



Issues and Challenges in Developing Shariah Governance and Shariah Audit in Islamic Cooperatives

Shariah
Governance

Isu dan Cabaran dalam Membangunkan Tadbir Urus Syariah dan Audit Syariah dalam Koperasi Islam

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ABSTRACT

The development of Shariah governance and audit in Islamic Cooperatives in Malaysia is one of the primary concerns since some issues were raised throughout the process. Islamic cooperatives in Malaysia are regulated by Suruhanjaya Koperasi Malaysia (SKM), which aims to encourage the growth of cooperatives that comply with Shariah. Islamic cooperatives operate their business under supervision from SKM regarding governance and Shariah perspective. The development of Shariah governance and Shariah audit support the Shariah compliance system that already operates in most Islamic institutions. During the Shariah governance and audit process, some issues are addressed during the development, which involves guidelines, Shariah auditor competency, staff skills, and governance and Shariah audit of the cooperative sector. The study's approach included an interview with practitioners from cooperatives, auditors, and experts in the industry. This paper aims to identify the issues and challenges of Shariah governance and Shariah audit in the Islamic cooperative sector. The study will contribute to one of the key critical elements in strengthening the Shariah governance and Shariah audit in the cooperative sector.

Keywords: Shariah audit, Shariah Governance, microfinance institutions, cooperative, Ar-Rahnu





ABSTRAK

Pembangunan tadbir urus Syariah dan audit dalam Koperasi Islam di Malaysia merupakan salah satu kebimbangan utama memandangkan beberapa isu telah dibangkitkan sepanjang proses tersebut. Koperasi Islam di Malaysia dikawal selia oleh Suruhanjaya Koperasi Malaysia (SKM), yang bertujuan untuk menggalakkan pertumbuhan koperasi yang mematuhi Syariah. Koperasi Islam menjalankan perniagaan mereka di bawah seliaan daripada SKM berkaitan tadbir urus dan perspektif Syariah. Pembangunan tadbir urus Syariah dan audit Syariah menyokong sistem pematuhan Syariah yang telah beroperasi di kebanyakan institusi Islam. Semasa proses tadbir urus dan audit Syariah, beberapa isu ditangani semasa pembangunan, yang melibatkan garis panduan, kecekapan juruaudit Syariah, kemahiran kakitangan, dan tadbir urus serta audit Syariah sektor koperasi. Pendekatan kajian termasuk temu bual dengan pengamal daripada koperasi, juruaudit, dan pakar dalam industri. Kertas kerja ini bertujuan untuk mengenal pasti isu dan cabaran tadbir urus Syariah dan audit Syariah dalam sektor koperasi Islam. Kajian itu akan menyumbang kepada salah satu elemen kritikal utama dalam mengukuhkan tadbir urus Syariah dan audit Syariah dalam sektor koperasi.

Kata kunci: Audit Syariah, Tadbir Urus Syariah, institusi kewangan mikro, koperasi, Ar-Rahnu

INTRODUCTION

Most of the cooperatives carry out Shariah-based activities in their institutions, such as Ar-Rahnu, also known as Islamic pawnbroking. Cooperative sectors have evolved in Malaysia's Islamic financial contracts and have continued to grow and become Islamic cooperatives. Due to the implications of Malaysia's rapid growth of the Islamic banking industry from the 1980s to the present, the creation of a Shariah-compliant cooperative sector is growing fast (Hassan, Samad, & Shafii, 2018). Business activities based on Shariah in the industry are encouraged to operate based on Shariah governance and perform Shariah audits to ensure the effectiveness of Shariah compliance. The main objectives of Shariah governance and Shariah audit practices are to improve the integrity of the cooperative sector and increase Shariah compliance.

Addink (2019) defines good governance as an appropriate use of the regulator's responsibilities and obeying the established regulations. A good governance structure can assist the organization in attaining its objectives while ensuring that all partners maintain a high standard of accountability. As a result, it is also suggested by Samad & Shafii (2021), that effective governance is essential for long-term efficiency. In terms of Shariah governance, it is a form of institution, for instance, cooperatives, that makes sure the management, board of directors, and Shariah Committee are effectively responsible and accountable for developing an environment where businesses operate following Islamic principles (Samad & Shafii, 2021). Shariah governance organs in the cooperative include Board of Directors, Board Audit Committees, Shariah committees, internal audits, and management that helps to govern Islamic cooperatives. Any organization, including cooperatives, must have good governance to fulfill its



established purpose Shariah governance guidelines is also needed to provide clear roles of board management, establishing Shariah Committees, and other aspects to enhance the credibility and soundness of the cooperatives. The most important in Shariah governance and audit are Islamic cooperative's regulations, frameworks, and guidelines that will boost stakeholder confidence that the operations and activities comply with Islamic law. Shariah audit is part of the Shariah governance in the Islamic cooperatives.

