



SHARIYAH
REVIEW BUREAU



SHARIA GOVERNANCE: WHO DOES WHAT?

Simplifying What
Consumers Should Know



Dec 2022

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INTRODUCTION

In the last 10 years, Sharia governance of Islamic financial institutions in the GCC and Asian countries has grown significantly, as a result of successive waves of regulation. However, many assume that all of the 'front end' information published by institutions offering Sharia compliant transactions in different parts of the world are subject to the same level of governance and scrutiny than they actually are. This is a common misconception because many of the offerings worldwide do not have the same level of Sharia governance checks and measures in the same way as in developed and mature jurisdictions like Bahrain, UAE, Oman, Malaysia, Pakistan and most recently Kingdom of Saudi Arabia. The only procedures being offered by institutions in different parts of the world is the assignment of a Sharia Board to review and certify their product. As readers of this paper will see this is not enough because all of the players in the Sharia governance system are collectively responsible in different ways for ensuring investments, transactions and activities pass the test of Sharia compliance.

Sharia compliance and its ongoing assurance needs to improve, and everyone involved – including the investors and consumers – need to play their part. We hope this paper helps provide an overview of the key actors making up Sharia governance and the role each function plays.



WHAT IS SHARIA GOVERNANCE?

When companies decide to offer Sharia compliant products or choose to operate their entire business in a Sharia compliant way then they are expected to create a system to manage the Sharia compliance of their activities. This system is made up of structures and processes that define the set of relationships to govern all the business activities and are designed to ensure accountability and transparency.

WHAT DOES IT MEAN TO BE "SHARIA COMPLIANT"?

It is a "status" which confirms that the activity of an entire business or only its product, service or investment complies with the specifications of the Sharia standard being used such as but not limited to AAOIFI Sharia standards, rulings of the Central Sharia Board of the respective jurisdiction, approvals and rulings given by the Sharia Supervisory Board of the IFI (as the case may be). It should be noted that current use of the term "Sharia-compliant" generally refers to the Sharia ruling as per the review and interpretation of the participating Sharia scholar or Sharia Supervisory Board typically in conformance to the four primary schools of Islamic jurisprudence namely Hanafi, Shafi'i, Maliki and Hanbali rites.

WHAT IS A SHARIA SUPERVISORY BOARD?

A Sharia Supervisory Board (“SSB”) is an independent committee of two or more qualified Sharia scholars [jurists] specializing in contemporary transactional jurisprudence, who are well acquainted with and experienced in the Islamic financial system in particular and the Islamic economic system in general. They issue binding Sharia pronouncements (certificates) and recommendations, and oversee the task of supervising the institution*. In developed jurisdictions, regulatory authorities** require IFI’s (or conventional institutions offering Sharia compliant products) to assign an SSB and submit annual Sharia compliance reports that are accurate, truthful, and complete and prepared according to a set of rules directed by the regulator themselves. In mature jurisdictions like Bahrain, Oman and Pakistan the Sharia controls and transactions - including those stated in the company's Sharia compliance report and those provided to shareholders must be examined and reported on by an independent external Sharia auditor.

Who is a Sharia scholar?

(S)he is a specialized jurist who has pursued academic and intellectual activities in Fiqh al-Muamalat (Islamic commercial jurisprudence) with particular expertise in Islamic law and contemporary transactional jurisprudence. A Sharia scholar may be an academic, who works as a professor, teacher or researcher at a university or other higher Islamic education institution.



*[source: IFSB Terminologies].

**see regulations of CBB (Bahrain), CBUAE-HSA (UAE), CBO (Oman), SBP (Pakistan) and SCM (Malaysia).

What is a Sharia Certificate?

