

Shari'ah Supervision Board Roles And Approaches In Developing Islamic Financial Institutions

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Abstract

The obligatory of indoctrinating muslim society with Islamic norm is unequivocally a need itself. Since the demand and the progress of Islamic financial industry has been growth immensely, an independent body auditing the operation becomes indispensable from day today. It is not only auditing for the accountability of the Islamic financial institution's operation but also an auditing for the operation to be Shariah compliance. The Shari'ah supervisory board (SSB), comprises high caliber scholars, is formed in order to assess whether the operations and the products offered by Islamic Financial Institutions (IFI's) are complying to Shariah rules. This paper elaborates the SSB roles and approaches in developing Islamic financial institutions and applies qualitative method as well in order to achieve the shari'ah objectives (maqasid as-shari'ah). In the end of the paper the researcher highlights some important recommendations or suggestions about the roles and approaches of SSB in the developing Islamic financial institutions as a whole.

Keywords: Shari'ah Supervisory Board (SSB), shari'ah objectives, shari'ah compliance, Islamic financial institutions.

A. Introduction

One of the most important issues and main aspects that must exist in any Islamic banking and finance institution, including Islamic microfinance institutions is the *Shari'ah* supervision aspect. This aspect has been seriously taken into consideration, as there is a special body to oversee and ensure the Islamicity of a particular product or service to be examined and endorsed before promoting it to the public or customers. The *Shari'ah* supervision aspect can be considered as the backbone of Islamic financial industry. Without it, the compliance aspects might be at stake (Daud Bakar, 2008, 57).

According to Rusni Hassan, Agus Triyanta and Adnan Yusoff, it is the duty of the Islamic financial institutions to ensure that all activities and products are *Shari'ah* compliant. The body that is specifically responsible for the supervision towards such compliance is the *Shari'ah* Advisory Council (SAC) or *Shari'ah* Supervisory Board (SSB) of the financial institutions. The SAC or SSB is an independent body of specialized in *fiqh al-mu'amalat al-maliyyah* (Islamic law of financial transactions) entrusted with the duty of directing, reviewing, supervision and/or approving the

activities of Islamic financial institutions in order to ensure compliance with *Shari'ah* rules and principles. Corresponding to the faith based nature of the Islamic financial institutions business, the task of the SAC or SSB in the Islamic financial institutions is much wider and more comprehensive as compared to SAC or SSB in conventional financial institutions. They are required to possess significant understanding on *Shari'ah* principles not only in the product development, but also in Islamic financial operations and activities (Rusni Hassan *et al.* 2011, xxx-xxxi).

Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)² has defined the *Shari'ah* Supervisory Board (SSB) as follows:

Shari'ah Supervisory Board (SSB) are jurists specializing or experts in the field of *fiqh al-mu'amalat al-maliyyah* (Islamic law of financial transactions) and Islamic finance, entrusted with the duty of directing, reviewing and supervising the activities of the Islamic financial institution to ensure that they are in compliance with Islamic *Shari'ah* rules and principles. The *fatwa* and rulings of the board shall be binding on the Islamic financial institution (AAOIFI, 2007, 4).

Furthermore, Daud Bakar has clarified that the above definition indicates that SSB members must have good knowledge in Islamic law of financial transactions (*fiqh al-mu'amalat al-maliyyah*). This is important because the Islamic finance and banking products and services in general are based on underlying contracts discussed by the scholars, under the purview of Islamic law of financial transactions (*fiqh al-mu'amalat al-maliyyah*). Moreover, the possibility of including experts from other fields related to the products and services of capital market is also important, as their knowledge and experience will assist the SSB in making precise decisions (Daud Bakar, 2008, 58).

The important roles of SSB, as outlined in the definition given, directing the related party on the intended products and services and reviewing the products and services and supervising the execution of such products, in order to ensure compliance with all requirements and specifications of *Shari'ah* law from beginning of funding until the ending of financing. The above AAOFI definition also reiterates the status of the decision made by the SSB, i.e. that they are binding in the specific areas of supervision. This signifies the fact that others cannot challenge the *Shari'ah* decision issued by the SSB on a particular product or service.

