

Shariah Governance and Assurance Practices: Expert-Driven Solutions for Ar-Rahnu Cooperatives

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ABSTRACT

Developing a strong and comprehensive Shariah governance and assurance system is essential for Ar-Rahnu cooperatives to boost the level of Shariah compliance, protect their reputation, and fulfill the interests and expectations of shareholders and stakeholders. Potential Shariah compliance risk (SCR) to the Ar-Rahnu cooperatives influenced by deficiencies in Shariah governance and assurance processes. Thus, this study aims to gather perspectives from industry experts on strengthening the Shariah governance and assurance aspects in Ar-Rahnu cooperatives. The qualitative research design underpinned this study, and the purposive sampling method guided the selection of the study's sample. An interview was employed for data collection involving eight respondents comprised of key governance bodies of cooperatives. The results of the study highlight the need for a strong Shariah governance and assurance structure, which can be accomplished by effective collaboration among cooperative management and regulatory entities. A good governance system and adherence to Shariah aspects significantly enhance the reputation of an Islamic-based sector and the sustainability of Ar-Rahnu cooperatives in the country.

Keywords: Shariah governance, Assurance, Ar-Rahnu, Cooperative.

INTRODUCTION

Compliance with Shariah law is the key element and salient feature of the Islamic financial sector. For the Islamic financial sector, the financial business engages in a fair transaction based on a Shariah contract; activities must be clear from unlawful items, and there must be no exploitation in the business. These principles reflect the accountability and justice held by Islamic finance sectors, which are not only for the sake of profit maximization but also for social benefit and the ultimate goal of achieving commands of Allah s.w.t. They are accountable to Allah s.w.t. and, most importantly, utilize the resources according to the rules stipulated in the Al-Qur'an, Surah Al-Anbiya:

“And we also made them leaders, guiding(mankind) by Our command, and inspired them to do good deeds, performing As-Salah (prayer) and the giving of zakat. And they were devoted to Our worship. (Al-Qur'an. Al-Anbiya 21: 73)

Despite adhering to Shariah-compliant aspects, having mechanisms to assure Shariah compliance is paramount for the Islamic financial sector. It is vital to prohibit impermissible elements such as *riba*, uncertainty, and unethical conduct in their business and services. Therefore, there must be appropriate mechanisms to monitor, supervise, and control the

business of Islamic financial sectors to emulate Islamic values in all aspects. Having robust Shariah governance and assurance practices is essential to ensure the institution's operations align with Islamic rules.

Ar-Rahnu cooperatives are one of the pioneers in the business of Islamic pawn broking, formally known as Ar-Rahnu in the country. Cooperatives began to flourish in Malaysia in the early 1920s. The establishment of cooperatives is to enhance the social and economic welfare of their members (Issyam et al., 2016). In the year 2022, out of 15,315, there are 566 cooperatives that offer credit to the communities (SKM, *Laporan Tahunan* 2023).

However, a number of challenges and issues have been identified in conjunction with the increasing number of cooperatives that engage in Ar-Rahnu business. Ar-Rahnu's business faces a variety of risks, including operational and Shariah-compliant risks. For instance, the practice of charging extra costs as a benefit or profit in *Rahn* financing could potentially trigger a Shariah issue, leading to the imposition of interest (*riba*) on the loan amount. This issue reflects the weakness of the Shariah function and management to ensure adherence to the Shariah rules. Trust, accountability, and compliance with Shariah elements are vital foundations for conducting the business of Ar-Rahnu (Abdul Hamid et al., 2014).

A sound and robust Shariah governance and assurance practice is important for Ar-Rahnu Cooperatives to enhance the quality of Shariah compliance and thus protect and fulfill the interests, expectations, and demands of the shareholders and stakeholders of Ar-Rahnu Cooperatives. Therefore, the study aims to explore the perspectives of industry professionals in strengthening the Shariah governance and assurance practices. Practitioners' view is essential to gain practical insight, address the current challenges, and enhance the effectiveness of the governance framework in achieving *maqasid Shariah*.

LITERATURE REVIEW

The Growth and Performance of Cooperatives.