Shariah audit provides a fair assessment and objective assurance to improve institutions (Shariah Governance Policy Document, 2019). Shariah audit should perform a broad coverage of the audit scope and not just ensure the proper internal control of the operation; however, it should cover Shariah aspects. The Shariah audit scope must cover all Shariah areas in operating cooperatives that conduct Shariah-based operations. To ensure the effectiveness of a Shariah audit, the Shariah auditor must have good knowledge of accounting and Shariah, and competency is the main challenge, especially in the Islamic sector. Shariah audit elements are one of the key elements in ensuring the cooperatives sector conducts operations in Shariah compliance. It can be seen; that a Shariah audit is crucial to ensure the effectiveness of Shariah governance in Islamic institutions as Shariah audit is part of Shariah Governance.

Islamic cooperatives were the main subject of this study since there are significant numbers of them in Malaysia. The issues and challenges with Shariah governance and auditing in the cooperative sector will be the focus of this study. Several issues and challenges arise while establishing and implementing Shariah governance and Shariah audit. Most of the challenges involved the staff, the Shariah auditor, and the guidelines. It is crucial to identify issues and challenges of Shariah governance and Shariah audit in the cooperative sector so that management can rectify the issues and improve the loophole from the governance perspective. These issues and challenges will have some impact on the effectiveness of developing Shariah governance and Shariah audit. Therefore, the study will benefit the Shariah auditor and cooperatives sector to strengthen the Shariah governance of the institutions.

In this study, researchers conducted an interview session with practitioners that included regulators, SKM, internal auditors, and cooperative representatives. Researchers analyzed the findings based on thematic analysis after transcribing the data from the interview session. The analysis will be based on the theme according to the study. The findings will benefit the regulators and management's efforts to address the issues and assist them in reducing the gaps in internal control and Shariah principles.

LITERATURE REVIEW

Shariah Governance and Shariah Audit

In general, governance is the principles under which an institution operates and the process by which its employees are held accountable. Governance is not a single



activity, but the framework and process to operate an institution. As a result, implementing a good governance strategy requires an organized process that includes planning, risk assessment, and performance evaluation. Consequently, a good governance framework can enable an organization to achieve its goals while ensuring sufficient accountabilities for all parties concerned. Therefore, good governance is essential to their long-term effectiveness (Samad & Shafii, 2021). As previously said, the author highlighted the importance of good governance for cooperatives to achieve their goals. Following the same study, Indonesia, and Malaysia supported their economic cooperative movements by developing the necessary laws, regulations, and guidelines.

The efficacy of the Islamic banking system is dependent on Shariah governance, and the same with the Islamic cooperative. Establishing a strong Shariah governance structure boosts public trust in the Islamic Financial institution's governance, management, and business practices (BNM, 2019). Islamic cooperatives could apply Shariah governance in IFI institutions and fit in with the governance structure in cooperatives. Development of Shariah Governance must be formed properly to ensure the effectiveness of Shariah compliance in the institutions. Shariah governance components include the Shariah Committee, management, and Internal auditor. It has been discussed by a previous study on the formation of Shariah Governance, the responsibility of Shariah governance components, and the importance which boosting public trust in the institutions and achieving the effectiveness of Shariah compliance in Islamic cooperatives (GP28 Garis Panduan Tadbir (2015), Surkery & Yaacob (2019), Samad & Shafii (2021)).

An earlier study by Musa, Shah & Yaacob (2018) found Shariah governance is still new for the cooperative sector. His study on SWOT analysis revealed some weaknesses and threats that each Ar-Rahnu service provider needs to form the Shariah governance properly. Strengthening the Shariah governance process in cooperatives requires support from the Shariah Committee, Internal audit, management, and the Board of Directors. These components are fundamental criteria that each Islamic cooperative must have. By introducing the GP 28 Garis Panduan Tadbir Urus Syariah, which supports Shariah governance, the SKM has continued to strive to improve Shariah principles in the cooperative sector. The guideline applies to cooperatives involved in Shariah compliance activities, including banking, microcredit and Ar-Rahnu activities.

The roles of each Shariah governance organ, such as the Board of Directors, Shariah Committee, Management and Cooperative, are outlined in GP 28 Garis Panduan Tadbir Urus Syariah, 2015. The Board of Directors is responsible for monitoring the performance of the Shariah Committee, responsible for the overall governance compliance of the cooperative based on the advice of the Shariah Committee, ensuring effective communication within the organization, and ensuring the Shariah Committee understands their fiduciary responsibility. The Shariah Committee needs to identify the issues of concern and propose preventive and corrective measures. Besides, the Shariah Committee must be aware and responsible for all the decisions, views, and opinions relating to the Shariah matter. The Shariah Committee will supervise



Shariah related to the business and report directly to the Board of Co-operatives. Management is responsible for implementing the decision made by the Shariah Committee, ensuring the Shariah's policies and procedures can be accessed at any time and referring Shariah issues to the Shariah Committee for its decision and allocating sufficient workforce and providing training to the Shariah Committee in the cooperatives. Lastly, the Internal Audit Committee must ensure an effective internal control and risk management system and monitor the implementation of recommendations and opinions issued by the Shariah Committee. Internal auditors must investigate any matter as directed by the Shariah Committee and inform the Shariah Committee of any suspicious transactions (GP 28 Garis Panduan Tadbir Urus Syariah, 2015).

