



# Corporate governance

## Introduction

Albaraka is committed to high standards of corporate governance, seeking to reinforce these through the establishment of strong ethical values with integrity and professionalism in all of its activities. Corporate governance at Albaraka Bank is accorded significant priority and is the responsibility of Albaraka Bank's Board of Directors.

## Board of Directors

The Board comprises non-Executive and Executive Directors. The composition of the Board, with a strong independent element, ensures that no one individual has unfettered powers of decision and authority.

The function of the Board is to consider in depth issues of fundamental strategic importance to the bank.

New Directors may hold office only until the next Annual General Meeting at which they retire and become available for re-election, while all Directors are subject to retirement by rotation and re-election by shareholders at least once every three years.

The Board is responsible to the shareholders for setting the direction of the bank through the establishment of strategic objectives and key policies. The Board is accountable to shareholders for exercising leadership, enterprise, integrity and judgement in directing the organisation so as to achieve continuing prosperity for the bank.

The Board meets regularly, at least four times a year, and retains full and effective control of the bank. As part of this process the Board operates a comprehensive system of financial monitoring, involving detailed quarterly reporting, to ensure that performance is continually assessed and there is regular reporting on relevant non-financial matters.

Control is also exercised through the Executive Directors who, together with management, are responsible for taking and implementing operational decisions in managing the bank's business. They are also required to provide the Board with appropriate and timely information necessary for it to fulfil its responsibilities, which is provided for through a framework of open communication and integrated financial reporting systems.

All Directors have access to management, and to such information as is needed to carry out their duties and responsibilities fully in furtherance of their duties to take independent professional advice, if necessary, at the company's expense.

## Board Committees

To assist the Board in the discharge of its duties and responsibilities, a number of Board committees have been established.

There are five principal board committees, namely the Board Credit Committee, the Directors' Affairs Committee, the Audit Committee, the Remuneration Committee and the Risk Committee. These committees are assisted by Management Committees comprising the Executive Committee, the Assets and Liabilities Committee and other Management Committees that are important to the effective operation of the bank.

These committees have formal written terms of reference that are reviewed regularly, and updated as necessary, to take account of developments and any specific requirements of the bank and the changes in banking regulation.

### *Board Credit Committee*

The Board Credit Committee meets at least four times a year. The Committee, comprising of Adv Aboobaker Mahomed SC (Chairman), Yusuf Asmall, Shabir Chohan, Thys McLean, Shabir Randeree, Othman Suleiman and Mohamed Sadeck Paruk, is primarily responsible for evaluating the appropriateness, adequacy and efficiency of credit policies and procedures as well as approving credit applications in terms of its mandate and monitoring credit risk and other risks which are material.

### *The Directors' Affairs Committee*

This committee was formed in 2004 in line with the bank's corporate governance policy. This committee has a formal written terms of reference and effectively manages certain of the Board's responsibilities.

This committee meets at least four times a year and consists of Shabir Randeree (Chairman), Adv Aboobaker Mahomed SC and Yunus Paruk.

### *Audit Committee*

This committee, comprising of Mohamed Sadeck Paruk (Chairman), Yusuf Asmall, Adv Aboobaker Mahomed SC, Othman Suleiman and Mahmoud Youssef, takes place four times per annum. In attendance at committee meetings are the non-Executive Directors, Executive Management and both internal and external Auditors of Albaraka Bank.

### *Remuneration Committee*

This committee, comprising mainly non-Executive Directors, is chaired by a non-Executive Director. Its members are Yusuf Asmall (Chairman), Othman Suleiman, Shabir Randeree and the Chief Executive. Remuneration Committee meetings are held at least twice a year. The committee's primary objective is to ensure that the right calibre of personnel is recruited and retained. It is also responsible for evaluating the performances of Executive Directors. Executive Directors are not involved in the determination of their own remuneration.

### Risk Committee

The Risk Committee comprises mainly non-Executive Directors and is chaired by a non-Executive Director. The members during the year were : Yunus Paruk (Chairman), Adv Aboobaker Mahomed SC, Thys McLean, Mohamed Sadeck Paruk and the Chief Executive. In attendance at meetings are both the Internal Auditor and the Compliance Officer.

In fulfilling its duties, the Board has agreed on a terms of reference for the Risk Committee. The purpose of this committee is to help the Board review issues for consideration as identified by Internal Audit and Compliance, or by any other Risk Officer of Albaraka Bank with specific reference to the risk implication of issues such as major control breakdowns and weaknesses, and losses affecting the bank resulting from illegal or criminal conduct or irregular activities. The Risk Committee also assists the Board in developing a risk mitigation strategy to ensure that the bank manages the risks in an optimal manner.

