

**Exposure Draft on
Governance Standard for Islamic Financial
Institutions No. 7**

**Corporate Social Responsibility
Conduct and Disclosure for Islamic Financial
Institutions**

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In the name of Allah, the Beneficent, the Merciful

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 provide guidance on disclosure of CSR information** to the IFI's stakeholders (para 1).

2. Scope of this 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).

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).

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.

4. Objectives of this 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 mandatory 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 provisions:

- 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 principles 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.

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 14).

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.

The procedure above should be read in conjunction with and supplements any existing AAOIFI standards that relate to earnings and expenditure prohibited by Shari'a (para 15).

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 employees, regardless of gender, race, religion, disability or socio-economic background,
- c) establishing long term incentive schemes and further development and training incentive schemes for all employees,
- 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 background, 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 (including 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.

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 16).

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. xx, 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 on Zakah* (para 17).

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.

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 18).

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.

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 19).

5/3/5 Policy for social, development and environment based investment 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 20).

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 disadvantaged 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 21).

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 infrastructure in the country of operation or for another developing 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 22).

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 23).

This policy may be monitored on a yearly basis, with revisions being made on based on quota/target performance (para 24).

5/3/6 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 Institutions* 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 performance/quality and likely areas of improvement (para 25).

5/3/7 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 (for 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 investment depositors (for e.g. savings deposit with higher rates of return and investment loan discounts etc) (para 26).

5/3/8 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) establishing 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 27).

5/3/9 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 28).

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 29).

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 30).

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 31).

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 32).

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 (revenue, expense, liability or asset) and reasons for undertaking the 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* alternatives, if any, for similar impermissible transactions in the future (para 33).

This comprehensive disclosure supplements existing disclosure required by other AAOIFI standards (*Financial Accounting Standard 1: General Presentation and Disclosure in the Financial Statements of Islamic Banks and Financial Institutions* section 3/6) (para 34).

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 35).

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.

6/1/5 Disclosure of policy for *Zakah*

Disclosure should be made for *Zakah*, in the financial statements, in accordance with the provisions of *Financial Accounting Standard No. 9 on Zakah* (para 36).

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 38).

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 39).

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 environmental 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 40).

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 overall quality of customer service and areas of improvement (para 41).

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 42).

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.

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 Institutions* section 4/7 and *Financial Accounting Standard 1: General Presentation and Disclosure in the Financial Statements of Islamic Banks and Financial Institutions* section 4/7 (para 42).

7/2/5 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 beneficiary 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.

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 43).

7/2/11 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 44).

7. Responsibility under this standard

7/1 Compliance and attestation function

It is the responsibility of the Board of Directors to ensure compliance with the provisions of this standard and provide an independent attestation of CSR conduct as an assurance to stakeholders (para 45).

The compliance function will comprise testing whether the *mandatory* and *recommended* CSR conduct provisions of this standard are implemented both in form and in substance by the IFI (para 46).

The attestation function will comprise signing off by the board of directors or its main representative on the CSR report provided by management. The attestation may include:

- a) providing 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) providing a statement which stipulates that management's representations in the annual report regarding its CSR conduct fairly represent management's actual conduct (para 47).

7/2 Implementation function

The responsibility for implementation of this standard lies with the management of an IFI (para 48).

8. Effective Date

This standard shall be effective for financial periods beginning (Arabic Date) or (English Date) (para 48).

Adoption of the Standard

The Islamic Corporate Social Responsibility Standard was adopted by the Board in its meeting No. () held in (Arabic Date) corresponding to (English Date).

Members of the board:

Appendices

Appendix A: Brief history on the preparation of the standard

On xx Jumuda Al-Akhir 1427, corresponding to xx July 2006, the consultant was formally notified of his assignment to prepare the standard and its requirements. The preliminary study of the standard was discussed in the Committee meeting No. xx held in Bahrain on xx month 14xx, corresponding to xx month 2007.

On the 14 Rajab 1429, corresponding to 17 July, 2008, the preliminary version of the standard was discussed in the Committee Meeting No. xx held in Bahrain. The committee members gave their comments and some details thereon and the consultant was asked to take them into consideration. The revised version of the standard was prepared in Shaaban 1429, corresponding to August 2008. It was also agreed that this revised version along with a field study would be sent to all IFI member institutions to gauge their reaction to compliance with the provisions of the standard.

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 shouldn't 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 Holy 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: **I will create a vicegerent on earth**²; and Allah further states: **It is he who hath made you the inheritors of the earth,**³

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: **Allah takes careful account of everything,**⁴ and **Then shall anyone who has done an atom's weight of good shall see it and anyone who has done an atom's weight of evil, shall see it.**⁵ This divine accountability is the basis for all actions of a Muslim⁶, and in turn the representative organizations of Muslims.

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 that: **The Believers, men and women, are protectors one of another; they enjoin what is just (accepted), and forbid what is unjust (rejected)...**⁷ and in another verse, Allah states: **You are the best of peoples, evolved for mankind, enjoining what is just (accepted), forbidding what is unjust (rejected), and believing in Allah**⁸. 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*)⁹ 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:

- i. invest their money as shareholders or investment account holders,
- 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,

² Surat Al Baqarah (The Heifer) verse 30.

³ Surat Al Ana'm (Cattle) verse 165.

⁴ Surat Al Nisa (Women) verse 86.

⁵ Surat Al Zalzala (The Earthquake) verse 7-8)

⁶ One who submits to the will of Allah.

⁷ Surat Tawba (The Repentance), verse 71.

⁸ Surat Al-e-Imran (The Family of Imran) verse 110.

⁹ *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.

- v. in addition to the above, have a 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*.¹⁰ 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: 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 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: **On no soul doth Allah Place a burden greater than it can bear.**¹¹

¹⁰ *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.

¹¹ Surat Al Baqarah (The Heifer) verse 286.

Appendix E: Definitions

Clients

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

Contractors

Contractors in this standard are defined as businesses or corporations who provide services to the IFI in return for a contractually agreed consideration. 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 account holders.

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 *Awqāf*) 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 F: 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 the 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.

Exhibit A: Example of Comprehensive CSR Report

In the Name of Allah, The Beneficent, The Merciful

(Name of Bank or Institution) Islamic Corporate Social Responsibility Report For the year ended xxx

(Name of Bank or 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 Bank or 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 Bank or Institution) has implemented both mandatory and recommended forms of Islamic Corporate Social Responsibility.

The implementation of these standards in true Islamic form and substance by the management of (Name of Bank or 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 Bank or 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 information 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]