nisa' (The Women): 58].

principles may be derived. This will provide the necessary grounds for complying with the code's requirements. The currently available codes of professional ethics for accountants are based purely on human thought. Enforceability of these codes hinges on professional commitment, desire for the flourishing of the profession and for gaining the trust of clients and the public at large; or it may be a legal requirement. From an Islamic perspective, the ethics of accountants or auditors (accountants)[3], depends primarily (in addition to all previous bases) on the principles and rules of Islamic faith and Shari'a. Furthermore, Shari'a principles and rules confer on these ethics potential enforceability which stems from the permanent and constant religious incentives that surpass in their purposes all other incentives. Moreover, ethical principles derived from Shari'a enjoy certain attributes which characterise Shari'a such as universality and both permanence and flexibility. Because accounting is a profession that is sensitive to the values and ethics of society, the values and ethics of Islamic society must affect the profession in such a society or community. Therefore, in such a society or community Islamic values and ethics must be reflected in the personal profile as well as the formal education and professional training of the accountant and in observed practice.

The rules of ethical conduct stated in this code shall apply to internal accountants and internal auditors of Islamic financial institutions (IFI) as well as to external auditors alike, except where the wording of the rules indicates otherwise. Professional accountants shall be held responsible for compliance with the rules of this code on the part of their assistants and subordinates. Should there be other codes of professional ethics that require additional rules and are not in conflict with Shari'a rules and principles, such additional requirements may be complied with.

2. Objectives of the Code

This code presents an ethical framework for accountants derived from Shari'a rules and principles. Thus, it is believed that (Muslim) accountants will be motivated to comply with such a code for reasons due to religious beliefs and as a means of obeying Allah's orders and refraining from

(3) The word accountant is used hereafter to mean accountant or auditor.

things forbidden by Him. In addition, accountants will be motivated
to observe the ethical principles contained in professional codes of ethics provided the latter principles do not contravene Shari'a rules and principles. It is hoped that the accountants' compliance with the ethical guidance mentioned in this code, while performing their professional services, will lead to the fulfillment of the following objectives:

2/1 To help in developing the accountant's ethical awareness by bringing to their attention ethical issues involved in professional practice and indicating for any given act whether or not it is considered an ethically acceptable behaviour from a Shari'a perspective in addition to their normal professional ethical commitments.

2/2 To ensure the accuracy and reliability of accounting information presented in the financial statements, thus enhancing its credibility and promoting confidence in the accountants' professional services. In addition, it enhances protection of the interests of both the institution and the parties dealing with it.

3. Structure of the Code

The code consists of three sections,
namely: a) Shari'a foundations of
accountants' ethics. b) Principles of ethics
for accountants.
c) Rules of ethical conduct for
accountants.

The first section states the Shari'a foundations and principles of faith on which the ethical principles for accountants are based. The second sec- tion comprises the general ethical principles derived from Shari'a foun- dations and those contained in currently available codes of professional ethics, provided the latter do not contravene Shari'a rules and principles. Finally, the third section, a procedural section, includes the rules of eth- ical conduct derived from the general ethical principles laid down in the second section. These rules are meant to provide guidance for the ac- countant as to what is and is not acceptable behaviour from a Shari'a and professional perspective in situations that involve ethical issues which arise in the course of performing professional duties or services.

4. Section (1): Shari'a Foundations of Accountants' Ethics

Ethics are an integral part of Shari'a. Islam accords them a high value and considers them one of the objectives of legislation, as confirmed by the Hadith (saying of the Prophet, peace and blessing upon him): ***"I have been sent to complement the most noble morals."***(4) It is known that some of the fundamentals of ethics which are exhorted by Islam are also derived from human thought, while others are unique to revealed faiths, particularly Islam, which was their culmination. The major Shari'a foundations of accountants' ethics are the following:

4/1
Integrity

Islam is a religion that highly values integrity and makes it govern all acts. Islam also values the capability to perform duties, which requires that the accountant and others who are in charge be competent and adequately qualified. This is confirmed in the Holy Qur`an: ***{"Verily, the best of men for you to hire is the strong, the trustworthy..."}***,(5) and also in the saying of the Prophet (peace and blessings be upon him): ***"Every one of you is a shepherd and every one of you is responsible for his flock",***(6) and his saying: ***"Give back the trust to whoever has entrusted you with it"***.(7) The great importance accorded to integrity may be inferred from the fact that Islam itself is considered a trust for those who are following it. This requires them to be true to Allah, themselves and to their societies. This is established in Allah's Saying: ***{"Truly, We did offer Al-Amanah (the trust or moral responsibility or honesty and all the duties which Allah has ordained) to the heavens and the earth, and the mountains, but they declined to bear it and were afraid of***

(4) Related by Ahmed in his Musnad, Al-Bayhaqi and Al-Hakim. Al-Bayhaqi said: "It has been related by Ahmed and its narrators are the same narrators of Al-Bukhari and Muslim." *"Fayd Al-Qadir"*, Al-Manawi, [2: 573].

(5) [Al-Qasas (The Narrative): 26].

(6) Related by Al-Bukhari in his book "Sahih Al-Bukhari" [3: 115] and by Muslim in his

book, "Sahih Muslim." [6: 8].

(7) Related by Al-Tabarani in his two Mu'jams, *"Al-Saghir"* and *"Al-Kabir"*. Al-Bayhaqi said: "Its narrators are reliable." *"Fayd Al-Qadir"*, Al-Manawi [1: 223].

it (i.e. afraid of Allah's Torment). But man bore it. Verily, he was unjust (to himself) and ignorant (of its results)"}.[8]

4/2 The principle of vicegerency of humanity on earth

Allah expressed the principle of vicegerency in the Holy Qur'an: ***{"Verily, I am going to place (mankind) generations after generations on earth..."}***,[9] and His Saying: ***{"And it is He Who has made you generations coming after generations, replacing each other on the earth..."}***,[10] and His Saying: ***{"...He brought you forth from the earth and settled you therein..."}***,[11] meaning He trusted you with the task of developing the earth. This vicegerency is based on the principle that the supreme authority is that of the Almighty Allah, and that man's ownership of property is not an end in itself, but a means to provide a decent life for him and for his family and society. Man should also observe the commandments and prohibitions of Allah the Almighty in owning property and disposing of it, because he is responsible for this property and will be held accountable for the way he has acquired it and how he used it, as recorded in the hadith.[12]

Shari'a has pervasive objectives, one of which being the preservation of property. That is, property and funds should not be squandered and wasted uselessly or used in prohibited matters (e.g., usurious transactions) or traded unjustly or by denying the rights established in it for Allah the Almighty and for His servants. Anything that is prohibited in Shari'a should not be given neither verbal nor documentary support in any way whatsoever. Allah, the Almighty, says: ***{"...Help you one another in Al-Birr and Al-Taqwa (virtue,***

(8) [Al-Ahzab (The Allied Parties):
72]. (9) [Al-Baqarah (The Cow): 30].
(10) [Al-An'am (The Cattle):
165]. (11) [Hud (The Prophet
Hud): 61].

(12) Its text is: *"The feet of a servant will not slip until he is asked about four things: his life how he spent it, his knowledge how he did with it, his property how he acquired it and how he spent it, and his health how he consumed it."* Related by Al-Tirmidhi who stated that the hadith is good and sound. The hadith was also confirmed by Al-Munziri, *"Tuhfat Al-Ahwazi"* (A commentary on Al-Tirmidhi); Al-Munziri, *"Al-Traghib Wa Al-Tarhib"*, [4: 198].

righteousness and piety); but do not help one another in sin and transgression...”}.(13)

The accountant, therefore, has to comply with this principle in performing his professional duty.

4/3 Sincerity

This means the accountant should seek to obey Allah in performing his work, and not to seek hypocrisy, fame, flattery, boasting or ostentation. Being sincere entails that the accountant does not subject himself to external influences or pressures, but applies himself to his work as a religious commitment as well as a performance of his professional duty. Thus, his ordinary occupational and professional duty turns into a form of worship, because one of the established Shari’a fundamentals is that good intention turns a habit into worship. Hence, the accountant becomes worthy of reward from Almighty Allah, apart from the material gain, and the usual praise he receives for his efforts, without making such gains and praise his sole objective.