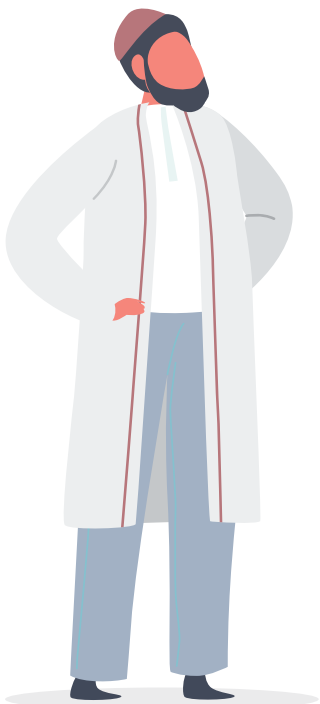
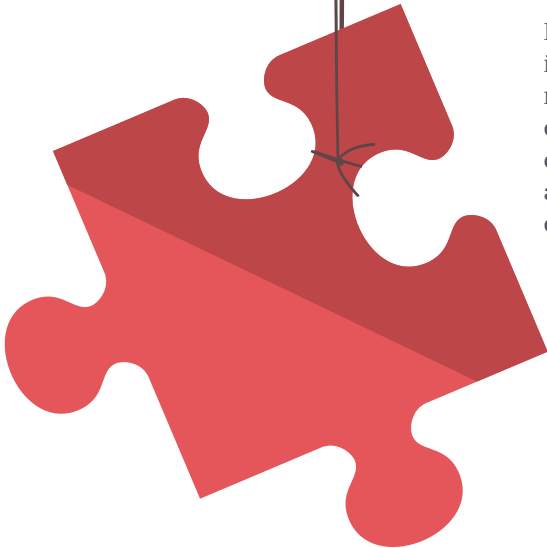
This is a document in which the Sharia Supervisory Board expresses its opinion, based on the appropriate methodology, that the product or financial offering or institution in question meets specific requirements of Sharia standards. The Sharia Certificate is issued after conducting a comprehensive examination of the legal documents making up the product, service, offering or institution (as the case may be).



DO SHARIA SUPERVISORY BOARDS CONDUCT AUDIT?

In mature markets Sharia Boards have a responsibility of conducting annual supervisory assessments. These are not audits rather a review-based assessment involving the examination of the extent of an IFI's compliance during a specific time period including assessing contracts, agreements, policies, products, transactions, financial statements etc. This assessment is conducted for the purpose of measuring the compliance of executed transactions and related operations in light of Sharia standards upon which the Sharia certificate was issued.

However, things are less straightforward in markets with no Sharia governance requirements. Therefore, you are advised to reach out the company of your interest and ask specific questions on the role, responsibility, limitations and nature of Sharia assurance (if any) being offered by the representative Sharia Board.



How to identify well-structured Sharia governance structures?

This is an interesting question for many investors. If your company is regulated in jurisdictions like Bahrain, UAE, Oman, Malaysia and Pakistan, you don't have to worry about Sharia governance as the regulators, through various means, ensure the effective deployment of such structures. However, consumers living in countries with no or little regulation should carefully check the following aspects:

- Does the company have an established Sharia Board? What information is disclosed about the members (or the Sharia advisory company) other than the profiles of the scholars?
- Does the company have a dedicated in-house Sharia auditor?
- Does the company have a Sharia certificate specific to each product. Check when the certificate was signed?
- Check the scope of certification. Is the entire business operations and all activities certified or is it selected products? The certificate should detail the scope of activities being validated from a Sharia perspective. Sometimes a single portfolio is certified, and maybe not the portfolio you're interested in!
- Check if the scholars who signed the certificate are responsible for ongoing Sharia supervision or were only responsible for reviewing the documents one time? In case of ambiguous wordings, you may wish to contact the scholars yourself to check whether he is still responsible for the Sharia supervision or not.
- Enquire how frequently the Sharia scholars do a Sharia audit? You will need to request for the latest copy of the Sharia audit report.
- Enquire why the company does not have an external Sharia audit arrangements.

Most companies will have no qualms about providing the aforementioned information because if they've genuinely put in the effort to maintaining Sharia compliance, what do they have to hide?



WHAT IS INTERNAL SHARIA AUDIT?

Like an internal financial audit of a company, the internal Sharia audit function is designed to provide assurance, in the form of an opinion, to those charged with Sharia governance in respect to adherence of the IFI with the Sharia rulings as laid down by the IFI's respective Sharia Supervisory Board. According to the Central Bank of Bahrain "this involves giving an opinion whether adequate internal controls have been designed and implemented and that adequate governance structure is in place for proper functioning of the IFI in line with Sharia principles and rules and relevant governance requirements and that the management has established adequate risk assessment criteria and management mechanism to ensure compliance with Sharia principles and rules and to cater to the specific risks related to Islamic finance transactions."*

How Can I Find Out Who Conducts the Internal Sharia Audit of a Particular Company?