Cooperatives have played significant roles in the country to uplift the standard of living of their members and contribute to the social benefit of society. Since its establishment, Cooperatives have demonstrated consistent enhancement in delivering products and services to its members and the community. *Suruhanjaya Koperasi Malaysia* (SKM) is the government entity under the Ministry of Entrepreneur and Cooperatives Development (MECD) and authorized entity to supervise nine cooperative functions.

Table 1 shows the performance of cooperatives, including the numbers of cooperatives by function, the value of assets, and turnover, which indicates the performance of the cooperatives in 2022.

Table 1
Summary Statistics of Cooperatives by Function Interim 2022

No.	Function	Numbers of Cooperatives	Asset (RM million)	Turnover (RM million)
1.	Banking	2	124,878.15	34,263.45
2.	Credit	566	15,878.66	4,217.30
3.	Services	4,377	10,660.46	3,188.31

4.	Agricultural	3,451	4,006.06	1,579.23
5.	Consumer	5,567	2,547.19	1,316.64
6.	Housing	308	1,042.99	128.14
7.	Transportation	471	389.63	710.02
8.	Construction	256	121.86	71.67
9.	Industrial	3,57	82.79	27.57
Total		15,315	159,607.79	45,502.33

Source: SKM, Interim Statistic (2022)

Based on Table 1 the nine functions of the cooperatives include banking, credit, services, agriculture, consumers, housing, construction, transportation, and industry. Total cooperatives in 2022 were 15,315 cooperatives with RM159,607.79 million of assets and RM45,502.33 million turnovers. At present, there are growing numbers of cooperatives involved in the business of Ar-Rahnu, and most of them indicate progressive performance in the market. According to the 100 best cooperatives statistic, Ar-Rahnu activities amounted to RM32 billion (84%) of the total earnings of the cooperative movement (RM37.89 billion) (SKM, *Laporan Ekonomi Sektor Koperasi*, 2021).

Shariah Governance of Ar-Rahnu Cooperatives.

Numerous studies highlight the accomplishments of Ar-Rahnu in helping to serve the community, particularly low- and middle-class borrowers. Studies by Shukor & Sabri, (2013) mentioned that Ar-Rahnu provides financial assistance, especially during critical times. Furthermore, Nur Hayati & Markom, (2014) it stated that Ar-Rahnu fulfills its social obligation by serving the community by helping them to finance educational needs, medical costs, agricultural sectors, and village industries. Besides, studies Md Noor et.al., (2020) also highlighted the contribution of Ar-Rahnu during the crisis in serving the community, which needed immediate cash for their survival and emergency needs. The contribution of Ar-Rahnu to the community can't be denied.

Ar-Rahnu is currently being served by various Islamic institutions, including Islamic banks, Islamic bank cooperatives, Islamic cooperatives, and private entities. As Islamic-based sectors, Ar-Rahnu cooperatives are obligated to implement Shariah governance. Shariah governance is defined as:

“Shariah governance is integral to Islamic financial system stability. The institutionalization of a sound Shariah governance framework strengthens public confidence in the aims, management, and business operations of the Islamic financial institutions”

Source: BNM, SGPD (2019)

The fundamental objective of Shariah governance is significantly beyond the objectives of corporate governance. The aim was not only to meet the objectives and goals of shareholders and stakeholders but also to ensure the institution remained viable and growing without compromising the principle of Shariah. The foundation of Shariah governance involves the connection between the spiritual and material paradigms (Bhatt, 2008). Meanwhile, Shariah assurance is the process or stage where the Islamic institutions not only ensure the Shariah-compliant aspects but, at another level, enhance the Shariah-assurance, particularly Shariah audit practices within the cooperatives.

Started in the year 2015, GP 28 *Garis Panduan Shariah* was established by SKM to strengthen the Shariah governance aspects. SKM formed GP 28 in response to community demand for cooperative activities carried out in accordance with the rules of Shariah (Musa et al., 2018). The guideline is applicable to Islamic cooperatives that conduct banking activities, offering credit, financing, and Ar-Rahnu. The introduction of the GP 28 guideline aims to enhance the effective responsibility and accountability of the members of the organization, including the board of directors, Management, and Shariah Committee, to lead business according to Islamic rules.

