

AAOIFI – Governance and Auditing Standards

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Overview of AAOIFI

AAOIFI

- AAOIFI is responsible for developing and issuing standards for international Islamic finance industry.
- Supported by over 200 institutional members from over 40 countries.
- Members are central banks, regulatory authorities, financial institutions, accounting & auditing firms, legal firms, etc.

Overview of AAOIFI *(cont'd)*

Standards

Total of 88 standards issued:

- 48 Shari'a standards.
- 26 accounting standards.
- 5 auditing standards.
- 7 governance standards.
- 2 codes of ethics.
- In addition, new standards are being developed and existing standards reviewed.

Overview of AAOIFI *(cont'd)*

Shari'a Standards

- Guidances on Shari'a permissibility and rules for specific Islamic finance products and mechanisms.

Accounting Standards

- Guidances on accounting treatment for specific Islamic finance products and mechanisms.
- Guidances on presentation of financial statements for Islamic financial institutions.

Overview of AAOIFI *(cont'd)*

Auditing Standards

- Guidances on external auditing of Islamic financial institutions.

Governance Standards

- Guidances on Shari'a compliance and supervision processes and framework for Islamic financial institutions.

Codes of Ethics

- Codes of ethics for employees, accountants and auditors for Islamic financial institutions.

Overview of AAOIFI *(cont'd)*

Adoption of standards

- AAOIFI accounting standards have been made part of mandatory regulatory requirement in jurisdictions such as Bahrain, Jordan, Qatar, Qatar Financial Centre, Sudan, and Syria.
- AAOIFI accounting standards have also been adopted by Islamic Development Bank Group, a multilateral institution.
- In addition, AAOIFI accounting standards have also been used as basis of national accounting standards in jurisdictions such as Indonesia and Pakistan.
- In other jurisdictions including Brunei, Dubai International Financial Centre, Egypt, France, Kuwait, Lebanon, Malaysia, Saudi Arabia, South Africa, United Arab Emirates and United Kingdom as well as in Africa and Central Asia, AAOIFI accounting standards have been used voluntarily as basis of internal guidelines by leading Islamic financial institutions.

Overview of AAOIFI *(cont'd)*

Adoption of standards

- AAOIFI Shari'a standards have been made part of mandatory regulatory requirement in jurisdictions such as Bahrain, Pakistan, Sudan, and Syria.
- AAOIFI Shari'a standards have also been adopted by Islamic Development Bank Group, a multilateral institution.
- In addition, AAOIFI Shari'a standards have also been used as basis of national Shari'a guidelines in jurisdictions such as Indonesia and Malaysia.
- In other jurisdictions including Brunei, Dubai International Financial Centre, France, Jordan, Kuwait, Lebanon, Saudi Arabia, Qatar, Qatar Financial Centre, South Africa, United Arab Emirates and United Kingdom as well as in Africa, Central Asia and North America, AAOIFI Shari'a standards have been used voluntarily as basis of internal guidelines by leading Islamic financial institutions.

Overview of AAOIFI *(cont'd)*

Application of standards

- Expertise for technical application of standards is supported by AAOIFI's professional development qualification programs:

Certified Shari'a Adviser and Auditor (CSAA).

Certified Islamic Professional Accountant (CIPA).

Overview of AAOIFI *(cont'd)*

Application of standards *(cont'd)*

- AAOIFI has also launched Contract Certification Program – to certify that financial contracts between Islamic financial institutions and their clients are in compliance with AAOIFI standards and Shari'a rules and principles.
- This is to give further support for application of AAOIFI standards and harmonisation of Islamic finance practices.

AAOIFI Governance Standards – on *Shari'a Supervision and Compliance*

AAOIFI Governance Standards

- Shari'a Supervisory Board (SSB): Appointment, Composition and Report.
- Shari'a Review
- Internal Shari'a Review.
- Audit and Governance Committee.
- Independence of SSB.
- Governance Principles.
- Corporate Social Responsibility (CSR).

AAOIFI Governance Standards – on *Shari’a Supervision and Compliance* (cont’d)

**Key
components of
Shari’a
supervision and
compliance**

- Shari’a Supervisory Board.
- Shari’a Review.
- Internal Shari’a Review.

AAOIFI Governance Standards – on *Shari'a Supervision and Compliance* (cont'd)

Shari'a Supervisory Board (SSB)

- Appointed by shareholders at annual meeting.
- At least 3 members.
- Experts in Islamic commercial jurisprudence.
- May include 1 member with expertise in Islamic finance (rather than jurisprudence).