The concept of a Shariah Governance and audit cannot be entirely conducted in the cooperatives because some aspects are not adequately complete from the viewpoint of governance, management, and products in the cooperative itself, as per a prior study, that found GP28 Garis Panduan Tadbir (2015) still needs improvement (Surkery & Yaacob, 2019). The improvement may take some time, but the most crucial part of the components of Shariah governance is to strengthen the fundamentals of Shariah governance for the cooperatives sector. Shariah governance can boost the identity and development of each element of governance to create more competitive and evolved cooperatives that conduct with integrity (Hassan, Samad, & Shafii, 2018). This highlights the importance of Shariah governance that all cooperatives must start to develop in their institutions.

The study also identifies that the importance of institutions in conducting an audit is to avoid any governance issues. If a Shariah audit is conducted, it can prevent the Islamic institutions from any Shariah issues that might happen. Recently it was reported that there had been a lot of governance issues in cooperative institutions (A Rahman (2020)). Based on the issues, the board of the cooperative sector must play an essential role in ensuring the cooperative can operate based on the regulations required. Even though the case is on governance and not Shariah governance, it still gives insight that Shariah governance should be executed properly to avoid any issues.

Guideline standard in SKM

A few guidelines from SKM have been provided for cooperatives to assist them in carrying on with their operations. To ensure that the activities conducted are practical, guidelines may also strengthen cooperative similarity in terms of operation. Guidelines can be a reference and make it easier for employees to work together and be consistent with their task, which is essential for ensuring that the actions taken are successful. Each of the regulators of companies has its own set of rules and legal requirements to maintain a positive environment of competition in the industry Bahari, Shafii, & Ahmad (2021) including Suruhanjaya Koperasi Malaysia (SKM), which provides guidelines according to the cooperative's business activities.



Bank Negara Malaysia (BNM) regulates Islamic Financial Institutions and provides policy documents for IFIs to operate their businesses earlier than other regulators. Even though BNM does not govern cooperatives, cooperative sectors can apply and adapt some of the processes appropriated from IFI. The guideline provided by Suruhanjaya Koperasi Malaysia (SKM) for cooperatives on Shariah governance is (GP 28 Garis Panduan Tadbir Urus Syariah, 2015). GP 28 describes the procedures and requirements cooperatives must comply with to establish Shariah governance. The guidelines also outline the formation of Shariah governance in cooperatives and the responsibilities of the internal audit Committee, cooperative board, Shariah Committee, and management. GP 28 must be implanted by cooperatives that run financial intermediation activities based on Shariah that involve cooperatives in the following categories or carry out banking, credit, financing, and Ar-Rahnu.

The cooperative that conducts Islamic credit and Ar-Rahnu are required to follow the GP 28 Garis Panduan Tadbir Urus Syariah, (2015), and the guidelines for the respective activities. For instance, cooperatives must follow the GP 6 Garis Panduan Mengenai Kemudahan Kredit oleh Koperasi (2009) oleh Koperasi if they conduct credit activity. Previously, Ar-Rahnu cooperatives followed GP 25. However, Ar-Rahnu is required to follow a new instruction, Arahan Suruhanjaya Koperasi Malaysia Bil. 2 Tahun 2022 – Aktiviti Pajak Gadai Islam (Ar-Rahnu), which becomes effective on November 23, 2022. The new instruction is issued to guide cooperatives in implementing Islamic Pawn Broking (Ar-Rahnu) activities where cooperatives must ensure compliance with Shariah principles in carrying out Ar-Rahnu activities. The updated instructions are more thorough and have some adjustments to the financing limit control, which states that the cooperative will only pay each borrower up to RM 300,000 or 80% of the value of the *marhun*, whichever is less.

Regulators such as SKM are taking proactive action by issuing Shariah guidelines and rules relating to Shariah governance to ensure Shariah compliance with the activities. A previous study by (Bahari, Shafii, & Ahmad, 2021) stated that SKM released GP 28 Garis Panduan Tadbir Urus Syariah, (2015) to strengthen the compliance of Shariah laws by authorized Islamic financial institutions. These guidelines ensure that the activities of all regulated Islamic financial institutions are in line with Shariah requirements. Since Ar-Rahnu carry out Shariah compliance activities under SKM's direction, they are both governed by GP 28 Garis Panduan Tadbir Urus Syariah, (2015), or Shariah laws, and subject to Ar-Rahnu guidelines.