The introduction of GP 28 indicates positive action taken by the SKM as the authority party to support the aims of Malaysia's government to strengthen the Shariah governance structure in the Islamic financial sector.

Nevertheless, Ar-Rahnu cooperatives are exposed to a few external and internal influences, some of which may cause significant damage to the reputation of Ar-Rahnu cooperatives. The existence of Shariah non-compliance (SNC) activities is the reason for reputation risks that can trigger Ar-Rahnu failure and cause systemic risk. These challenges influenced the need for effective Shariah governance and assurance functions in the Ar-Rahnu cooperatives. Insights and opinions from experts in the field are crucial for enhancing the Shariah governance and assurance structure of Ar-Rahnu cooperatives.

METHODOLOGY

This study uses a qualitative method, which employs a case study approach. According to Yin, (2001), a case study is an empirical method that examines a current phenomenon (the "case") in depth and within its real-world environment, particularly when the distinctions between phenomenon and context are unclear. In other words, the researcher aims to comprehend a real-world scenario and believes that such an understanding is necessary. For the purpose of this study, which was to obtain insights from experts on strengthening the Shariah governance and assurance practices, the case study approach was selected as the most appropriate method.

The sample involved Islamic credit cooperatives that provide the Ar-Rahnu scheme, and the respondents were those working in Islamic cooperatives but in different sizes of cooperatives and different positions. The semi-structured interviews with the industry experts involved four key governance organs: branch managers, board members, Shariah officers, and senior management. Interview questions focus on the current practice of Shariah governance and assurance, and the recommendation from the professional experts to strengthen the Shariah governance and assurance practices in Ar-Rahnu cooperatives. They are experienced, knowledgeable individuals and most of the respondents have 10 to 20 years of working experience in the financial sector.

A total of eight practitioners from different positions were interviewed. The real names of the interviewees will not be publicized, and their information will be kept confidential (Wiles.,2008). The interviews were documented and subsequently transcribed. The thematic analysis method was employed for data analysis.

EMPIRICAL RESULTS

Based on the findings, several perspectives and recommendations were given by the interviewees. Most of the interviewees are dissatisfied with the available Acts and guidelines for Ar-Rahnu cooperatives, and they are aware of the obligation of each cooperative to adhere to the GP28 *Garis Panduan Syariah*. There should be a new Ar-Rahnu guideline as guidance since the previous Ar-Rahnu guideline was terminated. The revision of the GP 28 guideline is essential. The guideline should be revised in accordance with the present context if to strengthen the Shariah governance and assurance aspects for Ar-Rahnu cooperatives. Furthermore, the interviewee emphasizes the need for the Ar-Rahnu Act. The following quote articulates this opinion, as shown in Table 2.

Table 2

Response from Interviewees on Legal Aspects

Response	Subjects/ Theme	Recommendation
<p><i>Alhamdulillah</i>, we have obeyed. We have made sure from the beginning that we comply with the guidelines of GP 28. But we do not yet have a specific Act for Ar-Rahnu” (Interviewee 1)</p> <p>“we have complied with the Shariah governance elements prior to the establishment of GP 28.”(Interviewee 2)</p> <p>The implementation of Shariah has already been done.”(Interviewee 3)</p>	<p>Compliant to Shariah Governance guideline</p>	<p>Propose new Act for Ar-Rahnu & revision of current</p>
<p>“Current regulations are highly retrograde and prevent cooperatives from implementing Shariah governance. I also would like to comment regarding GP25 <i>Garis Panduan Pajak Gadai Islam</i>; it no longer suits the current market situation because when <i>tawarruq</i> was introduced as the current Shariah contract in Ar-Rahnu, there was no guideline to be referred to.” (Interviewee 4)</p>	<p>Issues on Legal aspects</p>	
<p>“Actually, the Act from the MCSC is outdated.” (interviewee 5)</p>		