Thus, specific roles of the SSB in Islamic securities, including the Islamic microfinance activities will be discussed belows. Although these points belong to SSB, they are strongly applicable to Islamic microfinance institutions. Therefore, the researcher wants to discuss them here. In this regards, Daud Bakar furthermore clarifies its:

- i. Ensuring the products are developed using the acceptable principles of *Shari'ah*. Several contracts are allowed to be used in developing a particular structure. What is important in the development of a product or service is to ensure all aspects of the products or services comply with *Shari'ah* requirements;

- ii. Ensuring an underlying assets used in the issuance of the products are consistent with the requirements of *Shari'ah*. This usually involves assets that are partially was considered as non-compliant such as a building which is partially used to operate non-compliant activities like conventional banks, gambling outlets, and etc.;
- iii. *Shari'ah* committee should ensure that securities being traded are asset-backed, as this is an important distinguishing feature of Islamic instruments. All assets and the income must be legitimated and compliant with the Islamic law. Therefore, the securities being traded must be properly designated with respect to the underlying finance being provided;
- iv. Ensuring decisions of the SSB is understood by the financial institutions and implemented according to what has been decided. This is one of the most challenging tasks, as many of the staff of financial institutions had conventional training and they are very familiar with the conventional issuance which does not compliant with *Shari'ah* requirements. Therefore, it is important for the SSB to be satisfied with the comprehension of the issuers so as they are able to uphold and implement the decisions accordingly;
- v. SSB must be competent enough to scrutinize the documents related to the issuance, as there are many documents involved in the issuance. The negligence in scrutinizing the documents might lead to non-compliance and to a certain extent might have negative legal consequences on the issuance;
- vi. It is very important for the SSB to have full knowledge about the purpose of the issuance and how the proceeds are going to be used and ensure that the proceeds are for the purpose which complies with *Shari'ah* requirements;
- vii. A part from the technicalities is the issuance. Therefore, it is important to take into account the economic implications of the issuance to the *ummah* as a whole. This area might need to be done with the expertise in the area. At present, many quarters are questioning about the corporate and social responsibilities of institutions undertaking economic activities. Therefore, it is vital to examine the impact of the issuance and advice the issuers from the *maqasid* perspective;
- viii. Lastly, one other important fact that must be realized about *Shari'ah* supervision is that SSB are not rubber stamps that will endorse whatever comes to them. The endorsement must be done only after a full investigation and being satisfied that the product is in line with *Shari'ah* requirements. On the other hand, the advisory process also requires inputs on the credibility and technical aspects of the issuance. Therefore, the *Shari'ah* advisors will be able to make correct and precise decision.

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a full investigation and being satisfied that the product is in line with *Shari'ah* requirements.³ On the other hand, the advisory process also requires inputs on the credibility and technical aspects of the issuance, so that the *Shari'ah* advisors will be able to make correct and precise decisions (ibid, 59-60).

Nevertheless, in response to the SSB's approaches in the *Shari'ah* supervision of the products or services related to the banking, capital markets and Islamic microfinance institutions, generally three different approaches have been developed by the Muslim scholars (*al-ulama'*) in making *Shari'ah* decisions. According Daud Bakar these approaches are as follows:

I. Rigidity and inflexibility (*al-tadyiq wa al-tashaddud*) in making *Shari'ah* decisions

Islam, as *al-din* (the way of life) teaches its followers to be moderate in all their undertakings. It also emphasizes on the importance of making decisions which will serve the needs of the people and at the same time, are practical to be implemented. The concept of "al-yusr" or choosing the simple and accurate decision also means choosing the easier things, as long as it is allowed in Islam and will always encourage its followers to facilitate the need in life without going through difficulties, provided that it is allowed in Islam. Islamic system was revealed to bring blessings in life and not rigidity. This is evidently stated in the following verse:

﴿۱۰۷﴾ وَمَا أَرْسَلْنَاكَ إِلَّا رَحْمَةً لِّلْعَالَمِينَ

And We (Allah s.w.t.) have sent you (O Mohammad) not but as a mercy for the 'Alamin (mankind, Jinns and all that exist (Q.S. al-Anbiya' [21]: 107).