Musa, Shah & Yaacob, (2018) identify that the guidelines provided by BNM for microfinance, which is A-Rahnu, more comprehensively cover the concept of Ar-Rahnu compared to other agencies. Therefore, the efforts made by SKM and Majlis Agama Islam dan Adat Melayu Terengganu (MAIDAM) to explain the modus operandi of the implementation of Ar-Rahnu activities are seen to complement the guidelines provided by BNM. This concludes that the guideline needs to be regularly revised or updated to ensure it is relevant to the current practices of the institutions. Cooperatives must ensure they follow the guidelines to reduce any internal issues or challenges during the execution of the operation.



This can relate to a previous study Asiah et al., (2018) where even though regulators already provide guidelines, there are cooperatives that conduct Ar-Rahnu services that are not guided by a platform that specializes in Shariah. This statement is seen as not complying with the Shariah Governance structure (Asiah et al., 2018). From this result, we can conclude that a lack of governance in the institutions may expose them to failure in the cooperative sector, and, if the Shariah governance is lacking it might affect Shariah compliance for the institutions. However, management and SKM must investigate governance issues and strengthen the development of Shariah governance in Islamic cooperatives.

Shariah Auditor Competency

Knowledge and qualification are the components of the auditor's competency. An interesting point is made regarding the importance of Shariah auditor competency in a previous study by Yusuf (2018) where, there is no required professional Shariah audit framework to follow in IFI. However, the requirement for a Shariah auditor in the cooperative industry can also be adapted based on the procedure for recruiting a Shariah auditor in IFI. According to a recent study Mohamad Puad, Abdullah, & Shafii, (2020) an auditor needs to be well-versed in accounting and Shariah to truly comprehend and conduct a Shariah audit. Besides, a Shariah auditor must be able to make decisions to achieve the institution's purpose. The competency of Shariah auditor is vital to ensuring the Shariah auditor can perform the audit work effectively and meet the objectives.

Competency of a Shariah auditor has been found to be one of the main challenges for institutions to find one and provide training to the Shariah auditor. Mohamad Puad, Abdullah, & Shafii, (2020) agree that competency is the main difficulty, especially for IFIs, and that the Shariah auditor himself should be competent enough to make a judgment to ensure effectiveness. Musa, Shah & Yaacob, (2018) in their finding study on Shariah governance reported that SKM lacks in terms of providing Shariah-related reference. Currently, SKM has limited competence and skills in Shariah to conduct audits in the cooperative sector. The cooperative sector must not only recruit Shariah auditors but also improve their skills by providing training or classes to Shariah auditors. It is suggested institutions such as Institut Koperasi Malaysia (IKMA), SKM, and the cooperative sector shall provide necessary training to improve the Shariah auditor's competency and skills which can contribute to the cooperative goals.

Shariah auditors must be competent in performing their job to conduct audits in Shariah-based business activities. There have also been earlier studies to strengthen Shariah auditor competency in IFI, where the program for Shariah audit training is available (SAT). From the training, management will be able to identify any weaknesses and support the Shariah auditor in strengthening their capabilities (Kamaruddin & Mohd Hanefah, 2017). One of the interviewees in the study is also a graduate of a Certified Professional Shariah auditor program. The CPSA program is meant to provide a few modules for candidates with the appropriate professional skills and technical knowledge for Shariah compliance audit and review processes for the Islamic banking



and finance sector. Shariah auditors for cooperatives are recommended to take part in the training to upgrade their skills and gain a deeper understanding of cooperative business operations.

Lack of Training in the Cooperative Sector

An employee's competency and skill level directly affect the institution's performance. If the institutions have set workplace skills, the employee must comply with the requirement. Most institutions require the staff to comply with academic requirements and skills and provide training to improve their competency level. Some business activities in the cooperative sector have minimum criteria to hire the staff, for instance, having basic knowledge in calculation and Ar-Rahnu activities to ensure at least the staff can perform daily operations. Training sessions could be conducted regularly or monthly to enhance the skills of the employee.

A previous study by Musa, Shah & Yaacob, (2018) identified the internal and external factors to evaluate the strategic management and governance of five different Ar-Rahnu providers. Two Ar-Rahnu providers found from the analysis that one of their strengths is having ethical staff, and one of their weaknesses is having incompetent employees work in Ar-Rahnu. The analysis allows the author to identify the best strategies to improve staff competency. The study proposes that Ar-Rahnu providers continue to provide skill training to increase staff competency and ensure effective operation. Companies can identify the knowledge and abilities they want their employees to have by providing opportunities for development and training. Employees can learn new skills or updates on existing skills through training and development programs, which could improve productivity.