Secondly, the interviewees express the need to strengthen the internal Shariah function. Operating with only Shariah secretariat functions in Ar-Rahnu may ineffectively solve any Shariah issues encountered in the business of Ar-Rahnu. The roles of Shariah functions; Shariah Secretariat, Shariah Review, Shariah Audit, and Shariah Risk are needed for the cooperatives under the categories of "premier" and "100 best cooperatives." Responses received from the interviews indicate that most of the interviewees agree with the need for Shariah control functions in their cooperatives. They are aware of the importance of having a Shariah Review, Shariah Risk, and Shariah Audit function in strengthening the quality of Shariah-compliant practice. At present most of the cooperatives only have the Shariah Committee and Shariah secretariat officer. For the aspects of Shariah assurance, most cooperatives conduct conventional audits and have not yet implemented Shariah audits except bank cooperatives. This is based on the following quotes in Table 3.

Table 3
Response from Interviewees on Legal Aspects

Response	Subjects/ Theme	Recommendation
<p>“SC in the cooperative itself is still not ready to run a business based on Shariah. It does not have a complete Shariah advisor”. (Interviewee 6)</p> <p>“From my point of view, when we offer Islamic products, the Shariah control function is compulsory.” (Interviewee 7)</p> <p>“Shariah auditing is something new in the bank and not yet practiced in the non-banking sector” (Interviewee 8)</p> <p>Perhaps what I can suggest is that cooperatives should have a list for Shariah audits and a uniformed audit monitoring list. (Interviewee 2)</p>	Shariah function	Strengthen Internal Shariah audit and Control function

Thirdly, the competency aspects. The competency of cooperative members is one of the important factors that may contribute to the successful implementation of Shariah governance and assurance in Ar-Rahnu cooperatives. Starting from the top, board members in cooperatives until the business unit line officers should enhance their knowledge, skill, and experience in the business and Shariah aspects. Most of the cooperative’s auditors are not clear on how to conduct the Shariah audit. The skills of the cooperative’s members can be improved through intensive training either from the cooperative itself or from an external body, such as training provided by IKMA. The following quotations as mentioned in Table 4.

Table 4
Response from Interviewees on Competency

Response	Subjects/ Theme	Recommendation
<p>“As far as I’m concerned, some of the management members do not have high qualifications. A branch manager only requires experience and certain training to become qualified to become a branch manager.” (Interviewee 1)</p> <p>“The board needs to have the knowledge, experience, and comprehension to comprehend issues in business.” (Interviewee 3)</p> <p>“SKM, through IKMA, can conduct Shariah governance module training for internal and external Shariah audits.” (Interviewee 4)</p>	Competency	Enhance competency through internal or external

Fourthly the discussion further received an interesting response from interviewee 2, where he highlighted the adoption of "Shariah culture" in Ar-Rahnu cooperatives. A holistic Shariah culture and Shariah awareness must be emphasized to all cooperative management. It is not only the responsibility of the Shariah Committee, Shariah Officers, or Shariah Audit but also of each cooperative's management to ensure that the entire process, from top to bottom, adheres to Shariah rules without exception.

“I would like to suggest that this Shariah guideline should emphasize the implementation of Shariah compliance from the perspective of "culture”.

We want a holistic culture; even at the level of business units and operations, they know about Shariah compliance” (Interviewee 2)

Based on the findings, the majority of the interviewees agree that the Shariah governance and assurance aspects must be strengthened. The summary of the recommendations from the practitioners is illustrated in Figure 1.

Figure 1

Recommendations to Strengthen the Shariah Governance and Assurance for Ar-Rahnu Cooperatives



CONCLUSION

As an Islamic-based sector, Ar-Rahnu cooperatives should operate in a manner that upholds Islamic values, avoiding prohibited elements in Islam and emphasizing Islamic ethical values that contribute positively to society. The study's findings highlighted that the practice of Shariah governance and assurance still required improvement, and the study's recommendations should be considered to reduce potential Shariah-compliant risks. Practically, this study may provide valuable information to the Ar-Rahnu providers, particularly cooperatives and regulatory bodies, to propose a good Shariah governance and assurance framework for Ar-Rahnu cooperatives.

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