4/4 Piety

Piety is fearing Allah in secret and in public as a way of protecting one’s self from adverse consequences as a result of departure from the Shari’a, particularly when property is involved, which diverts man’s attention and leads him into transgression. Piety is realized by observing Allah’s commandments and respecting His prohibitions. One of the prerequisites of this is the righteous deed, enjoining good and forbidding evil, and that man guards himself against being led astray. Allah, the Almighty, says: ***{“O you who believe! Fear Allah (by doing all that He has ordered and by abstaining from all that He has forbidden) as He should be feared. [Obey Him, be thankful to Him, and remember Him always]...”}***.(14) He also says: ***{“...And whosoever fears Allah and keeps his duty to Him, He will make a***

(13) [Al-Ma`idah (The Table): 2].
(14) [Al-’Imran (The Household of ’Imran): 102].

way for him to get out (from every difficulty). And He will provide him from (sources) he never could imagine..."}.[15] In another verse Allah says: *{"By Al-'Asr (the time). Verily! Man is in loss. Except those who believe (in Islamic Monotheism) and do righteous good deeds, and recommend one another to the truth (i.e. order one another to perform all kinds of good deeds (Al-Ma'ruf) which Allah has ordained, and abstain from all kinds of sins and evil deeds (Al-Munkar) which Allah has forbidden), and recommend one another to patience (for the sufferings, harms, and injuries which one may encounter in Allah's Cause during preaching His religion of Islamic Monotheism or Jihad, etc.)"};*[16] and He also says: *{"Let there arise out of you a group of people inviting to all that is good (Islam), enjoining Al-Ma'ruf (i.e. Islamic Monotheism and all that Islam orders one to do) and forbidding Al-Munkar (polytheism and disbelief and all that Islam has forbidden). And it is they who are the successful"}.*[17] The hadith also says: *"Fear Allah wherever you are, and follow the evil with good to obliterate it, and deal with people in good conduct."*[18]

The accountant, therefore, has to fear Allah in performing his profes- sional duty.

4/5 Righteousness and making one's work perfect

The accountant should not only confine himself to performing his occupational and professional duties, but should also strive to attain the degree of righteousness and perfection in his work by performing the duties assigned to him in the best manner possible. This cannot be realized except through academic qualifications, practical experience and acquisition of religious knowledge, which is a religious duty in the scope of the accountant's work. Allah, the

(15) [Al-Talaq (Divorce): 2-3].
(16) [Al-'Asr (The Afternoon): 1-3].
(17) [Al-'Imran (The Household of 'Imran): 104].
(18) Related by Al-Hakim. Al-Dhahabi verified it and deemed it sound (*"Fayd Al-Qadir"*, Al-Manawi [1: 121]).

Almighty, says: *{"Verily, Allah enjoins Al-'Adl (i.e. justice and worshiping none but Allah Alone - Islamic Monotheism) and Al-Ihsan [i.e. to be patient in performing your duties to Allah, totally for Allah's sake and in accordance with the Sunnah (legal ways) of the Prophet in a perfect manner]..."},*[19] and: *{"...and do good. Truly, Allah loves Al-Muhsinun (the good-doers)"}.*[20] The Prophet (peace and blessing be upon him) says: "*Allah likes when someone performs his work to do it perfectly,*[21] *and Allah has prescribed righteousness in everything"*.[22]

4/6 Allah-fearing conduct in everything

This is the belief that Allah is observing the acts of all His servants, and taking this into consideration in desisting from what does not please Him. This implies that the accountant should act in Allah-fearing manner regardless of the opinion of other people or his superiors. This is self-monitoring the intensity of which does not change from time to time and from one person to another, whether he is able to get his rights or is unable to do so. Allah, the Almighty, says: *{"...Surely, Allah is Ever an All Watcher over you."},*[23] and He also says: *{"Is then He (Allah) Who takes charge (guards, maintains, provides, etc.) of every person and knows all that he has earned (like any other deities who know nothing)?..."}.*[24] Self-monitoring stemming from intrinsic motives, as it is supposed to be in the contemporary codes of ethics for accountants, may weaken unless it is tied to both faith and the feeling that one is being observed by Allah from whom nothing is concealed in heaven or on earth. Allah, the Almighty,