Before hiring new cooperative employees, management must ensure that the candidates are competent and have the necessary skills. Besides that, the cooperative sector must appoint competent Shariah auditors to conduct an audit at their institutions. By having a competent Shariah auditor, they can also conduct training for the employees. Shariah auditors can give exposure on the audit findings and educate employees on how to mitigate the risk or findings. This has been discussed (Hassan, Samad, & Shafii, 2018), where management must maintain staff placement, development, careers, and training in addition to hiring qualified and competent workers. Competent Shariah auditors and skilled staff working in an institution can help the company ensure productivity and meet its objectives.

To ensure the staff is competent while working, management must play a significant role. For instance, a cooperative sector that conducts Ar-Rahnu may experience other changes in the development of the product. Therefore, Ar-Rahnu staff must receive training regularly, especially on gold and current operations as it is more technical. For instance, on 25th June 2019 after The Shariah Advisory Council (SAC) of Bank Negara Malaysia resolve that the Ar-Rahnu product structure offered by Islamic Financial Institutions (IFIs) through combination of *qard* (loan), *rahn* (pledge), *wadi'ah* (safekeeping) and *ujrah* (fee) does not fulfill the Shariah requirements in Rahn Policy



Document due to some conditions, some of cooperatives that conduct Ar-Rahnu business activities also shift to another Islamic contract. Not only IFI can change the Islamic contract for Ar-Rahnu but cooperatives also be in the same category to change the contract for Ar-Rahnu business. Management should conduct training on any changes made in the operations to ensure staff are well equipped with the new changes. Training may be time-consuming, even though in the long term it can help the business to operate effectively and have good internal control.

METHODOLOGY

The study used a qualitative method that reviews and gathers input and feedback from the interview session. The interview structure includes the practice of Shariah governance and Shariah audit from the cooperatives sector, the formation process of Shariah governance, frameworks, guidelines, and Shariah audit issues. Interviews have the advantage of emphasizing individuality and human perspectives that the quantitative method does not address or analyze. Furthermore, interviews allow us to observe social indicators like the interviewee's voice, intonation, and body language. The method allows the interviewer to learn a great deal of information that may be added to the interviewee's verbal response to a question (Opdenakker, 2006).

Regulators, cooperative internal auditors, and cooperative representatives are a few samples of experienced and knowledgeable individuals in the cooperative sector. The experience level for most respondents is 3-10 years working in their expertise. An expert must be qualified and aware of cooperative operations and Shariah-related matters. Seven (7) targeted samples were initially planned, but the study could only interview five informants.

It was reported how these individuals responded to the questions given. The study used a theme-based approach. It included interview transcriptions, and the coding steps carried forward. After the collection of the data from the interview sessions, the data was transcribed in order to gain a basic understanding of the responses provided by the respondents and to further evaluate their context before being coded. The researchers first examined and reviewed transcripts to identify possible themes based on the research questions before coming up with the final themes. Table 1 provides the details of the interviewees.



Table 1: Details of the Interviewees

Interviewees	Gender	Role	Years of experience in the industry
Respondent 1	Male	Cooperatives	3 years
Respondent 2	Male	Cooperatives	3 years
Respondent 3	Male	Cooperatives	3-5 years
Respondent 4	Male	Cooperatives	3-5 years
Respondent 5	Male	Shariah auditor	3-5 years
Respondent 6	Male	Shariah auditor	5-10 years
Respondent 7	Female	Shariah auditor	5-10 years

Sources: (Mahmud Sabri, et al.) (2023)

RESULTS AND DISCUSSION

Lack of Shariah Governance and Shariah Audit Guidelines in the Islamic Cooperative Sector

The first round of interview sessions starts with the awareness and understanding of Shariah audit definition. Shariah audit is recommended since most institutions provide Islamic financing contracts, including the cooperative sector. Most respondents understand that the nearest definition of Shariah audit in cooperatives can refer to Shariah principles mentioned in GP 28. It can be concluded that, most of the respondents understand and are aware of the importance of Shariah governance and Shariah audit in the Islamic cooperative institutions.

Respondent 1 (R1) mentioned that:

“Our cooperative currently tries to adapt to Shariah governance elements, for instance, now we outsource Shariah advisors and start to recruit auditors that have Shariah background to conduct Shariah audits.”

In a similar assertion, Respondent 3 (R3) stated that:

“We are aware of the importance of Shariah audits, and complying with Shariah, but currently we still train our staff on Shariah knowledge to adapt in daily transaction, especially on Ar-Rahnu daily operation.”

Shariah principles are based on Shariah with compliance with the pillars, principles established by Shariah rulings (syarak) as the main characteristic. Complying with Shariah law will increase the community's faith in the legitimacy of the Islamic financial system, particularly in the cooperative industry. The findings conclude that most the respondents were aware of the necessity of appointing a Shariah auditor to ensure the Shariah compliance of the institutions.