AAOIFI Governance Standards – on *Shari'a Supervision and Compliance* (cont'd)

SSB (cont'd)

- May not include significant shareholder or member of Board of Directors.
- May engage external consultants to assist duties.
- Terms of engagement to be agreed with the institution and included in letter of appointment.

AAOIFI Governance Standards – on *Shari'a Supervision and Compliance* (cont'd)

SSB (cont'd)

Main functions:

- Directing, reviewing and supervising institution's activities to ensure Shari'a compliance.
- Shari'a advice and guidelines.
- Shari'a approval on products and services.
- Shari'a review.

AAOIFI Governance Standards – on *Shari'a Supervision and Compliance* (cont'd)

Shari'a Review

- Examination – carried out on behalf of SSB – of the extent of an institution's compliance to Shari'a.
- Covers contracts, transactions, policies, etc.
- Forms basis of SSB's report in institution's annual financial report.
- Does not relieve management's responsibility on compliance.

AAOIFI Governance Standards – on *Shari'a Supervision and Compliance* (cont'd)

Internal Shari'a Review

- Carried out by an independent department or as part of internal audit functions.
- Continuous examination and evaluation of the extent of an institution's compliance to Shari'a.
- Periodical reports submitted to audit committee or such similar body of an institution.

AAOIFI Auditing Standards

AAOIFI Auditing Standards

- Objective and Principles of Auditing.
- The Auditor's Report.
- Terms of Audit Engagement.
- Testing for Compliance with Shari'a Rules and Principles by an External Audit.
- The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements.

AAOIFI Auditing Standards *(cont'd)*

Objective of Audit

- To enable auditor of financial statements to express an opinion as to whether the financial statements are prepared, in all material respects, in accordance to Shari'a rules and principles, AAOIFI accounting standards, and other relevant accounting standards and practices.

AAOIFI Auditing Standards *(cont'd)*

Concept of Reasonable Assurance

- An audit is designed to provide reasonable assurance that financial statements taken as a whole are free from material misstatement.
- Reasonable assurance also means that the auditor has satisfied himself or herself that transactions examined during audit comply with Shari'a rules and principles as determined by the Islamic financial institution's (IFI's) Shari'a Supervisory Board (SSB).

AAOIFI Auditing Standards *(cont'd)*

Responsibility of an external auditor for compliance with Shari'a rules and principles

- While the auditor is responsible for forming and expressing an opinion on the financial statements, the management of the IFI is responsible for ensuring that the financial statements and the IFI's activities comply with Shari'a rules and principles as determined by the IFI's SSB.
- The responsibility to interpret Shari'a rules and principles lies with the IFI's SSB.

AAOIFI Auditing Standards *(cont'd)*

Responsibility of an external auditor for compliance with Shari'a rules and principles *(cont'd)*

- The auditor shall be knowledgeable about Shari'a rules and principles, but would not possess the same level of knowledge as that of SSB members, and thus the auditor shall not be expected to provide interpretation of these rules and principles.
- The fatwas, rulings and guidance issued by the SSB form the basis on which the auditor considers whether the IFI has complied with Shari'a rules and principles.

AAOIFI Auditing Standards *(cont'd)*

Scope of auditor's work

- The responsibility of the auditor is to form an opinion on whether the transactions of the IFI are in compliance with the fatwas, rulings and guidance issued by its SSB.
- The auditor shall have no responsibility for assessing the competence of the members of the SSB.
- The IFI's process for introducing new products or modifying existing products shall include appropriate procedures for ensuring compliance with Shari'a rules and principles including reviews by the IFI's management, internal audit and the SSB.

AAOIFI Auditing Standards *(cont'd)*

Scope of auditor's work *(cont'd)*

- Review available documents to ensure that all types of products offered by the IFI have been subject to a review by the SSB, and that the SSB has found these products to be in compliance with Shari'a rules and principles.
- Verify that the transactions entered into by the IFI are consistent with the fatwas, rulings and guidelines of the SSB.
- Review the findings of all internal reviews carried out by the IFI management, the internal audit, and the internal Shari'a review by or on behalf of the SSB.