(19) [Al-Nahl (The Bee): 90].
(20) [Al-Baqarah (The Cow): 195].
(21) Related by Al-Bayhaqi in *"Shu'ab Al-Iman"*, Ibn Asakir and Abu Ya'la in his *"Musnad"* (Book of narrated hadith). Al-Manawi stated that one of the narrators is controversial, *"Fayd Al-Qadir"* [2: 286].
(22) Related by Muslim in his *"Sahih Muslim"* [6: 72].
(23) [Al-Nisa` (The Women): 1].
(24) [Al-Ra'd (Thunder): 33].

says: ***{"...then verily, He knows the secret and that which is yet more hidden"}***.(25)

4/7 Men's accountability before Allah

It is the belief by the accountant that Almighty Allah is observing all his acts, and that he will be accountable to Him on the Day of Judgement for every small and big thing he did in his life. Hence, the accountant should take precautions against this by avoiding what may incur Allah's punishment (self-accountability). Allah, the Almighty, says: ***{"So whosoever does good equal to the weight of an atom (or a small ant), shall see it. And whosoever does evil equal to the weight of an atom (or a small ant), shall see it"}***.(26) He also says: ***{"...Certainly, Allah is Ever a Careful Account Taker of all things"}***.(27) He also says: ***{"...and Allah is All Sufficient in taking account"}***.(28) Allah also says: ***{"... Surely, Allah is Swift in account"}***.(29) Therefore, the accountant should always remember that he is accountable before Almighty Allah, and before his society, profession, superiors (in case of internal accountant), client (in case of the external auditor) and finally before himself.

The accountant should also hold himself to self-accountability in all his acts. One of the sayings of Omar Ibn Al-Khattab (may Allah be pleased with Him) is: ***"Hold yourselves to account before you are held to account, for it is easier for your accounting, and measure your deeds before they are measured for you."***(30) Self-accountability would have no meaning if it is not linked to faith and belief in the Hereafter, and accountability for one's deeds, and reward and punishment.

(25) [Ta-ha: 7].
(26) [Al-Zalzalah (The Earthquaking): 7-8].
(27) [Al-Nisa` (Women): 86].
(28) [Al-Nisa` (Women) : 6].
(29) [Al-'Imran (The Household of Imran) : 199].
(30) Related by Ahmed, *"Al-Zuhd"*; Ibn 'Asakir and Abu Nu'aym, *"Al-Hilyah"*; Ibn Abu Al-Dunya, *"Muhasabat Al-Nafs"*; Al-Asyuti, *"Al-Jami' Al-Kabir"* [1: 1159]. It is also related by Al-Tirmidhi quoting the follower Maymun Ibn Mahran using the following wording: "A servant will not be righteous until he holds himself to account in the same way as he holds his partner to account", *"Sunan Al-Tirmidhi"* [2: 75].

5. Section (2): Principles of Ethics for Accountants

Based on the Shari'a foundations of the ethical principles for accountants and the principles that are contained in currently available codes of professional ethics for accountants, provided these principles do not contravene Shari'a rules and principles, the following ethical principles for accountants are derived:

5/1
Trustworthiness

The accountant should be trustworthy and honest in performing his professional duties or services. Trustworthiness also entails that the accountant should have a high degree of integrity, truthfulness, honesty and probity, and that he should respect the confidentiality of information acquired in the course of performing professional services to his organization (internal accountant) or his client (external auditor). Further, the accountant should not deliberately present facts and information untruthfully.

5/2
Legitimacy

The accountant should make certain of the legitimacy of everything relating to his performing professional duties or services according to Shari'a rules and principles.

5/3
Objectivity

The accountant should be fair, impartial and unbiased, free from conflicts of interest and independent in fact as well as in appearance. Objectivity also entails that the accountant should not subordinate his professional judgement and duties to suggestions of others.

5/4 Professional competence and diligence

The accountant should be professionally competent and well equipped for carrying out tasks required in the course of performing professional duties or services so that he can perform such tasks diligently and properly, saving no effort in order to discharge his responsibilities towards Almighty Allah and towards his society, profession, superiors, client, and himself.

5/5 Faith-driven conduct

The accountant's behaviour and conduct should be consistent with faith values derived from Shari'a rules and principles.

5/6 Professional conduct and technical standards

In the course of performing his duties, the accountant should observe the rules of professional conduct presented in Section (3), and comply with the accounting and auditing standards for Islamic financial insti- tutions.