In his discussion, Yusuf al-Qaradawi (2002) has identified some main factors that might lead a person to be rigid. They are as follows:

- i. Fanaticism towards a particular madhhab, view or scholar: Fanaticism towards a particular view should not be the driving factor in making any *Shari'ah* decision, be it in matters relating to 'ibadah or *mu'amalat*. This is because every scholar will give his view based on the circumstances in which they are in and the issues posed to him. The requirements as well as the circumstances might change over the passage of time. In this respect, Imam Ahmad ibn Hanbal (164H-241H) was reported to have said: "Whoever issues any *fatwa* shall not impose or force anyone to abide by his view" (Ibn Muflih, 45).

In his respect, he [Imam Ahmad, 164H-241H] emphasized the statement as follows:

Some scholars when asked about a particular issue related to contemporary issue *mu'amalat*, they will always refer to a particular *maddhab* literature. If there are no similar instances in these literatures; they will disallow the referred *mu'amalat*, issues on the ground that these issues do not exist in the classical literature; as originally any matter *mu'amalat* is not permissible unless it is stipulated in the classical literature.

- ii. Depending on the literal meaning of the text of Qur'an and the Sunnah without referring to its objectives (*maqasid*): It is important for a scholar to understand the objectives of *Shari'ah* (*maqasid al-Shari'ah*) in making any decision and not just rely on the literal meaning of the text. In this respect, Ibn Qayyim al-Jawziyyah (691H-751) has emphasized that it is not allowed for a *mufti* to quote the Qur'an or the Sunnah literally and say this is what is intended by the Lawgiver (Ibid).
- iii. Unnecessarily propagating the usage of concept "Sadd al-Dhara'I" (blocking the means to evil) in disputed issues. Some scholars will unnecessarily propagate the usage of this concept in Islamic law which might lead to difficulties. This is evident when some scholars held the view that it is forbidden to plant grapes as the grape might possibly be used to make wine. Similarly, some would go to the extent of disallowing Islamic products because of their imitation of the conventional products or services because they have no origin in Islamic *mu'amalat*. This approach is questionable as there is nothing which forbids such activities, as the benefits (*al-maslahah*) of such actions supersede its harm (*mafsadah*). The means should not be disallowed if the benefit of such action is greater than its harm. Ibn Qayyim al-Jawziyyah (691H-751H) clarifies the prohibitions of ways and means when he says:

When Allah (s.w.t) forbids a particular thing and there are means and ways to realize it, He will forbid these means and ways in order to reiterate the prohibition so as to ensure no one will take any step towards the prohibited actions (Al-Qaradhawy, 175).

II. Excessive flexibility (*al-tasahul*) in making the *Shari'ah* decisions

This kind of approach is obvious among some *Shari'ah* scholars who will agree and allow mostly if not all which is brought to them. This approach is sometimes taken as a result of pressure from certain quarters for products' or services' approval or the negligence on the part of the scholars in the investigation on the the given issues. The other factor that cannot be overloaded is the tendency to please others and lack of much needed knowledge in arriving at the best decision (Daud Bakar, 61).

No doubt, Islam propagates tolerance and taking the easy and simple decision but this does not justify any decision arrived at negligently. In this respect, it is important for all scholars to understand the true meaning of *Ijtihad*. *Ijtihad* is the utilization of maximum effort by *mujtahid* in

arriving at a certain decision where he sees no possibility for him to further investigate the issues. If this is done by the scholars, then they will be qualified to obtain the reward as mentioned by the Prophet (p.b.u.h.) in *hadith* where he said:

عَنْ عَمْرِو بْنِ الْعَاصِ رَضِيَ اللَّهُ عَنْهُمَا قَالَ: قَالَ رَسُولُ اللَّهِ (صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ) : إِذَا حَكَمَ الْحَاكِمُ فَاجْتَهَدَ ثُمَّ أَصَابَ فَلَهُ أَجْرَانِ، وَإِذَا حَكَمَ فَاجْتَهَدَ ثُمَّ أَخْطَأَ فَلَهُ أَجْرٌ .

‘Amru ibn al-‘As (r.a.) reported that Rasulullah (p.b.u.h.) said, “If a judge makes the right decision through *ijtihad*, he shall be doubly compensated. However, if he errs, he shall be compensated once” (Bukhari, no. 6919 and Muslim, no. 1716).

