



SHARIYAH
REVIEW BUREAU

Tel +966 12 2293424
P.O.Box 40469, Jeddah 21499
- SAUDI ARABIA -

Tel +971 4 4096974
P.O.Box 124342, Dubai
- UNITED ARAB EMIRATES -

Tel +973 17215698
P.O.Box 21051, Al Manama,
- BAHRAIN -

Kazakhstan Ijara Company

Shari'a Audit Report

2019



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In The Name of Allah Ever Gracious Ever Merciful

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Section I

1. Introduction:

This report has been prepared after conducting the Shari'a audit ("Audit") for Kazakhstan Ijara Company ("Company") for the year ended December 31, 2019. In compliance with the agreement of appointment, our responsibility as Shari'a Auditors along with Shari'a Supervisory Board ("SSB") for the Company is to carry out Shari'a Audit in accord with the scope of work agreed upon with Management (the "Management").

2. Standards and Guidelines:

The audit was conducted in light of:

- Shari'a guidelines issued by the SSB of the Company.
- Taking into consideration the Shari'a standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions standards ("AAOIFI").

3. Responsibility:

The Management is responsible for ensuring that the financial arrangements, contracts and transactions having Shari'a implications, entered with its clients/second party, other financial institutions and stakeholders and related policies, procedures and systems are, in substance and in their legal form, in compliance with the requirements of Shari'a rules and principles laid down by the SSB. The management is also responsible for:

- Design, implementation and maintenance of appropriate internal Shari'a control procedures with respect to such compliance and maintenance of relevant product documents approved by the SSB, internal control manuals and Islamic accounting records;
- Prevention and detection of fraud and breaches in Shari'a Compliance for identifying and ensuring that the Company complies with SSB requirements, laws and regulations applicable to its activities;
- Arranging trainings and / or orientation programs on Islamic banking and finance for the staff and appropriate training programs for senior executives to improve their understanding and general acumen in Islamic finance;
- Arranging programs on a regular basis for orienting and sensitizing the key executives about the business utility and importance of enabling Shari'a compliance environment and the key distinguishing features of Islamic finance products vis-à-vis conventional banking products; and

- Providing us with access to all information of which you are aware that is relevant to the compliance with the Shari'a rules and principles such as records, source documentation and other matters, additional information that we may request for the purpose of the engagement; and unrestricted access to persons from whom we determine it necessary to obtain evidence.

4. *Scope of the Audit:*

The Shari'a Audit was carried out in accordance with the professional Auditing standards laid down by AAOIFI Governance Standards [GSIFI 2] and in accord to the guidelines laid down by the SSB. Our review covered the following scope:

- Analyzing the Products' Deals and transactions related processes and identifying internal controls in place to address significant risks;
- Evaluating the effectiveness of the control procedures in mitigating the identified risks;
- Testing to confirm if the products dealings and transactions are operating as intended by SSB's approved directives and guidelines.
- SSB approval for each the Product and also the Management adherence to the Shari'a directives;
- Completeness of documentation required to execute transactions;
- Activities performed by departments.
- Administration of the documentation and their execution.
- Follow up on the observations as noted in the last Audit cycle.

5. *Objectives and Notes:*

The main objective of the report is to evaluate the products and control procedures relating to Shari'a compliance and governance structure and operations of the Company in light of Shari'a directives and guidelines issued by the SSB. This work is not primarily directed towards the discovery of weaknesses (other than those which would influence us in forming such a view) or the detection of fraud and should not, therefore, be relied upon to show that no other weaknesses exist. Accordingly, our Shari'a Audit would not necessarily allow us to identify all possible improvements that a more exhaustive systems review might develop. Our observations contained herein are of three types:

- Observations relating to the Financial Statements of the Company: These observations aim to assess the Company's financial dealings as reflected on the Financial Statements; This is done by verifying the sources of funds, nature of the investments carried out during the year and review the Zakat calculation mechanism.



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- Observations on the executed transactions: These observations are a result of the Audit procedures carried out on the Shari'a compliant products. They exhibit shortcomings in the implementation and execution of such products in light of the directives approved by the SSB. The objective of these remarks is to support and improve the Company's internal Shari'a supervisory systems and thus improve the level of compliance with the approved Shari'a standards and guidelines.

- Observations on activities of the different departments of the Company: The purpose of these observations is to review the Shari'a control systems of the departments making up the Company, which aims to ensure work within these departments is in accordance with the policies and procedures that govern its activities and that the different departments complement each other to better comply with the approved Shari'a standards and guidelines.