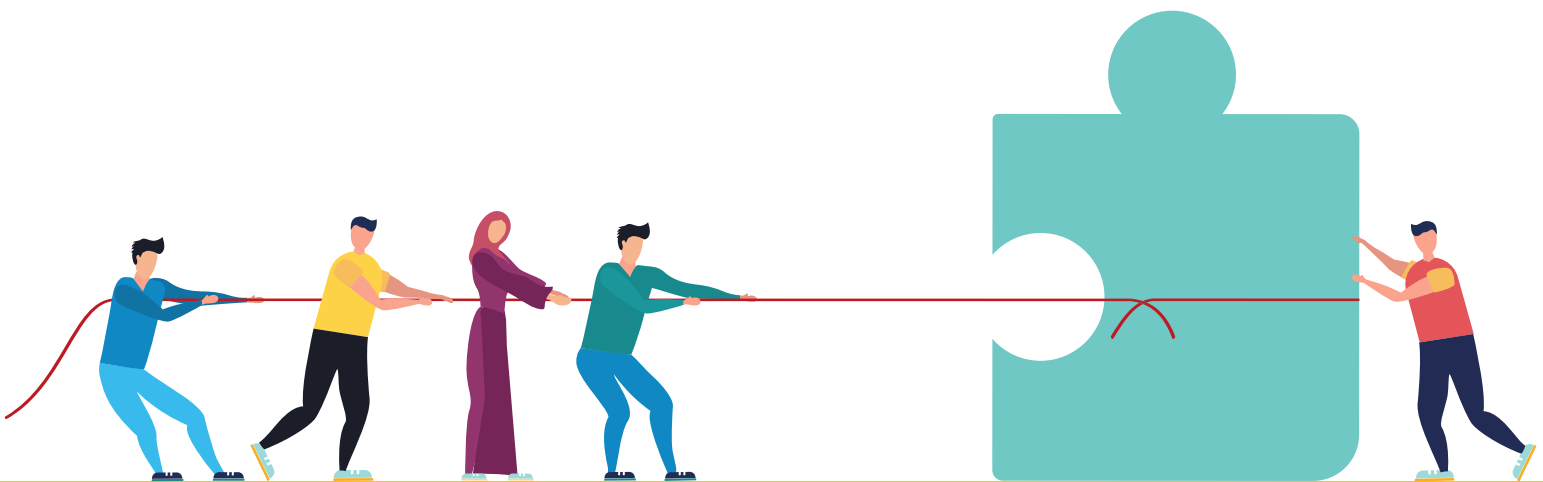
In well governed jurisdictions like Bahrain this function is a "controlled" practice which means the regulator personally ensures that these positions are managed by qualified people with the relevant background and experience. However, this may not be the case in countries with no Sharia governance requirements so you may want to write to the company seeking this information directly. You can also check the information contained in resource materials on the Internet or on the specific company's website or annual report.



* Source: CBB SG module

Key responsibilities of an internal Sharia auditor in Bahrain

- (a) review and examine the adequacy and effectiveness of the Sharia compliance system which cover all aspects of Operations in order to assess the extent of Sharia compliance with the:
 - (1) Sharia principles and rules,
 - (2) SSB's fatawa, guidelines, pronouncements and instructions/ recommendations,
 - (3) the Sharia related regulations, resolutions and directives issued by CBB;
 - (4) the Sharia standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions ("AAOIFI") and
 - (5) the company's internal Sharia related policies and procedures;
- (b) prepare the periodic Sharia audit reports to the SSB, Audit Committee and the CEO based on the audit plan for consideration and appropriate action;
- (c) follow up to ascertain whether appropriate action has been taken on the reported findings and recommended actions and any other recommendations relating to Sharia matters made by the SSB, the independent external Sharia compliance audit and the CBB;
- (d) prepare the internal Sharia audit plan to be approved by the SSB on an annual basis; and
- (e) review the nature of charity transactions made for purification, the causes of non-compliance and establish procedures and processes to ensure that such cases are not repeated in the future;



WHAT IS EXTERNAL SHARIA AUDIT?