### Internal audit and control

The Board of Albaraka Bank acknowledges that it is responsible for internal financial control. For this purpose, Internal Audit performs an independent appraisal of the bank's systems of internal control and operation. This is conducted with the full co-operation of the Board and management. With the increasing

convergence of internal audit functions with those of other risk-related and compliance functions, internal audit operates closely in a co-ordinated way with the other functions in the bank responsible for risk management.

By virtue of its mandate any material or significant control weaknesses that are identified are brought to the attention of management and the Audit Committee for consideration and the necessary remedial action.

### Compliance function

Albaraka Bank has a Compliance function, which reports to the Chief Executive and the Board. This department has been enhanced to meet the requirements of the Banks Act and has adopted a risk-based approach to compliance monitoring. The focus has been placed on identifying both regulatory and reputational risks as well as facilitating, monitoring, training and servicing the Bank as a whole.

### Code of conduct

The bank's policy commits management and employees to high standards of ethical behaviour. It provides a clear guide as to the expected behaviour of management and employees in their dealings with each other and the bank's stakeholders. Failure to maintain ethical standards will result in disciplinary action.

## Attendance register

Attendance of Directors at Board/ Board Committee Meetings for the 2004 calendar year

	Board Meetings	Audit Committee Meetings	Board Credit Committee Meetings	Remuneration Committee Meetings	Risk Committee Meetings	Directors' Affairs Committee Meetings
Total number of meetings	4	4	4	3	5	3
<b>Executive Directors</b>						
E E Vawda, retired 23/03/04	1	1	1			
M G McLean	4	4	4	2	3	
S A E Chohan, appointed 13/12/04	1	1	1	1	–	
M J D Courtiade, appointed 15/12/04	1	1	1			
<b>Non-Executive Directors</b>						
A A Sabbahi	3					
O A Suleiman	4	4	4	3		
M Youssef	4	4				
S A Randeree	4		4	3		2
Y M Paruk	4				4	3
Adv A B Mohamed SC	4	4	4		5	3
Y D Asmall	4	4	1	3		
E Y Varachia, resigned 30/09/04	3		3			
M S Paruk, appointed 04/11/04	1	1	1		–	

Shading indicates that Directors are not members of the committee.



## Introduction

The Board recognises that risk and the sound management thereof is integral and fundamental to the business of banking. In essence, risk management includes the identification and evaluation of key risk areas and ensuring that internal control systems and risk management processes, which are appropriate and commensurate with the nature and complexity levels of the bank's activities, are in place.

To achieve the above-mentioned objective, the Board has adopted an integrated approach to risk management in which the compliance, internal audit, legal, secretarial and other risk specialist functions work together with management and various Management and Board Committees within a common framework. The establishment of a risk governance structure that allows for independent oversight and the development and maintenance of risk management policies and processes to ensure that risks are identified, measured and reported on regularly, underpin this approach. In addition, the bank has adopted a strategy that seeks to entrench at all levels within the bank a culture that is risk-management orientated.

While the Board is ultimately responsible for risk management and to determine the type and level of risk which the bank is willing to accept in conducting its banking activities, the effective management of risk has been delegated to three Board Committees, namely, the Risk Committee, the Audit Committee and the Credit Committee. These committees are assisted by management committees (more particularly the Management Assets and Liabilities Committee, the Executive Credit Committee and the IT Steering Committee) to discharge their responsibilities effectively. The composition, terms of reference and delegated powers of authority of the Board committees are set by the Board and are reviewed annually.

## Major risks

The following are the major forms of risks that the bank is exposed to :

- Credit risk
- Liquidity risk
- Profit rate risk
- Shari'ah risk
- Operational risk

## Credit risk

Credit risk refers to the potential loss that the bank could sustain as a result of counter-party default.

The bank manages its credit risk within a governance structure supported by delegated powers of authority as approved by the Board. The credit approval process is graduated whereby increasingly higher levels of authorisation is required depending on the type and value of the transactions concerned. Applications for credit may therefore be considered progressively by line management, senior and executive management, the Management Credit Committee, the Board Credit Committee and the Board itself.

The underlying principles guiding the extension of credit are primarily based on the results of qualitative and quantitative assessments undertaken as part of the approval process. In carrying out such assessments due consideration is given to, inter alia, the following issues :

- The applicant's financial status and repayment capacity.
- The type, quality and value of security to be provided.
- Information obtained from credit agencies and other parties.
- The applicant's performance relating to any prior transactions.
- Any other factors that may impact on the collection process.

Credit exposures are subsequently monitored primarily on performance. Defaulting accounts receive prompt attention. Initially they are dealt with by line management and, in instances where further degeneration occurs, they are handed over to the bank's collections and legal specialists.

