

**AAOIFI Governance and Ethics Board (AGEB) Statement**

**AGEB-1/2020**

**Application of AAOIFI governance, ethics and auditing standards in  
view of the impact of COVID-19 pandemic**

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## Preface

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### Background

- PR1 The COVID-19 pandemic continues to have a profound effect on the lifestyle of the society. Besides the numerous social implications, the pandemic has had a significant impact on the global economy. In numerous jurisdictions, businesses are forced to close down; in others, they are forced to operate under financial and resources constraints. COVID-19 pandemic is an unprecedented situation that the world has never contemplated nor have experienced in the modern history.
- PR2 The pandemic has led to a humanitarian crisis where to save the humankind from suffering, the countries practised lock down approach where the business activities except for basic necessities were halted creating cash flow problems to the businesses. This is forcing them to lay off their employees as they struggle to pay their salaries while potentially heading towards insolvency. The sudden unemployment created by this event and the subsequent financial constraints faced by the businesses did not have any immediate solutions; except for the respective governments to step in and provide relief / flexibility via stimulus or aid packages.
- PR3 The respective governments work towards enacting and implementing certain fiscal policy measures while the financial market regulatory authorities also play their part in providing the required support to the individuals and businesses affected due to COVID-19 pandemic. In various jurisdictions where Islamic finance is adopted, the Islamic Financial Institutions (IFIs) have also been affected due to the market conditions and the measures the government and the regulatory authorities have implemented to provide relief to the parties affected by COVID-19 pandemic.

### Applicability of AAOIFI governance, ethics and auditing standards

- PR4 AAOIFI Governance and Ethics Board (AGEB / the board), with due support of the AAOIFI secretariat, is closely monitoring the economic situation in the countries affected by the pandemic and taking notice of certain challenges that the IFIs are currently facing in application and interpretation of the relevant AAOIFI standards amidst the unprecedented circumstances.
- PR5 AGEB observes that the AAOIFI governance, ethics and auditing standards provide a robust framework in their respective areas (while considering other relevant standards, as referred to in such standards). Notably, the board of directors and those charged with governance, and the executive management of IFIs are expected to play a vital role in maintaining their going concern status, securing the rights of their stakeholders (including equity and quasi-equity holders and fund providers) and in this process, maintaining regular and effective communication with all the stakeholders. Accordingly, AGEB reiterates the importance of implementing AAOIFI's Governance Standard (GS) 6 "Statement on Governance Principles for Islamic Financial Institutions," which sets out overarching framework on the role of the board of directors and management, risk management and compensation practices and disclosures.
- PR6 Considering the unprecedented constraints caused by COVID-19 pandemic to IFIs in different countries of the world, AGEB has deliberated ways in which certain flexibilities could be given in the application and interpretation of the relevant AAOIFI standards.

## **Rationale for issuing this statement**

- PR7 After thorough consideration and discussion among the members of AGEB, it has been decided that the IFIs following AAOIFI governance, ethics and auditing standards are in need of some clarification and interpretation that ought to be made considering the role they are expected to play in the present situation while being dictated by the respective governments and the regulatory authorities.
- PR8 As such, AGEB decided to issue this statement to provide clarifications and certain relaxations for implementation of relevant standards in the exceptional circumstances created by COVID-19 pandemic.

## **AAOIFI Governance and Ethics Board (AGEB) statement 1/2020**

### ***Application of AAOIFI governance, ethics and auditing standards in view of the impact of COVID-19 pandemic***

#### **Objective of the statement**

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1. The objective of this statement is to provide clarifications and interpretations as well as flexible options available for IFIs to apply AAOIFI governance, ethics and auditing standards (herein after referred as the relevant standards) considering the challenges that the IFIs are facing in different jurisdictions due to the role they have to play under the direction given by the respective governments and regulatory authorities to overcome the economic situation created by the COVID-19 pandemic. This statement further includes several recommendations for ethical responses by the businesses to the challenges posed by the pandemic.