Thank You

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Appendix I – List of current standards

Shari'a Standards

1	Trading in Currencies	19	Loan (Qard)
2	Debit Card, Charge Card and Credit Card	20	Commodities in Organised Markets
3	Default in Payment by a Debtor	21	Financial Papers (Shares and Bonds)
4	Settlement of Debt by Set-Off	22	Concession Contracts
5	Guarantees	23	Agency
6	Conversion of a Conventional Bank to an Islamic Bank	24	Syndicated Financing
7	Hawala	25	Combination of Contracts
8	Murabaha to the Purchase Orderer	26	Islamic Insurance
9	Ijarah and Ijarah Muntahia Bittamleek	27	Indices
10	Salam and Parallel Salam	28	Banking Services
11	Istisna'a and Parallel Istisna'a	29	Ethics and Stipulations for Fatwa
12	Sharika (Musharaka) and Modern Corporations	30	Monetization (Tawarruq)
13	Mudaraba	31	Gharar (Uncertainty) Stipulations in Financial Transactions
14	Documentary Credit	32	Arbitration
15	Jua'la	33	Waqf
16	Commercial Papers	34	Ijarah on Labour (Individuals)
17	Investment Sukuk	35	Zakah
18	Possession (Qabd)	36	Contingent Obligations

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Shari'a Standards (continued)

37	Credit Facilities
38	Online Financial Transactions
39	Rahn (Pledge)
40	Investment Accounts and Profit Distribution
41	Reinsurance
42	Disposal of Rights
43	Bankruptcy
44	Liquidity Management
45	Capital Protection (in Investment Products)
46	Investment Agency
47	Stipulations on Income and Profit (in Financial Transactions)
48	Options in Legal Contracts

Accounting Statements & Standards

SFA 1	Conceptual Framework for Financial Reporting by Islamic Financial Institutions
FAS 1	General Presentation and Disclosure in the Financial Statements of Islamic Banks and Financial Institutions
FAS 2	Murabaha and Murabaha to the Purchase Orderer
FAS 3	Mudaraba Financing
FAS 4	Musharaka Financing
FAS 5	Disclosure of Bases for Profit Allocation between Owners' Equity and Investment Account Holders
FAS 6	Equity of Investment Account Holders and Their Equivalent
FAS 7	Salam and Parallel Salam
FAS 8	Ijarah and Ijarah Muntahia Bittamleek
FAS 9	Zakah
FAS 10	Istisna'a and Parallel Istisna'a
FAS 11	Provisions and Reserves
FAS 12	General Presentation and Disclosure in the Financial Statements of Islamic Insurance Companies
FAS 13	Disclosure of Bases for Determining and Allocating Surplus or Deficit in Islamic Insurance Companies
FAS 14	Investment Funds
FAS 15	Provisions and Reserves in Islamic Insurance Companies
FAS 16	Foreign Currency Transactions and Foreign Operations
FAS 17	Investments for Real Estates

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Accounting Statements & Standards (continued)

FAS 18	Islamic Financial Services Offered by Conventional Financial Institutions
FAS 19	Contributions in Islamic Insurance Companies
FAS 20	Deferred Payment Sale
FAS 21	Disclosure on Transfer of Assets
FAS 22	Segment Reporting
FAS 23	Consolidation
FAS 24	Investments in Associates
FAS 25	Investments in Sukuk, Shares, and Similar Instruments

SFA = Financial Accounting Statements

FAS = Financial Accounting Standards

Accounting Guidance Note

1	Guidance Note on First Time Adoption of AAOIFI Accounting Standards
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Auditing Standards

1	Objectives and Principles of Auditing
2	The Auditor's Report
3	Terms of Audit Engagement
4	Testing for Compliance with Shari'a Rules and Principles by an External Auditor
5	The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements

Governance Standards

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
6	Statement on Governance Principles for Islamic Financial Institutions
7	Corporate Social Responsibility Conduct and Disclosure for Islamic Financial Institutions

Ethics Standards

1	Codes of Ethics for Accountants and Auditors of Islamic Financial Institutions
2	Codes of Ethics for the Employees of Islamic Financial Institutions

Appendix II – List of standards included in standards development programs for 2011 onwards

List of standards included in the standards development program – 2011 onwards

Accounting Standards

- New Conceptual Framework for Financial Reporting (to replace Statements of Financial Accounting 1 and 2) – *issued in 2011.*
- Revised / new Financial Accounting Standard (FAS) 25 Investments in Sukuk, Shares, and Similar Instruments – *issued in 2011.*
- Revised / new FAS on Investments in Real Estate – *exposure draft released in Jan 2012.*

List of standards included in the standards development program – 2011 onwards (*cont'd*)

Accounting Standards (*cont'd*)

- Revised FAS 5 and 6 Equity on Investment Accountholders – *consultation note released in Jan 2012.*
- Revised FAS 12, 13, 15 and 19 relating to Takaful – *consultation note to be released in 2H 2012.*
- Revised FAS 1 General Presentation and Disclosures in Financial Statements – *consultation note to be released in 2H 2012.*

List of standards included in the standards development program – 2011 onwards (*cont'd*)

Accounting Standards (*cont'd*)

- Revised FAS 2 Murabaha.
- Revised FAS 3 Mudaraba.
- Revised FAS 4 Musharaka.
- Revised FAS 8 Ijarah.
- Revised FAS 11 Provisions and Reserves.
- Revised FAS 14 Investment Funds.
- New standard on accounting for Sukuk.