In this regard, it can be said that a scholar can be ‘right’ in his professional conduct as a scholar without necessarily being ‘right’ in his conclusions, provided that he has exercised all the means to arrive at the right decision. Among the reasons for excessive flexibility are (Ibid, 62):

- i. Excessive utilization of the principles of *maslahah* and *darurah* which might lead to the misuse of these two principles: Among the examples of such usage in *mu’amalah* is the view which allows including interest (*riba*) in order to generate economic activities. Practising usury (*riba*) is obviously against the *Qur’anic* and *Sunn’ic* injunctions. It should be emphasized here that utilization of *maslahah* is disallowed in the situation where it is against the explicit text. Similarly, the utilization of *darurah* has its limitation, as stipulated in the maxim which reads, “The necessity should be estimated according to its required amount (*al-daruratu tuqaddaru bi qadariha*)” (al-Ghazali, 174-175).
- ii. Choosing the facility (*tatabbu‘ al-rukhas*) and taking the easiest view of the madhahib (*al-tawfiq bayn al-madhahib*): No doubt, Islam allows its followers to utilize the facility given by Allah. However, there are limits to it, as stipulated in the legal maxim: “Whatever is allowed because of an excuse would be cancelled when the excuse disappears (*ma jaza li al-‘udhr batala bi al-zawalih*)”. As for choosing the different views provided by the schools of Islamic thought, the method should be finding the strongest view and not the easiest, as the strongest view is the best view to be followed.
- iii. Finding legal devices (*al-tahayul al-fiqhi*) in order to justify certain rulings: In arriving at a particular decision, a scholar shall examine the available texts or exercise *ijtihad* according to the prescribed acceptable methodology. The usage of legal devices particularly to allow any prohibited matters is not allowed. Ibn Qayyim al-Jawziyyah (691H-751) elaborated on the approved legal devices and when the scholars are allowed to engage the *haram* (prohibited) and *makruh* (disliked) actions as legal devices. However, if he has a good intention in engaging

the allowable legal devices, than it is allowed, as done by the Prophet (p.b.u.h.) when he instructed Bilal ibn Rabah (r.a.) to exchange dates with Dirham currency and buy with the Dirham currency the intended dates so as to free himself from the *ribawi* transaction.

III. Moderate approach (*al-mutawassit*) in arriving the *Shari'ah* decisions

Islam is a system that emphasizes the importance of moderation (*al-wasatiyyah*) in everything. Therefore, it is vital for *Shari'ah* advisors to follow this method in resolving and arriving at *Shari'ah* decision, including tackling issues related to the Islamic financial industry. This means, the scholars must investigate the issues of the *Shari'ah*. As for the interpretations, it might vary from one situation to another depending on the circumstances, practices, as well as the needs of the society and the industry as a whole. Imam al-Shatibi (d. 790H) emphasized the importance of moderation when he says:

A wise *mufti* is the one who provides moderate and practical solutions for the public and will not place on them unnecessary burdens (*al-shiddah*) and will also not be inclined towards excessive flexibility (to the point of compromising *Shari'ah* principles (al-Shatibi, 276).

Thus, in the context of development of the Islamic finance market, it is important to the *Shari'ah* scholars to follow this method. The most important factor is to study the suitable *Shari'ah* principles to be applied to any product and understand the needs of the market. *Shari'ah* scholars must also assist those in the industry to come up with competitive products or services which are marketable locally and at the global level. All this has to be done without jeopardizing the fundamentals of *Shari'ah*.

B. *SHARI'AH* OBJECTIVES OF FINANCIAL TRANSACTIONS

In order to transform financial transactions and activities into positive and humane activities, the *Shari'ah* comprehensively outlines several objectives and purposes to be pursued by Muslims in their economic and financial activities, including cooperative sectors. These objectives remain theoretical until they are applied and brought into a sphere of reality by providing the guiding principles for Muslims to follow and implement. In this discussion, we will discuss these objectives as they are important for financial activities, including Islamic microfinance transactions.