#### **Scope**

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2. The scope of this statement is:
  - a. to provide clarifications and interpretations of the relevant standards in the light of the unprecedented situation faced by IFIs as a result of the pandemic; and
  - b. to provide flexibility in the implementation of the relevant standards by allowing deferment of effective dates of certain provisions of the relevant standards.

#### **Definitions**

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3. For the purpose of interpreting and applying various terms used in this statement, the definitions provided in the relevant standards shall be applied.

#### **Significant issues related to governance, ethics and auditing**

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4. The significant issues identified are discussed in paragraphs 5 to 39.

#### **Role of the board of directors and other organs of governance**

##### *Issue*

5. IFIs, unlike conventional financial institutions, use the funds substantially provided by their participatory stakeholders (e.g. investment account holders (IAH), Sukuk-holders etc.) on a risk and reward sharing principle. In meeting their expectations, IFIs not only have to find a balance between institutional viability in a time of pandemic but also preserving the rights of these fund providers.

##### *Clarification and recommendation*

6. In view of the above, and in line with the requirements of relevant AAOIFI GSs, AGEB recommends the board of directors and executive management of the IFIs to play an effective role in implementing their crisis management plan by enhancing their reporting system, information system and effectively implementing their disaster recovery plan. Moreover, the IFIs shall review their business continuity and operational risk management plans to evaluate possible implications on their payment obligations, impact tolerance (i.e. maximum tolerable level of disruption) and risk management measures.

7. Simultaneously, due to the different business model and contractual relationship of IFIs with their fund providers [IAH (in banks), Takaful participants (in Takaful companies) and Sukuk-holders (in case of Sukuk) etc.], ensuring the sanctity of business decisions, transparency in operations and avoiding conflict of interest for these stakeholders should be given paramount importance. In this context, AGEB recommends that various organs of governance in IFIs such as the board of directors, executive management, audit and governance committee and Shari'ah Supervisory Board (SSB) should proactively play their respective roles and fulfil their fiduciary responsibilities.
8. IFIs shall continuously assess the extent of the adverse implications of COVID-19 pandemic related developments and communicate to stakeholders any corrective actions the IFI is taking to mitigate such impact. Similarly, any changes to the business model and operations that have material consequences to the interest of the IFI, its payment obligations and expected returns to fund providers shall be communicated to stakeholders in a timely and reasonable manner without unnecessary delay.

## **Payment moratoriums / deferment**

### *Issue*

9. In many jurisdictions, governments and regulators have announced various types of payment moratoriums, deferments and suspensions for the customers and suppliers of financial institutions, including IFIs. However, there are no such initiatives in other jurisdictions, or at times these initiatives might not be sufficient or adequate to address various situations of financial distress faced by different categories of customers of IFIs.

### *Clarification and recommendation*

10. In view of the specific nature of IFIs, it is important to note that ethical considerations should be paramount when dealing with their respective customers in these difficult times.
11. IFIs should preferably allow payment moratoriums to customers (who are suffering from COVID-19 pandemic related insolvency risk or financial difficulties) in bona fide cases, in line with the teachings of the Holy Quran<sup>1</sup>. Such practice shall be preferred by IFIs even if it is not imposed as a mandatory order by the respective regulatory authorities, as the IFIs, being established on the basis of principles of Shari'ah, shall stand out to distinguish themselves from the conventional financial institutions.
12. Payment moratoriums to the customers shall be granted in a just, fair and equitable manner and, in particular, without any bias or discrimination on account of race, gender, nationality, etc. of the customers.
13. Any harm, if inevitable, should preferably be minimised to uphold fairness, justice and compassion in accordance with Shari'ah. IFIs shall consider allowing financial concessions and facilitations by maintaining the delicate balance between the institution's sustainability and customers' wellbeing, disclosing any measures taken in this regard to the regulator(s). The disclosure shall include the rationale behind (i.e. the relevant teachings of the Holy Quran) and the applicable criteria. This will

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<sup>1</sup> If there is one (debtor) in misery, then (the creditor should allow) deferment till (debtor's) ease, and that you forego it as donation (waiver), is much better for you, if you really know. (2, 280)

increase stakeholders' confidence in the IFIs and prove the Islamic ethical values in the Islamic finance sector.

