



## Module 3: Shariah Governance in Islamic SACCOs

### 1. Introduction

With demand for Shari'ah-compliant financial services growing at a faster rate than conventional financial services, Shari'ah boards play a vital role in helping to develop new procedures and products to position the Islamic financial services to adapt to industry trends, and customers' expectations. In fact, Islamic financial products must be structured to conform to strict legal and Shari'ah requirements. Shari'ah Boards play an important role in that sense as they help ensure that the issued financial products strictly adhere to the principles of Shari'ah and offer constructive and creative recommendations to maintain Islamic financial services system in line with the continued challenges of working in a sophisticated and ever-changing financial environment. In addition, by showing flexibility based on their Ijtihad, Board's scholars help to respond to changes and diversity in day-to-day life by taking into consideration concepts of custom, general good, utility or necessity while remaining within the Islamic law boundaries.

### 2. Shari'ah Supervisory Board

#### 2.1 Qualifications and appointment

- The Board should consist of at least three trustworthy scholars appointed by the shareholders in their annual general meeting upon recommendation of the board of directors, taking into consideration the local legislation and regulations.
- The Shari'ah Supervisory Board and the Sacco should agree on the terms of engagement, which shall be recorded in an appointment letter.
- The Shari'ah Supervisory Board shall appoint among its members or any other person a supervisor(s) to help it in performing its duties.
- The shareholders may authorize the board of directors to fix the remuneration of the Shari'ah Supervisory Board. Shari'ah supervisory board's members should highly qualified to issue fatawa (religious rulings) on financial transactions. In addition, they ought to have considerable experience with knowledge of modern financial dealings and transactions.
- The Articles of Association, prospectuses, or statutes (depending on the type of activity) should provide for the existence of a Shari'ah board in an Islamic Sacco, whose fatawa and resolutions should be binding upon the Sacco's management. It should be independent and free to give opinions on proposed products and transactions. This should be expressly provided for in the Articles of Association or the prospectus.

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### 2.2 Roles of Shari'ah Supervisory Board

The role of the Shari'ah Supervisory Board (SSB) involves the:

- Reviewing and overseeing of all potential new product offerings. It has a significant investigatory function to interpret different financial concepts and ensure that they include no impermissible transactions such as Riba.
- It also provides the necessary expertise to create alternative framework of financial services which conform to the principles of Islam.
- The board continually adapts itself to the rapidly changing financial environment to apply the original Islamic philosophy to contemporary problem, while at the same time requiring the greatest adherence to the political, social and economic precepts of Islam.
- Board's members are in charge of the review, the approval, and supervision of all Shari'ah product offerings. Therefore, the board should work closely with product development teams, legal department, tax advisors and compliance departments to offer practical advice as to how to legitimate or amend conventional structures in order to make them Shari'ah compliant without compromising or deviating from the Shari'ah essentials and without being diluted in the conventional banking system.
- It is upon management to ensure conformity with Shari'ah, and it is required to periodically report and certify to the Board regarding the conformity of the actual investments. Shari'ah Boards should also be notified whenever a case arises where there are difficulties in applying any of the approved contracts; they would then come to decision and issue a fatwa which the management of the Islamic financial institution must follow.

### 2.3 Dismissal

- The dismissal of a member of the Shari'ah Supervisory Board shall require a recommendation by the board of directors and be subject to the approval of the shareholders in a general meeting.

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### 3. Internal Shariah Review and Audit

- Internal Shari'ah review refers to a day-to-day continuous oversight over the Sacco's daily transactions and ensuring that they are in line with the laid down Shari'ah principles. This is accomplished by a Shari'ah compliance/review officer who reports to the Shari'ah manager, who in turn reports to the Shari'ah Supervisory Board.
- On the other hand, Shari'ah audit refers to an afterwards periodic audit of the Sacco's activities whether financial or non-financial, and thereafter express an opinion on whether they were done within the Shari'ah requirements.

#### 3.1 Roles of the compliance officer

- The supervision of the daily Islamic Saccos' transactions for the purpose of Shari'ah compliance is one of the main functions of Shari'ah compliance officer through the compliance officer.
- He should continuously review and ensure that there is no any investment in companies with unacceptable business lines which produce or aid those who produce prohibited products and provide prohibited services.
- He should also ensure that financing modes that are linked to fixed rates of return and investments in capital markets conform to Shari'ah principles. Any income from investment in equities of prohibited companies or from Riba will have to be given in charity and should make sure it has been credited to charity accounts.
- The review officer should also clearly specify detailed controls and monitoring in respect to Shari'ah compliance that have to be carried out for the different modes of financing, in particular for modes which are susceptible to be used as back-door to interest such as Murabaha, Diminishing Musharaka and Ijarah. For example, in case of Diminishing Musharakah, he should oversee the different documents relating to creation of partnership, agency agreement, leasing and sale of units to the other party, all expenses relating to ownership must be borne by the parties in the proportion of their ownership, and the rate of Musharakah payments should be net of such expenses. The officer should also ensure that no rental should be charged if the jointly purchased asset is not capable of being leased, such as not being in the possession of the lessee. The officer should also ensure that profit on deposits mobilized through Musharakah are distributed among shareholders and various categories of depositors according to disclosed criteria and ratios, and that any loss is borne by the partners exactly in proportion of their share in the joint investment. He should also ensure that accounting on all products follows AAOIFI's Accounting Standards. The officer must ensure that in transactions that require the Sacco to

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physically or constructively have legal title of ownership, the asset is transferred to the Sacco before it sells the commodity to the customer, and that it retains all risks and rewards related to ownerships till the goods are sold to the customer. There should also be a control on documentation requirements to ensure that are being properly fulfilled and no change in the master agreement should be allowed without the board's prior approval.

- Another area of review is the general staff knowledge in regard to Shari'ah matters in their fields of expertise, and in general. Staff should also present themselves in Shari'ah acceptable apparels and live the Islamic ethics and morals in their interactions among themselves and towards the clients.