6. Rating:

The observations in the report differ in terms of the amount of risk according to their consequences. This is indicated by each observation and according to the risk measures shown in the following table:

Observation category	Risk Rating
High/Serious impact on business performance, the achievement of its objectives, or serious implications on general/controls or adherence to internal or external requirements.	High
Moderate impact on the overall position of the business or the business division on its own or significant implications on general/ controls or adherence to internal or external requirements.	Moderate
When an absence, weakness, or deficiency in controls exists that has or could have limited/low impact on the immediate or future performance of the business division but still requires attention.	Low

7. Confidentiality:

The contents of this report are strictly confidential and are being submitted to the Management of the Company and are not to be distributed to the divisions or departments not involved in the Audit process or which do not have the authority to respond to the observations made hereunder.

Section II

Observations:

In continuation of the scope of review and to support and develop the internal Shari'a supervision and controls, we viewed the operations of the following departments:

1. Finance Department:

We have examined the financial statements for the year ended 31st December 2019 in accordance with agreed-upon Shari'a Guidelines, and below are our observations:

- **Investments:**

It has been verified that the Company has invested its cash in ways that do not conflict with Shari'a guidelines.

- **Debt:**

After reviewing the financial statements of the Company, it became clear that there were no payments, loans, or facilities that were not in accordance with Shari'a standards.

Observation	Risk Rating: Medium	
	Impact	Recommendation
During our review process, it was observed that while a total of Tenge 9,729,089.43 was disposed to charity during the year, however, the balance in the Charity account was Tenge 3,552,444.76 at year end which was not disposed.	This arises the doubt that the company is benefitting from the funds placed in Charity Account. While its also not in line with the directives and guidelines of the SSB which requires to dispose the full Charity amount.	The amount of Tenge 3,552,444.76 needs to be disposed to an approved Charity body after obtaining the approval from the SSB. Alternatively, the Company can draft a charity disposal plan and present it to the SSB for review and approval.
Management Response	Responsibility	Target Date
There have been two reasons for less utilization of the charity sources: 1- When the BOD approved "Charity Strategy" there were no strict requirements for the full disposal of the Charity account. 2 - KIC	Finance Management	31.03.2021

utilizes the funds only for Shari'a complaint projects, hence, there was no additional request from the institution that had been decided to help in 2018, so we couldn't spend it. In case the full amount is not disposed off next audit cycle, the SSB will be notified a separate approval is to be taken.		
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- **Zakat:**

Observation	Risk Rating: Medium	
	Impact	Recommendation
During our assignment, we observed that the Zakat amount which the shareholders had been notified about in the Annual General Shareholders Meeting dated 20-May-2020 was in fact for the year ended 31-Dec-2018.	This is not in line with SSB guidelines and directives and will not clear the company from its responsibility of calculating and notifying the Zakat payable by the Shareholders therefore does not clear the Shareholders from their own Zakat liabilities.	The management should calculate the Zakat for financial year ended 31-Dec-2019 and officially notify the shareholders of the Zakat amount payable.
Management Response	Responsibility	Target Date
KIC will calculate the Zakat for financial year ended 31-Dec-2019 and notify the shareholders.	Finance Management	31.01.2021

2. Operations Department:

The audit process included the review of the approved products represented by Murabaha, and Ijarah documents in addition to the contracts executed by the Company with the relevant parties. A sample was selected from the transactions represent 27% of total number of transactions to ensure that they are being carried out in accordance with the Shari'a guidelines approved by the SSB. During the assignment, we found the following observations:

Observation 1	Risk Rating: Low	
	Impact	Recommendation
<p>Upon reviewing the documents of the transaction (Kompleksnaya Geologo-Ekologicheskaya Ekspediciya) it was noticed that the executed documents were not containing the Sharia certificate code. We have compared the documents with the approved version and it was identical.</p> <p>While the documents for transaction (Kurylys Ted Llp-1) did not mark the time stamps.</p>	<p>This arises the doubt that the company is using documents that are not approved, and this is also not in line with directives of the SSB, where it is clearly mentioned in the approved guidelines that Shari'a certificate code should be printed on each approved agreement/document deployed.</p> <p>Additionally, absence of time keeping mechanism results in inability to verify the transactional process flow and sequence of executed documents as determined by the guidelines approved by SSB.</p>	<p>Instruct employees to ensure that all agreements and contracts being used are complying with SSB guidelines and approvals and carrying the Shari'a Certificate Code while marking the time of signing the transaction documents in order to ensure that the transaction is carried out in the approved sequence.</p>
Management Response	Responsibility	Target Date
<p>1) We have started to indicate the Sharia certificate code starting from mid-April (namely 12.04.2019) when the previous AR had been issues, while this transaction was conducted earlier, i.e. 04.04.2019.</p> <p>2) TED Kurylys accepted observation.</p>	<p>Operations Management</p>	<p>Rectified</p>