14. AGEB is of the view that the business practices and commercial decisions of an IFI during COVID-19 pandemic shall remain in line with the values of fairness and justice (e.g. payments to suppliers in line with the committed schedules).

## **Shari'ah governance**

### *Issue*

15. In several jurisdictions, several central Shari'ah boards and other forums of Shari'ah scholars have attempted to provide guidance on emerging issues related to payment moratoriums, delay in instalment payments, as well as, restructuring of financing facilities. In this process, the entire Shari'ah governance organs in IFIs is expected to play a role.

### *Clarification and recommendation*

16. AGEB recommends that the central Shari'ah boards shall provide proactive resolutions and guidelines<sup>2</sup> in respect of matters arising as a result of the pandemic, affecting the IFIs and other stakeholders, in their respective jurisdictions.
17. Whether or not the central Shari'ah board in a jurisdiction has issued guidelines to IFIs in dealing with payment delays and restricting of existing financing facilities, AGEB emphasises on the crucial role that the individual SSBs need to play in this process. SSBs should remain proactive in dealing with ongoing and new Shari'ah issues arising due to pandemic on a continuing basis related to the contractual obligations of the IFIs and their customers.
18. Similarly, AGEB recommends that other organs of Shari'ah governance such as internal Shari'ah audit, Shari'ah compliance function and, audit and governance committee shall also play active roles in implementing the resolutions and guidelines of their central Shari'ah boards, regulators and SSBs. In this process, IFIs are expected to be diligent in managing the Shari'ah non-compliance risk since some checks and balances could be compromised or delayed in the time of remote work and irregular meetings.

## **Considerate and fair dealings with employees**

### *Issue*

19. The economic impact of the COVID-19 pandemic, directly and indirectly, is adversely affecting almost all sectors of economy. IFIs are struggling to maintain their sustainability by minimizing their operational costs just like any other business. A number of business entities are facing the pressure to either lay-off employees or reduce their remuneration, besides various other cost reduction measures. The same applies to dealings with other stakeholders as well.

### *Clarification and recommendation*

20. While the institution's survival and sustainability are important, IFIs, in line with the best ethical practices and values, shall apply utmost care in dealing with employees in these times.

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<sup>2</sup> For example, treatment with regards to payment moratoriums / deferments shall not involve any increase on already established debts.



21. IFIs shall take appropriate care of the health and well-being of the employees and their families, including allowing, where possible, flexible working arrangements in line with the health authorities' guidelines and following their respective safety instructions in office facilities.
22. IFI shall endeavour to ensure that the situation does not result in laying-off employees, as far as possible, and the IFIs shall consider absorbing the related costs as an investment in the future of the institution.
23. In general, a proportionate temporary reduction in salaries across the organization, unpaid leaves and other similar cost reduction measures are preferable over permanently laying off the employees.
24. If employee lay-off becomes inevitable for the institution's survival, such action shall be taken in a fair and equitable manner.
25. In all situations, the decisions shall be fair, just and equitable and shall be free of any biases or discrimination.

## **Use of charity (purification) funds and Corporate Social Responsibility (CSR) activities**

### *Issue*

26. It has been observed that various IFIs in different jurisdictions have significant amounts of charity funds (mainly purification funds) available, including balances held for long periods of time. Additionally, certain institutions have Zakah funds available at their disposal as well. The disbursement of Zakah and charity funds at this critical time is essential as there is a dire need to help those who have been affected negatively by the COVID-19 pandemic. These include the direct avenues (e.g. the healthcare initiatives) and the indirect avenues (e.g. the funding needs for supporting the poor and the needy, including those who have become needy only due to the COVID-19 pandemic).