Secondly, the study showed that Shariah audit is having some difficulties at the execution level since the regulator has yet to provide clear guidelines on Shariah audit functions. The structure of Shariah governance in Islamic cooperative sector still needs some improvements. This is in line with the previous study by Musa, Shah & Yaacob, (2018) where SKM still does not have a reference platform on matters related to Shariah. It becomes more complicated when SKM does not have a specific Shariah department or competent Shariah auditor.

According to respondent R2 (R2):

“In order for the cooperative sector to query concerns, regarding any Shariah-related matters, SKM should have Shariah references accessible, such as Shariah experts. In addition, our staff lacks Shariah knowledge, hence, we require the SKM at regulatory or management in cooperative level to provide training.”

Another respondent (R7) agrees with the opinion above saying that.

“Some of the guideline provided does not align with current practice in the Ar-Rahnu operation, if there is any competence Shariah officer, the cooperative can at least refer to Shariah expert in the operation.”

It is pointed out in the interview findings, that there are no additional guidelines pertaining to Shariah audit practices since SKM issued the GP25 in 2015. It is crucial for the regulators to issue current guidelines pertaining to Shariah to reflect the current demand in Islamic cooperatives landscape. For instance, in 2020 BNM announced the changes of the Shariah contract in the Ar-Rahnu operation. In conjunction to that, BNM takes the initiative to issue new parameters to reflect the current changes in Ar-Rahnu operation. Thus, it can be seen the dynamic of the regulator in playing its role towards the stability of IFIs.

Ar-Rahnu provider under the cooperative sector still refer to GP 25 Garis Panduan Aktiviti Pajak Gadai Islam for operating business activity, even though, SKM published new guideline on, Arahan Suruhanjaya Koperasi Malaysia Bil. 2 Tahun 2022 – Aktiviti Pajak Gadai Islam (Ar-Rahnu), which effective on November 23, 2022. This is due to lack of dissemination of information from the regulator to Ar-Rahnu providers under the cooperative sector.

Respondent R1 (R1) mentioned that:

“We were aware of the new changes on Islamic contract for Ar-Rahnu in IFIs but still searching the appropriate contract in our cooperative sector. We did not receive any update on the new instructions for Ar-Rahnu”

Another respondent (R4) suggested that:

“It is effective if SKM informs cooperative by giving us memo on the addition rulings in the operation so that we can start to implement them in the current practice.”

Based on the interview above, researchers conclude that it is important to disseminate information effectively to the Ar-Rahnu provider to reflect current changes in the



operation. Some cooperatives still use GP 25 Garis Panduan Ar-Rahnu and were not aware the guidelines were terminated by cooperatives in Nov 2022. Few are aware of the new rules from the cooperative sector for Arahan Suruhanjaya Koperasi Malaysia Bil.2 Tahun 2022 – Aktiviti Pajak Gadai Islam (Ar-Rahnu). It is one of the issues that should not happen as cooperatives that govern under the same regulator. Regulators and management of the cooperative play an important role in ensuring all employees and staff are aware of the new guidelines and changes happening in the operation.

The finding of the interview is in line with previous studies conducted by Musa & Yaacob (2018), that both guidelines and Shariah enforcement and compliance activities are not carried out according to the guidelines since SKM still lacks Shariah monitoring panel at the regulatory level or a specific section with expertise in the monitoring or enforcement aspects of Shariah compliance (Musa & Yaacob, 2018). Table 2 exhibits a summary of the response on the lack of Shariah governance and Shariah audit.

Table 2: Summary of the Response on the Lack of Shariah Governance and Shariah Audit

CATEGORY	RESPONSE
UNDERSTANDING OF SHARIAH AUDIT	<p>“Our cooperative currently tries to adapt to Shariah governance elements, for instance, now we outsource Shariah advisors and start to recruit auditors that have Shariah background to conduct Shariah audits.” (R1)</p> <p>“We are aware of the importance of Shariah audits, and complying with Shariah, but currently we still train our staff on Shariah knowledge to adapt in daily transactions, especially on Ar-Rahnu daily operation.” (R3)</p>
EXECUTION OF SHARIAH AUDIT IN	<p>“In order for the cooperative sector to queries concerns, regarding any Shariah- related matters, SKM should have Shariah references accessible, such as Shariah experts. In addition, our staff lacks in Shariah knowledge, hence, we require the SKM at regulatory or management in cooperative level to provide training.” (R2)</p>
LIMITED GUIDELINE	<p>“Some of the guidelines provided does not align with current practice in the Ar-Rahnu operation, if there is any competence Shariah officer, cooperative can at least refer to Shariah expert in the operation.” (R7)</p> <p>“We were aware of the new changes on the Islamic contract for Ar-Rahnu in IFIs but still searching the appropriate contract in our cooperative sector. We did not receive any update on the new instructions for Ar-Rahnu” (R1)</p>