Observation 2	Risk Rating: Low	
	Impact	Recommendation
<p>During our assignment, we have observed that the Company had signed with conventional insurance</p>	<p>Dealing with conventional insurance companies is not in compliance with the guidelines and directives approved by the SSB.</p>	<p>We advise the company to apply for Takaful insurance to comply with the Shari'a guidelines.</p>

companies for its Ijarah and Murabaha transactions.		If the Takaful or Shari'a compliant insurance companies is not applicable in the country, we advise the management to request exceptional approval from the SSB to deal with the conventional insurance companies until the Shari'a compliant alternative is available.
Management Response	Responsibility	Target Date
There are no takaful insurance companies registered in Kazakhstan, the management is going to send a letter requesting exceptional approval from the SSB to deal with the conventional insurance companies until the Shari'a compliant alternative is available.	Operations Management	Rectified

3. Compliance Department:

During the audit process, the policies and procedures of the Company and its departments along with the internal audit reports, were examined. There were no Shari'a observations found in the department's activities.

4. Human Resources Department:

After reviewing the overall work of the Human Resources department, it was found that the management concluded several administration agreements with several parties. Below are our observations regarding the same:

Observation 1	Risk Rating: Medium	
	Impact	Recommendation
It was observed from the samples of the administration contracts, that the "Agreement for the provision of Storage Service" contains a clause	Having this clause in the agreements are not in line with Sharia guidelines and directives, where Shari'a-compliant financial	The Management should ensure that all agreements with related parties don't contain late payment fees



related to late payment penalties to be charged.	institution cannot receive and pay late payment fees.	clause. If the other party insist on this clause then the management need to ensure that situation of paying a late payment fee must not arise.
Management Response	Responsibility	Target Date
<p>The Civil legislation of the Republic of Kazakhstan allows the application of the penalties in case of non-fulfillment or improper fulfillment of obligations by the parties under contracts, the counteragents of KIC basically insists on the inclusion of the penalties in the contract. At the same time, "Kazakhstan Ijara Company" JSC supplements the contracts with the following clause: "All amounts of forfeit / interest / fines received by "Kazakhstan Ijara Company" JSC under this Agreement are sent to charity in Agreement with the Council on the principles of Islamic financing of "Kazakhstan Ijara Company" JSC. As well, "Kazakhstan Ijara Company" JSC, for its part, always fulfills its obligations, including payment, so that there is no delay.</p>	HR Management	Unspecified

Observation 2	Risk Rating: Low	
	Impact	Recommendation
Upon reviewing the executed agreements and contracts, we noticed that the Company had execute a Medical insurance	Dealing with conventional insurance companies is not in compliance with the	We advise the company to apply for Takaful insurance to comply with the Shari'a guidelines.

policy and other insurance policies with conventional insurance providers.	guidelines and directives approved by the SSB.	If the Takaful or Shari'a compliant insurance companies is not applicable in the country, we advise the management to request exceptional approval from the SSB to deal with the conventional insurance companies until the Shari'a compliant alternative is available.
Management Response	Responsibility	Target Date
There are no takaful insurance companies registered in Kazakhstan, the management is going to send a letter requesting exceptional approval from the SSB to deal with the conventional insurance companies until the Shari'a compliant alternative is available.	Operations Management	Rectified



All praise is due to Allah...



04/11/2020

Appendix I

ASSUMPTIONS

Our Shari'a Audit is based upon the assumption (which may or may not be the case) that:

- a) All signatures and seals on all documents reviewed by us are genuine, all documents provided to us as certified copy or copy documents (whether provided in hard copy or electronically) are complete and conform to the originals approved by the Shari'a Supervisory Board, and all documents submitted to us as originals are genuine and complete and all translations are accurate translations of the original text thereof;
- b) All documents examined by us are and remain up-to-date and effective and have not been amended or supplemented;
- c) None of the parties to the Agreements is carrying out activities are breach of any regulations issued by the relevant central authority or other competent authority in the country;
- d) The documents which we have examined and audited, and on which we base this report, are in the form in which the documents were executed;
- e) Any translated document that we have reviewed is an accurate translation of the original text thereof;
- f) All parties involved in the executed Agreements have the power and legal capacity to enter into, perform and exercise its rights under the Agreements to which it is a party and the Agreements have been (in the case of the Executed Agreement) or will be (in the case of the Draft Agreements) duly executed and where applicable delivered by each party in accordance with all applicable laws;
- g) Each statement of fact made to us by or on behalf of the Company or any other party or otherwise contained in the audited Agreements remains true, complete and accurate in all material respects;