List of standards included in the standards development program – 2011 onwards (*cont'd*)

Accounting Standards (*cont'd*)

- New FAS on Interim Reporting.
- New FAS on Fair Value.
- New FAS on Assets Held for Sale.
- New FAS on Liabilities.
- New FAS on Revenue Recognition.
- New FAS on Related Party Transactions.

List of standards included in the standards development program – 2011 onwards (*cont'd*)

Auditing and Governance Standards

- New Governance Standard (GS) on Governance for Shari'a Supervisory Board (SSB) – *consultation note to be issued in 2H 2012.*
- Amendment to Auditing Standard (AS) 1, 2, 3 and 4 relating to auditors' opinion on Shari'a compliance.
- New GS on Relationship between Regulators, SSB and External Auditors.

List of standards included in the standards development program – 2011 onwards (*cont'd*)

Auditing and Governance Standards (*cont'd*)

- New AS on materiality in planning and performing an audit.
- New AS on audit evidence regarding specific financial statement account balances and disclosures.
- New AS on analytical procedures.
- New AS on quality control for an audit of financial statements.
- New AS on modifications to the auditor's opinion.
- New AS on auditor's responsibility regarding subsequent events.

List of standards included in the standards development program – 2011 onwards (*cont'd*)

Shari'a Standards

- New Shari'a Standards (SSs) on Disposal of Rights; Bankruptcy; Liquidity Management; Capital Protection (in Investment Products); Agency Investment Contracts; Stipulations on Income and Profits (in Financial Transactions); Options in Legal Contracts – *issued in 2011*.
- New SSs under development include those on Contracts Termination and Compensation; Fiduciary Investment Contracts; Promise and Bilateral Promise; Purification of Prohibited Income; Repos; Risk Management; and Special Purpose Vehicles.

Appendix III – Standards development process

Standards development process

Shari'a Board

- Ultimate authority on Shari'a standards.
- Comprises leading Shari'a scholars representing all major schools of thoughts.
- Also vets through other standards to ensure Shari'a compliance.



Shari'a standards committees

Accounting & Auditing Standards Board

- Ultimate authority on accounting, auditing, ethics, governance standards.
- Senior representatives of the industry.



- Accounting standard committee
- Auditing & governance standard committee

Standards development process (*cont'd*)

**Preliminary
study**



**Consultation
note**



**Exposure
draft**



**Review of
standard**



**Issuance of
standard**



Final standard



Standards development process (*cont'd*)

1. Preliminary study

- On potential new standard to be developed, or existing standard to be reviewed – based on suggestions from industry, AAOIFI or its boards.
- To cover general or broad issues relating to the standards concerned.
- For discussion by standards boards (i.e. Shari'a Board or Accounting and Auditing Standards Board) and their committees.



2. Consultation note

- Gives an outline on proposed major points of a new standard, or proposed major changes to an existing standard.
- For discussion by standards committees and boards.
- Subsequently to be released to the industry for comments and suggestions, and discussed at public hearing meetings.
- Comments and suggestions from industry and public hearing meetings to be considered when developing exposure draft.



Standards development process (*cont'd*)

3. Exposure draft

- To be prepared in the same format as a final standard.
- For discussion by standards committees and boards.
- Subsequently to be released to the industry for comments and suggestions, and discussed at public hearing meetings.
- Comments and suggestions from industry and public hearing meetings to be considered when developing final standard.



4. Final standard

- To be prepared for issuance as a standard for the industry.
- For discussion and approval by standards committees and boards.
- Once approved by standard boards, standard is issued and considered binding (taking into account effective date, if any, of the standard).



Standards development process (*cont'd*)

5. Issuance of standard

- Announcement on approval of new or revised standard, and issuance thereof, is carried out through media and industry publication.
- The new or revised standard is also included in AAOIFI standards publications.



6. Review of standard

- All existing standards are subject to review.
- Reviews of some specific existing standards have been included in current standards development and review program.
- Other existing standards may be reviewed upon suggestions from the industry.
- Review of existing standards follow the same processes as development of existing standards.



Thank You

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