Some of the ethical principles contained in this code have common bases from both Shari'a and the accounting profession, such as trustworthiness, objectivity and professional competence and diligence. Other principles are based entirely on a Shari'a foundation, such as religious legitimacy and faith-driven conduct. Finally, some of the ethical principles are based solely on a professional basis which does not violate the Shari'a rules and principles, such as the principle of professional conduct and technical standards.

6. Section (3): Rules of Ethical Conduct for Accountants

Rules of ethical conduct for the accountant are derived from the ethical principles presented in Section (2). These should be considered as minimum requirements of ethical conduct that must be observed by accountants in the course of performing professional duties or services. The following paragraphs detail some of the basic rules of ethical conduct, grouped by the ethical principle underlying them.

6/1 Rules of ethical conduct based on the principle of trustworthiness

The accountant should perform professional duties or services at the highest level of trustworthiness, integrity, truthfulness, honesty and probity. In particular, the accountant has a responsibility to:

6/1/1 Present and communicate favourable as well as unfavourable information and professional judgements and opinions honestly truthfully, and with adequate transparency.

6/1/2 Refrain from disclosing confidential information acquired in the course of performing professional duties or services, unless obligated to do so according to disclosure requirements through accounting and auditing standards for Islamic financial institutions or through legal requirements.

6/1/3 Refrain from using confidential information acquired in the course of performing his professional duties (in the case of internal accountant) or services (in the case of external auditor) for unethical personal advantage or for the advantage of third parties.

6/1/4 Refrain from either actively or passively engaging in any behaviour or activity that would jeopardise the attainment of the institution's religious and ethical objective (in the case of internal accountant).

6/2 Rules of ethical conduct based on the principle of religious legitimacy

The accountant is responsible for verifying the religious legitimacy of everything relating to his performing professional duties or services. In this respect the accountant should always remember his responsibilities towards Almighty Allah and towards his society, profession, superiors, client and himself. The following rules of conduct originate from the principle of religious legitimacy:

6/2/1 The accountant should discharge his responsibilities towards Almighty Allah in the best way possible, giving precedence to such responsibility over any other responsibilities and believing that discharging his responsibility towards Almighty Allah is conducive to discharging other responsibilities.

6/2/2 The accountant is responsible for being aware of Shari'a rules and principles relating to jurisprudence of financial transactions. Hence, the accountant should receive formal, adequate training in jurisprudence of financial dealings.

6/2/3 The accountant is responsible for verifying the religious legitimacy of events he is accounting for or auditing in view of Shari'a rules and principles as determined by the Shari’a

supervisory board of the IFI. He should also make certain that his conduct in the course of performing professional duties or services is in conformity with such rules and principles.

6/2/4 The accountant is responsible for adhering to Shari'a rules and principles as determined by the Shari'a supervisory board on the grounds that Shari'a is the formal frame of reference when ascertaining the legitimacy of dealings, actions and, in general, behaviour relating to the performance of professional duties or services. Anything that is not in conformity with Shari'a should be considered illegitimate even though it may otherwise agree with laws or established traditions of the profession.

6/3 Rules of ethical conduct based on the objectivity principle

The accountant is responsible for protecting his independence in fact and in appearance. Thus he should avoid situations involving conflicts of interest which might threaten his neutrality and fairness. The accountant should also avoid subjecting himself to the influence of others in order to ensure the objectivity of his professional judgements and should refrain from presenting information untruthfully. Based on the objectivity principle, the accountant has a responsibility to:

6/3/1 Refuse any gift, favour or hospitality that would threaten the objectivity of his professional judgement.

6/3/2 Avoid actual or apparent conflicts of interest with those to whom he provides services, such as having personal or family relationships with the client that would threaten his objectivity and professional independence.

6/3/3 Avoid situations that would impair his professional independence, in fact or in appearance, such as owning significant number of shares in his client's firm or having other forms of financial interest with the client or with other institutions related to the client.

6/3/4 Refrain from engaging in other professional services while auditing the client to avoid loss of objectivity in performing the financial statements audit.

6/3/5 Avoid contingent fees (e.g. fees contingent on the result of examinations such as defining the fees as a percentage of the income number) because it has detrimental effect on the accountant's independence and objectivity while performing professional duties and services.