Depending on the type of credit exposure, account reviews, which include the re-performance of qualitative and quantitative assessments, are conducted annually.

Based on the performance of individual debtors and the results of assessments conducted, credit exposures are classified under five main categories, viz Standard, Special Mention, Sub-standard, Doubtful and Loss.

Exposures that are current and where full repayment of the principal amount and profit is expected are classified under the Standard category.

Exposures where evidence exists that the borrower is experiencing some difficulties that may threaten the bank's

position but where ultimate loss is not expected but could occur if adverse conditions continue are classified under the Special Mention category.

Exposures that show underlying, well-defined weaknesses that could lead to probable loss if not corrected are classified under the Sub-standard category. The risk that such exposures may become impaired is probable and the bank relies to a large extent on available security.

Exposures that are considered to be impaired but are not yet considered total losses because of some pending factors that may strengthen the quality of such exposures are classified under the Doubtful category.

Exposures that are considered to be uncollectable and where the realisation of collateral and institution of legal proceedings have been unsuccessful are classified under the Loss category. These exposures are considered to be of such little value that they should no longer be included in the net assets of the bank.

Exposures that are classified under the Sub-standard, Doubtful and Loss categories are regarded as non-performing.

## Liquidity risk

Liquidity risk relates to the potential inability to repay deposits, fund asset growth or to service debt or other expense payments.

Liquidity risk is managed mainly by ensuring that the funding of the bank is sourced from a wide range of retail deposits with an appropriate spread of short, medium and long term maturities. Exposure to large deposits is strictly controlled. The Assets and Liabilities Committee monitors and reviews the maturity profiles of the bank's assets and liabilities on a regular basis to ensure that appropriate liquidity levels are maintained to meet future commitments.

The bank also has a policy of maintaining liquidity buffers (in the form of treasury bills and cash surpluses held on call) comfortably in excess of regulatory requirements.

## Profit rate risk

Profit rate risk relates to the potential loss that a bank could sustain as a result of a change in the margin between the mark-up earned from advances made to customers and the return paid to depositors.

Profit rate risk is managed mainly through matching the terms and the rates of return paid to depositors with the mark-up earned on the advances portfolio, thereby eliminating the bank's exposure to profit rate risk.

## Shari'ah risk

Shari'ah risk relates to the possibility that the bank may enter into or conclude transactions that may not be compliant with Islamic banking principles.

## Operational risk

Operational risk refers to those risks that do not have a direct financial impact as opposed to the pure financial risks such as liquidity risk, credit risk and profit rate risk. Operational risk is the risk of loss that could arise as a result of breakdowns in internal controls and processes, system inefficiencies, theft and fraud.

The bank seeks to minimise its exposure to operational risk by various means, including the following :

- The establishment of an independent compliance function to monitor compliance with relevant laws and regulations and to facilitate compliance awareness within the bank.
- The establishment of an independent internal audit function.
- The compilation of Board-approved delegated powers of authority.
- The compilation of policies and procedures manual.
- The provision of staff training (including fraud awareness programmes) and ensuring that they are well versed with the bank's policies and procedures.
- The implementation and maintenance of comprehensive security measures to protect the bank's staff and to safeguard the bank's assets.
- The establishment of a comprehensive insurance programme to protect itself against material losses that may arise.



## Directors' responsibility

Management is responsible to the Directors for the preparation and the integrity of the financial statements and all other financial information included in this report. The external auditors are responsible for reporting on the financial statements.

The financial statements have been prepared in accordance with the provisions of the Companies Act and the Banks Act, and comply with the South African Statements of Generally Accepted Accounting Practice.

In order for the Board to discharge its responsibilities, management has developed and continues to maintain a system of internal control. The Board has ultimate responsibility for the system of internal control and reviews the bank's operations primarily through the Audit Committee and various other risk monitoring committees.

The Directors rely on documented risk-based internal control systems and administrative controls, designed to provide reasonable assurance that the bank's assets are secured, and that transactions are conducted in accordance with prudent banking and business practice as well as the bank's policy guidelines.

These controls are implemented by trained and skilled personnel with an appropriate segregation of duties which are monitored by management, and include a comprehensive budgeting and reporting system operating within strict deadlines and appropriate controls.

The bank's internal audit function, which operates independently and unimpaired, has unrestricted access to the Audit Committee. It appraises, evaluates and, when necessary,

recommends improvements to the systems of internal control and accounting practices based on audit plans which take cognisance of the relevant degrees of risk of each function or aspect of business.

The group is exposed to a number of risks, the most significant being the market, credit, liquidity, operational and compliance risks. These risks are managed by policies and procedures approved by the Board of Directors.