"It is effective if SKM informs cooperative by giving us memo on the addition rulings in the operation so that we can start to implement them in the current practice." (R4)

The study concludes that the regulator (SKM) should provide guidelines on Shariah compliance to ensure cooperatives comply with its direction. It is not only the regulator who must act; the entire Shariah governance system's components must play their important roles. For cooperatives to be aligned with Shariah, the management, the Shariah Committee, the management, and the internal auditor must play their roles in the institutions. Since there are still cooperatives that do not have a Shariah governance structure or are still developing, one of the respondents suggests they try to add one function at a time when implementing Shariah governance. For instance, recruit a Shariah officer and outsource a Shariah advisor to which the cooperative can have an expert look into the compliance aspect.

Incompetency of Shariah Auditor

The following finding found during the interview is the incompetence of the Shariah auditor. Based on the interview, the current auditors need to gain the knowledge necessary to enforce certain parts of Shariah compliance and lack a few staff at the regulatory level. As reported by (Mariawati Omar, 2019) Shariah auditor must have the integrity, competence, and knowledge required to conduct an Internal Shariah audit. One must be familiar with Shariah standards and principles in General and Fiqh Al-Muamalat. The incompetence of Shariah auditors makes it difficult for institutions to get reliable audit reports. The inadequacy of Shariah governance at the regulator level makes it difficult for SKM to oversee and implement the guidelines. It is crucial to develop and improve Shariah governance and auditing in the cooperative sector to ensure the cooperative conducts business in Shariah-compliance activities.

Respondent 6 (R6) add on by saying that:

"It is difficult to recruit qualified Shariah auditor in Ar-Rahnu and in order to enhance the competency, the cooperative should provide training to equip the Shariah auditor with the skills."

Respondent 1 (R1) and Respondent 3 (R3) add same comment on the auditor competency:

"Shariah auditor should pass a specific Shariah audit paper to ensure competency, for example some of the Shariah auditor took Certified Professional Shariah Auditor by IBFIM".

Respondent 5 (R5) believe that Shariah auditor competency can measure the effectiveness by mentioning that:

"Shariah auditor competency can by evaluate by the effectiveness of audit in audit area and accuracy of audit finding in cooperative".



Furthermore, the findings showed that most respondents agreed that an auditor must be competent and possess the necessary skills and expertise before conducting the audit. The cooperative must have a Shariah governance and auditing model, incorporating the framework's elements, including a Shariah auditor, to promote stakeholder trust, and public confidence in cooperatives, management, and operations. Shariah auditor competency is essential to ensuring that the results are reliable and increase stakeholder trust.

The cooperative sector must appoint a competent Shariah auditor to ensure good audit quality when the auditor understands the nature of the business with the skills and knowledge. A cooperative must ensure that the Shariah auditor is competent in Shariah principles before appointing an external auditor to perform an audit. An auditor must have strong accounting knowledge and Shariah expertise to fully understand and complete a Shariah (Aimi et al., 2020). Furthermore, it is suggested that cooperatives appoint a qualified Shariah officer or internal auditor to ensure Shariah compliance. It's like a line of defense where a Shariah officer will first assess Shariah matters before an external Shariah auditor. The cooperative must recruit a competent auditor to offer users confidence and prevent allegations of wrongdoing from parties who dispute the cooperative operation's transparency. Table 3 summarizes the response on the competency of the Shariah auditor.

Table 3: Summary of Response on the Competency of the Shariah Auditor

CATEGORY	RESPONSE
COMPETENCY OF SHARIAH AUDITOR	<p>"It is difficult to recruit qualified Shariah auditor in Ar-Rahnu and in order to enhance the competency, cooperative should provide training to equip the Shariah auditor with the skills." R6</p> <p>"Shariah auditor should pass a specific Shariah audit paper to ensure competency, for example some of the Shariah auditor took Certified Professional Shariah Auditor by IBFIM" R1 and R3</p> <p>"Shariah auditor competency can be evaluated by the effectiveness of audit in audit area and accuracy of audit finding in cooperative" R5</p>

Lack of Training in the Cooperative Sector

An employee's competency and skill level directly affect the institution's performance. If the institutions have set workplace skills, the employee must comply with the requirement. Most institutions require the staff to comply with academic requirements and skills and train to improve their competency level. Some business activities in the cooperative sector have minimum criteria to hire the staff, for instance, basic knowledge in the calculation for Ar-Rahnu activities to ensure at least the staff can conduct daily transactions.



Respondent R2 (R2) mentioned that:

“I realize our cooperative is not getting much training on the operation or any Shariah courses, in future management or training departments can improve the competency of staff by providing effective training to them.”

Another respondent (R3) shared a different opinion on the training, He mentioned that: “Luckily our cooperative has a training department that could provide us with gold training, quarter assessment which I believe to improve the skills of the staff working in Ar-Rahnu operation.”