### *Clarification and recommendation*

27. AGEB recommends that the charity funds (and other similar funds) held with IFIs be utilized in these times on a priority basis to support the direct and indirect victims of the COVID-19 pandemic. The following factors shall, in particular, be considered:
  - a. find the suitable recipients for Zakah and charity funds and prioritize them based on their socio-economic factors;
  - b. avoid unwarranted delays in the distribution of the Zakah and charity funds;
  - c. maintain fairness and merit in disbursement and avoid discrimination of any kind (within the categories of eligible recipients);
  - d. collaborate with governments, Waqfs and aid / humanitarian institutions (regional or global) to enhance effectiveness and efficiencies of their aid activities on COVID-19 pandemic in congruence with the IFI's aim;
  - e. the SSBs to play an active and positive role by encouraging the timely disbursement of funds and fairness in disbursement of Zakah and charity funds and in this case, the SSB may consider allowing cross-border utilization of funds on need basis due to the global nature of the pandemic; and

- f. reasonable precautions shall be taken to ensure that funds are disbursed only to such charitable institutions that maintain proper institutionalization and legal registration as per law of the relevant jurisdiction, to avoid any misappropriation of funds or exposing the IFIs to any regulatory compliance or money laundering / terrorism financing breach.
28. The IFIs may also consider paying Zakah (where, and as, applicable) in advance, due to the dire need at this time, subject to approval of their respective SSBs.<sup>3</sup>
29. It is important to note that the charitable and social activities of IFIs shall not be confined to the activities funded by the charity / purification funds; rather they should follow the best practices of Corporate Social Responsibility (CSR), in line with Maqasid Al-Shari'ah (objectives of Shari'ah) and the UN's Sustainable Development Goals (SDGs).
30. IFIs shall follow the best practices provided by AAOIFI GS 7 "Corporate Social Responsibility, Conduct and Disclosure for Islamic Financial Institutions". Where practical, it is highly recommended that IFIs pool their resources to create a larger CSR fund, which may have a more substantive impact on society. This may take the form of one or more Waqf(s), subject to availability of appropriate legal framework.
31. IFIs shall also play a proactive role in reviving the economy by assisting individuals and companies to resume their business activities.

## **AAOIFI's governance, ethics and auditing standards implementation**

### *Issue*

32. Under the unprecedented circumstances, certain institutions, including IFIs and other institutions to whom such standards apply, might find it challenging to implement the issued governance, ethics and auditing for the first time, particularly due to resource constraints including lack of human resources during this pandemic crisis.

### *Conclusion*

33. AGEB has decided to defer the forthcoming implementation of certain standards during these difficult times and consider relaxation in their adoption as presented in the following table:

<b>Standard</b>	<b>Original effective date</b>	<b>Revised effective date</b>
GS 9: Shari'ah Compliance Function	1 January 2020	1 July 2021
GS 10: Shari'ah Compliance and Fiduciary Ratings for Islamic Financial Institutions	1 January 2020	1 July 2021
GS 11: Internal Shari'ah Audit	1 January 2020	1 July 2021
GS 12: Sukuk Governance	1 July 2020	1 July 2021

<sup>3</sup> See paragraph 10/6 of Shari'ah Standard 35

<b>Standard</b>	<b>Original effective date</b>	<b>Revised effective date</b>
AS 6: External Shari'ah Audit (Independent Assurance Engagement on an Islamic Financial Institution's Compliance with Shari'ah Principles and Rules) [For external Shari'ah auditors' reports covering periods beginning on or after] (see paragraph 35)	1 January 2019	1 January 2020
Code of Ethics for Islamic Finance Professionals	1 January 2021	1 July 2021

34. Notwithstanding the deferment allowed as per above table, if the specific circumstances of the relevant institutions allow, or the respective regulator requires as such, an earlier application of such standards shall be preferable.
35. In case of external Shari'ah audits, whereby the audit engagements are already initiated in line with the requirements of AS 6 (including the signing of letter of engagement, in line with such requirements), or where required by the respective regulators, the requirements of AS 6 shall remain valid.

## **Significant auditing considerations**

### *Issue*

36. The COVID-19 pandemic has a global impact that significantly affects entities and their auditors. From an auditing perspective, there should be a careful assessment of the situation with regards to whether or not there exists a serious going concern issue. While a number of issues are arising on a continuing basis, the most significant challenges for the auditors in these times are: the reliability of data and underlying evidence due to uncertainties involved; and the reliability and acceptability of significant judgements and estimates as applied by the management for the purpose of preparation of financial statements, particularly regarding the suitability of the going concern assumption, determination of provisions, impairment and credit losses, and the determination of fair values.