The Directors are of the opinion, based on the information and explanations given by management and the internal auditor, that the accounting controls are adequate and that the financial records may be relied upon in the preparation of the financial statements.

The Annual Financial Statements are prepared on a going concern basis. Nothing has come to the attention of the Directors to indicate that the company and the group will not remain a going concern until the next reporting date. Subsequent to the year end the shareholders have undertaken to increase the share capital to meet the revised capital adequacy ratio required by the South African Reserve Bank.

The Annual Financial Statements for the year ended 31 December 2004 as set out on pages 17 to 37 have been approved by the Board of Directors on 23 March 2005 and are signed on its behalf by :

Adnan Ahmed Yousif  
Chairman

Shabir Chohan  
Chief Executive

Durban, 23 March 2005



*The furnishings of Cairo's mosques, especially during the Mamluk period, were decorated with intricately constructed polygons and strapwork. Most often, the polygons were of wood, either carved or inlaid with ivory or coloured woods. These doors exhibit a great variety of patterns, most of which are also found in other media, such as stone carvings, marble mosaics, and stucco window grilles.*

*In the name of Allah, the Most Beneficent, the Most Merciful.*

## To the shareholders and depositors of Albaraka Bank

Assalam Alaikum Wa Rahmat Allah Wa Barakatuh

We have reviewed the principles and the contracts relating to the transactions and applications introduced by Albaraka Bank during the year under review. We have also conducted our review to form an opinion as to whether Albaraka Bank has complied with Shari'ah Rules and Principles and with the rulings set by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).

Albaraka Bank's management is responsible for ensuring that the bank conducts its business in accordance with Islamic Shari'ah Rule and Principles. It is the Shari'ah Supervisory Board's responsibility to form an independent opinion, based on its review of the operations of Albaraka Bank, on Shari'ah compliance.

We report that the Shari'ah Supervisory Board conducted the review by examining each type of transaction on a selection basis to give us reasonable assurance that Albaraka Bank has not violated Islamic Shari'ah Rules and Principles.

In our opinion the contracts, transactions and dealings entered into by Albaraka Bank during the year under review are generally in compliance with the Shari'ah Rules and Principles subject to certain concerns raised by the Shari'ah Supervisory Board which have been addressed.

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

Wassalam Alaikum Wa Rahmat Allah Wa Barakatuh

Dr Abdus Sattar Abu Ghudda  
Chairman of the Shari'ah Supervisory Board  
Durban, 26 May 2005

## Shari'ah supervisory board

The Shari'ah Supervisory Board is an independent body of specialist jurists in Islamic commercial jurisprudence. The Shari'ah Supervisory Board is entrusted with the duty of directing, reviewing and supervising the activities of Albaraka Bank to ensure that they are in compliance with the Shari'ah. They are also entrusted with ensuring that any Shari'ah issues pertaining to the bank are dealt with in a professional manner which is in line with standards set by international Islamic financial institutions. The rulings and resolutions of the Shari'ah Supervisory Board are binding on the bank. It is the responsibility of the Shari'ah Supervisory Board to conduct regular audits of transactions and to form an independent opinion based on their review of operations.

The bank's external Shari'ah Supervisory Board members are as follows :

**Dr Abdus Sattar Abu Ghudda** (Syria) – Dr Ghudda is the senior Shari'ah consultant for the Dallah Al Baraka group in Saudi Arabia. He is also a Director of the Department of Financial Instruments at Al Baraka Investment and Development Company and a member of the Shari'ah

Supervisory Boards of several Islamic financial institutions. He is an active member of the OIC Islamic Fiqh Academy and the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). He was responsible for research and compilation for the Encyclopedia of Fiqh of the Kuwait Ministry of Awqaf and Islamic Affairs and is a former member of the Ministry's Fatwa Board. He has taught fiqh and Islamic studies in Kuwait and Saudi Arabia.

Dr Abu Ghuddah obtained BA degrees in Islamic Shari'ah and in Law from Damascus University. He then went on to earn his MA degree in Shari'ah and hadith and his PhD in Shari'ah and comparative fiqh from Al-Azhar University, Cairo.

**Mahomed Shoaib Omar** – MS Omar serves as a member of the Shari'ah Board of Albaraka Bank SA. He completed his LLB at the University of KwaZulu-Natal in 1979 and studied Arabic and Islamic Law under Mufti Taqi Usmani in 1982. He was also a student of Qadhi Mujahidul Islam, the founder of the Islamic Fiqh Academy of India. In 1995, he was granted right of appearance in the High and Constitutional Courts of South Africa. Mahomed Shoaib Omar practises as an attorney and has authored over ten books and numerous articles in Islamic Law and Commerce.