Based on the interview, respondents agree that training sessions could be conducted regularly to increase the competency of the staff. The training covers current issues, new implementations, compliance, and operation training. One of the respondents mentioned that they received training on product knowledge and operation training to handle the tools in their cooperatives from internal auditors and management. As Ar-Rahnu has some required tools, it is good to have specific training to improve staff's skills to reduce risk or audit findings in the cooperative. During the training, the auditor may give some views on common audit findings and improvements in their operation that can be implemented in the cooperative's activities.

Besides improving staff competency, staff training is the opportunity to proactively fill those gaps, which reduces the likelihood that the cooperatives will need to hire new staff.

Respondent 4 (R4) mentioned that,

“In our cooperative, we really care about the competency of staff as we believe it can improve and equip the staff with knowledge and polish their skills. The auditor usually conducts audit checking and then presents the audit findings to the staff. In our cooperative that considered as one of the training that provided by the auditor based on the audit findings”

Training should be given to new staff before they start work to familiarize them with the business operations. From the interview session, one of the cooperatives requested a special course on Shariah from IKMA to help them improve their Shariah knowledge. The participants conclude that the most crucial factor that a cooperative should consider is staff and Shariah auditor competency to ensure Shariah governance and audit are performed properly.

In addition, some respondents agree that management plays an important role in ensuring the staff's competency. This also can be seen related to a previous study by Musa, Shah & Yaacob, (2018) that studied internal and external factors to evaluate the strategic management and governance of five different Ar-Rahnu providers. Two Ar-Rahnu providers found from the analysis that one of their strengths is having ethical staff, and one of their weaknesses is having incompetent employees work in Ar-Rahnu. The analysis allows the author to identify the best strategies to improve staff competency. The findings conclude that the cooperative sector or management must



continue to provide skill training to increase staff competency and ensure effective operation. Table 4 exhibits a summary of the response on training in the cooperative sector.

Table 4: Summary of the Response on Training in the Cooperative Sector

CATEGORY	RESPONSE
TRAINING COOPERATIVE SECTOR	<p>IN "I realize our cooperative are not getting much training on the operation or any Shariah courses, in future management or training department can improve the competency of staff by provide effective training to them." R2</p> <p>"Luckily our cooperative has a training department that could provide us with gold training, quarter assement which I believe to improve the skills for the staff working in Ar-Rahnu operation." (R3)</p> <p>"Shariah auditor competency can by evaluated by the effectiveness of audit in audit area and accuracy of audit finding in cooperative" R2</p> <p>"In our cooperative, we really care about the competency of staff as we believe it can improve and equip the staff with knowledge and polish their skills. The auditor usually conducts audit checking and then presents the audit findings to the staff. In our cooperative considered as one of the training provide by the auditor based on the audit findings" R4</p>

CONCLUSION

This paper identifies current issues and challenges in developing Shariah governance and audit in the cooperative sector. The development of the Shariah governance and Shariah audit process is still in its infancy in the cooperative sector. Many aspects still need to be enhanced even though SKM published GP 28 Garis Panduan Tadbir Urus Syariah. Issues such as the importance of having components of Shariah governance structure in each cooperative's institutions are deemed relevant to implementing Shariah governance. The current governance structure shows that some cooperatives still do not have a Shariah Committee or Shariah auditor to oversee and investigate Shariah matters and rectify any issues that may arise. It is vital to have competent Shariah auditors and staff in the cooperative sector to ensure the efficiency of jobs given. Competence Shariah auditors may result in good quality audit reports of the institutions. Secondly, among the issues discussed in this study is training for staff and Shariah auditors. Management must ensure the staff is adequately equipped with skills and to work in the cooperative sectors. Shariah auditors must be competent in knowledge and audit to perform the audit in cooperatives. Both staff and Shariah auditors in cooperatives required regular training to enhance the skills of Shariah knowledge and operation of the business. Shariah audit is a function that gives an



overall assessment of the standard and effectiveness of the institution's internal controls, risk management framework, governance procedures, and general compliance to Shariah in all business, issues, and activities. In addition, adopting Shariah audit functions will improve the level of institutional integrity in terms of Shariah and reduce the Shariah governance issues in the cooperative sector. Thirdly, one of the challenges with Shariah governance and audit is the lack of knowledge and skills of most Islamic cooperatives. Training sessions and human capital development are required to improve the employees of the cooperative's understanding of Shariah. Shariah auditors also find that they need to have the training to improve their skills and knowledge in the Shariah aspect. By identifying the issues and challenges in this research, regulators and management in the cooperative sector can gain a better understanding. If any issues may affect cooperative institutions, the regulator and management must act quickly. Future researchers may find this study beneficial for gathering information on issues and difficulties with Shariah governance and auditing in the cooperative sector.

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