### *Clarification and recommendation*

37. AAOIFI auditing standards are read with the relevant international standards and have significant focus on the Shari'ah compliance aspects of an audit.
38. Considering the importance of the subject, International Auditing and Assurance Standards Board (IAASB) has already issued certain pronouncements and is in the process of issuing further pronouncements. It is advised that these announcements shall be followed by the auditors performing audit engagements under AAOIFI auditing standards, insofar as, these are not against any specific requirements of such standards.

## **Date of issue**

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39. This statement is issued on 25 June 2020.

## **APPENDICES**

### **Appendix A: Adoption of the statement**

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This statement was presented in the AAOIFI Governance and Ethics Board's meeting No. fifteenth held on 18-19 Shawwal 1441H, corresponding to 10-11 June 2020 and was duly adopted with certain directions to the secretariat for final approval. After due process, the secretariat issued the statement on 4 Dhul-Qa'dah 1441H, corresponding to 25 June 2020.

#### **Members of the board**

1. Mr. Mohammad Farrukh Raza - Chairman
2. Dr. Walid Hegazy - Deputy Chairman
3. Dr. Abdulbari Mashal
4. Mr. Abdullah Almoqbel
5. Dr. Ahmet Albayrak
6. Dr. Ali AlSartawi
7. Mr. Ebrahim Sidat
8. Dr. Gaffar Abdalla Ahmed Khalid
9. Ms. Ibtihal Alshamali
10. Prof. Mohammad Kabir Hassan
11. Mr. Moosa Khoory
12. Mr. Muhammad Kasbati
13. Mr. Sohaib Umar
14. Mr. Wael Merza
15. Mr. Zahid ur Rehman Khokher

#### **Reservation**

The statement was approved unanimously.

### **Working group members**

1. Dr. Abdulbari Mashal
2. Mr. Ebrahim Sidat
3. Mr. Mohammad Farrukh Raza
4. Prof. Mohammad Kabir Hassan
5. Mr. Sohaib Umar
6. Dr. Walid Hegazy

### **Executive team**

1. Mr. Omar Mustafa Ansari (AAOIFI)
2. Ms. Zahra Jassim AlSairafi (AAOIFI)
3. Ms. Alyaa Adel Almahroos (AAOIFI)

## Appendix B: Brief history of the preparation of the statement

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- H1      The AAOIFI Governance and Ethics Board (AGEB) formed a working group to discuss the AGEB response to coronavirus (COVID-19) pandemic and the disruption it has cause on a global scale.
- H2      The working group’s first meeting was held on 14 Ramadan 1441H, corresponding to 7 May 2020 to discuss the scope and the key deliverables. The members further elaborated on the global impact created by COVID-19 pandemic and concluded that this would have an impact on the application of AAOIFI governance, ethics and auditing standards and decided to develop a response.
- H3      On 10 Shawwal 1441H, corresponding to 2 June 2020 the secretariat circulated the first version of exposure draft of the statement on the “Application of AAOIFI governance, ethics and auditing standards in view of the impact of COVID-19 pandemic” to the board for review and approval. The members provided comments on key matters to improve the draft.
- H4      The fifteenth meeting of AGEB was held on 18-19 Shawwal 1441H, corresponding to 10-11 June 2020. The board discussed the compiled comments of the working group and board and agreed on the way forward and advised to hold a second working group meeting to finalize the statement.
- H5      The working group’s second meeting was held on 24 Shawwal 1441H, corresponding to 16 June 2020 to continue the discussion on the statement.
- H6      The statement was discussed with and reviewed by the committee of the Shari’ah board for review of final statement on 29 Shawwal 1441H, corresponding to 21 June 2020. After due deliberation, the statement was finalized and approved for issuance.
- H7      The statement after incorporation of all changes and observations was issued on 4 Dhul-Qa’dah 1441H, corresponding to 25 June 2020.