This is a fairly new practice in the Islamic financial industry and its principal purpose is to form an opinion on whether the IFI complies with the Sharia principles and rules applicable to its financial arrangements, contracts and transactions during a specific period based on a specific set of Sharia principles and rules contained in the criteria like AAOIFI Sharia standards, regulatory Shari'ah requirements, rulings of the Central Sharia Board for the respective jurisdiction, approvals and rulings given by the Sharia Supervisory Board of the IFI (as the case may be).

In Bahrain this reasonable assurance engagement is conducted in light of international assurance standards, namely, ISAE 3000 - Assurance Engagements other than Audits or Review of Historical Financial Information on control procedures relating to Sharia compliance and governance structure and management's assertion on the design and operating effectiveness of these controls.

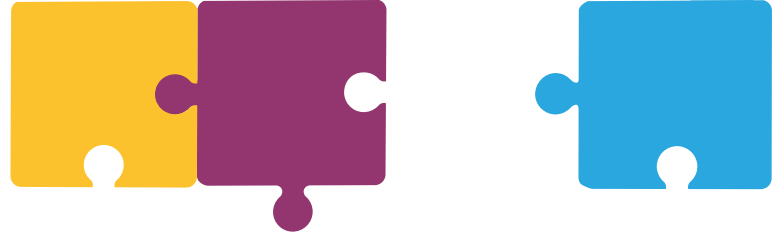
What is ISAE 3000 and how is suitable for Sharia compliance subject matters?

International Standard on Assurance Engagements (ISAE 3000) is a principles-based international assurance standard issued by the International Federation of Accountants (IFAC) for assurance over non-financial information. It is generally applied for audits of internal control, sustainability and compliance with laws and regulations. Given its capability of being applied effectively to a broad range of underlying subject matters, it provides a basis for Sharia compliance subject-specific engagements.

What are the requirements for ISAE 3000?

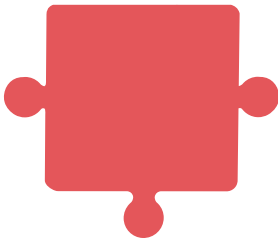
The ISAE 3000 requirements are included on the IFAC website which can be downloaded [here](#). The standard includes the following components: Ethical Requirements (under the IESBA code), Quality Control procedures (ISQC 1 requirements), Planning and Audit procedures, Reporting requirements, and Professional Skepticism. The five key components of the assurance engagement under this standard are:

- A three-party relationship involving: the external Sharia auditor, a responsible party and intended users.
- Appropriate subject matter.
- Suitable criteria.
- Sufficient, appropriate evidence to support the conclusion.
- A conclusion contained within a written report.



How to check for Sharia governance?

- > Is there an assigned Sharia Board?
- > Assess what information is disclosed about the Sharia Board other than the profiles of the scholars?
- > Ask for the Sharia certificate and check its issuance date?
- > Review the content of the certificate carefully to understand the scope and its limitation
- > Request for Sharia audit report
- > Check the scope of Sharia audit. Is the entire business operations and all activities certified or is it selected products?
- > Enquire if the company has internal or external Sharia audit
- > Request for Sharia audit report. Given the sensitivities some companies may not be able to share the audit report. In such a scenario you can request for a Sharia advisory account which is a briefing issued by the Sharia Board confirming the health of the company from a Sharia perspective.
- > Check when the last audit was done by the Sharia Board. If more 24 months have passed from the last audit date then enquire why there has not been any audit four the previous fiscal year.
- > Enquire if the company has an internal or external Sharia audit arrangement



WHAT ELSE SHOULD YOU KNOW?

Claiming Sharia assurance of an investment or transaction can reap benefits for a company. So if you are a client who has invested (or is seeking to invest) with a company because it calls its product or transaction Sharia compliant then you need to go beyond the traditional checks of a certificate and evaluate the Sharia governance structures from qualified Sharia officers to internal Sharia auditors and external Sharia assurance providers.



Disclaimer

While every attempt has been made to ensure that the information included in this document is accurate, it is intended ONLY as a guideline towards the subject of Sharia governance and should not be regarded as (or used in lieu of) legal advice. Shariyah Review Bureau will not, therefore, accept any liability for the consequences of any actions taken, or decisions made upon the information offered in this document.