6/4 Rules of ethical conduct based on the professional competence and diligence principle

The accountant is responsible towards Almighty Allah and towards his society, profession, superiors, client and himself in performing his professional duties and services diligently and properly. In particular, the accountant has a responsibility to:

6/4/1 Acquire an appropriate level of academic and professional competence, acquire sufficient working knowledge of Shari'a aspects relating to financial transactions and maintain competence through ongoing development of his skills and by keeping abreast of new developments in the accounting profession, especially the newly issued accounting and auditing standards.

6/4/2 Refrain from agreeing to perform professional duties or services unless he is sufficiently competent to perform such services or is able to obtain competent advice and assistance so as to be able to perform such services efficiently.

6/4/3 Do high quality work in performing professional duties or services in accordance with Shari'a rules and principles as well as national and international relevant laws that do not contravene Shari'a rules and principles.

6/4/4 Develop an integrated plan for performing professional duties and services, and adopt a programme designed to ensure quality control of the assistants' and subordinates' performance of such duties and services.

6/4/5 Ensure that the reports prepared by the internal accountant are complete, clear and supported by appropriate analyses of relevant and reliable information.

6/5 Rules of ethical conduct based on the principle of faith-driven conduct

In performing his professional duties and services, the accountant's behaviour and conduct should be consistent with religious values derived from Shari'a rules and principles. In particular, the accountant has a responsibility to:

6/5/1 Constantly be conscious of Allah's surveillance (self-monitoring).

6/5/2 Constantly be conscious of accountability before Allah on the
Day of Judgement (self-accountability).

6/5/3 Be sincere in performing professional duties and services seeking
Allah's satisfaction and not submitting to other pressures.

6/5/4 Fulfil promises and honour agreements. This is a fundamental requirement in all dealings and conduct.

6/5/5 Co-operate with others in a way that enables smooth and efficient performance of professional duties and services.

6/5/6 Show love and brotherhood for the sake of Allah to enhance co- operation and trust between him and those with whom he deals.

6/5/7 Be merciful and kind in dealing with others and patient in handling problems which he encounters in the practice of his profession.

6/5/8 Set a good example for his assistants and subordinates.

6/6 Rules of ethical conduct based on the principle of professional conduct and technical standards

Professional conduct requires adherence to high ethical standards as well as technical standards, namely the accounting and auditing standards for Islamic financial institutions in the course of performing professional duties and services. In this regard, the accountant has a responsibility to:

6/6/1 Comply with accounting and auditing standards for

Islamic financial institutions.

6/6/2 Perform professional duties and services diligently.

6/6/3 Refrain from engaging in any activities or conduct that would jeopardise his integrity, objectivity or independence in performing professional duties or services, or any personal behaviour or act that would discredit the profession and threaten its credibility. This requires that the accountant:

a) Refrain from marketing and promoting himself and his work in ways not commensurate with the status of the profession or that are distasteful;

b) Refrain from making exaggerated claims for the professional services he is capable of offering or for his qualifications or expertise;

c) Refrain from denigrating the work of other accountants; and d) Refrain from paying a commission for obtaining a new enga-
gement or for the referral of other accountants to a client.

6/6/4 When asked to replace another professional accountant, the new accountant should ascertain the reasons for the change of the extant accountant and refrain from accepting the new appointment unless the reasons for the change are acceptable and are not due to refusal of the extant accountant to submit to pressures asking him to violate Shari'a rules and principles or to depart from compliance with the accounting and auditing standards for Islamic financial institutions. In any event, the new accountant should hold in strict confidence any information disclosed to him in this regard.

7. Enforcement of the Code

7/1 Disciplinary actions and sanctions laid down by relevant bodies.

8. Effective Date

This Code of ethics for accountants and auditors of Islamic financial institutions shall be effective for fiscal periods beginning 1 Muharram
1420 A.H. or 1 January 1999 A.D.

Adoption of the Code

The Code of Ethics for Accountants and Auditors of Islamic Financial Institutions was adopted by the Accounting and Auditing Standards Board in its meeting No. (15) held on 27-28 Safar 1419 A.H., corresponding to
21-22 June 1998 A.D.