According to Lahsasna (2010), there are four objectives of *Shari'ah* (*maqasid al-Shari'ah*) in economic and financial activities. These objectives are as follows:

- i. The circulation of wealth and the continuity of its circulation: The circulation refers to the objective of preserving the financial transactional nature and enable large sector of

population to become a part of the monetary cycle of wealth. The *Shari'ah* is against the concentration of wealth in a few hands in the society. However, we can observe this objective of circulation of wealth through the following:

- a. Giving *zakah* (alms).
 - b. The generous donation (charities).
 - c. Spending for the sake of Allah (s.w.t).
 - d. Prohibition of monopoly in the business.
 - e. Facilitate the financial transaction.
 - f. Eliminate all elements that disturb the flow of circulation of wealth in the society.
 - g. Promoting profit sharing principle.
 - h. The blessing on the partnership business organization given by *Shari'ah*.
- ii. The investment of wealth and the continuity of its investment: To make a society prosperous, the wealth must be invested and should be available in many hands in a society for its investment and increment. We can observe this objective through the following features:
- a. *Shari'ah* encourages business and trade as the Prophet (p.b.u.h.) gave his blessings for performing trade or business.
 - b. *Shari'ah* gives blessings for investment transactions, such as *musharakah* and *mudarabah*.
 - c. *Shari'ah* emphasizes investing the capital of orphans and to keep it safe and grow it for their benefit.
- iii. Achieving comprehensive communal prosperity: This objective is directed to the whole society to fulfill the basic material need in life by achieving personal satisfaction. However, the achievement of this objective will also help to get rid of negative social attributes, such as stratification to privileged and non-privileged classes. In order to achieve this objective, *Shari'ah* encourages the following:
- a. Encourages donations.
 - b. Promotes profit sharing concept.
 - c. Encourages *qard hasan* concept from the rich people in the society and today from the Islamic banks and financial institutions.
 - d. Encourages to keep the circulation of wealth in the hands of all members of society.
 - e. Encourages business partnership, such as *murabahah* and *musharakah*.
- iv. The financial transparency: This aims to keep trade and finance transparent, clear and clean from any elements of cheating or misuse. The sub-objectives of the *Shari'ah* in financial transparency are as follows:
- a. To avoid all kinds of misuse of the property and squandering in business.
 - b. To prevent disputes and arguments among the community in financial matters.

- c. To ensure honesty in business transactions.
- d. To upgrade society to the level of trust and confidence.
- e. To make sure all the wealth in society is pure by paying *zakah*.
- f. Ensuring the *halal* income to the society and prevent *haram* income and investment (Lahsasna, 2010, 153-156).

Daud Bakar (2008) also has asserted the objectives of *Shari'ah* (*maqasid al-Shari'ah*) in financial transactions and activities to be pursued by Muslims in order to protect their life and make living easy and enjoyable. These objectives are pointed by him as follows:

- i. The continuity of circulation of wealth: This objective refers to the importance of preserving the transactional nature of the financial dealings, so as to enable large sectors of population to become part of the monetary cycle of wealth and to avoid the concentration of wealth in a few hands. This objective is underlined in several verses in the holy *Qur'an*⁴ and *Sunnah* which call for the giving of *zakah* (alms), the generous donations (*sadaqat*) to be spent for the sake of Allah and refrain from hoarding (*ihtikar*) and monopolizing wealth (*iktinaz al-amwal*).ⁱⁱ Ibn 'Ashur (1879-1973M), indicates the legitimate circulation of wealth among the largest number of people would surely and definitely bring prosperity and happiness to the whole society. Furthermore, it will protect the entire society against the crimes and greediness of opportunities. The objective is strengthened by several rulings and commands, including those of contractual transfer of money and other financial transactions, such as *mudarabah* (trust investment), *musharakah* (partnership), *rahn* (mortgage), *hiwalah* (transfer), etc. To emphasize the importance of this objective, the *Shari'ah* made the permissibility as the original ruling for all new financial contracts and activities unless there is a text which prohibits them. Accordingly, it may be concluded that this legal maxim aims at strengthening the objective of the continuity of the circulation of wealth (Ibn Ashur, 57).
- ii. Continuity of investment of wealth: As societies develop, economic activities and transactions increase and develop: It is natural that societies develop their finances to benefit their members. In order for a society to become prosperous, the wealth must be invested and should be made available to many people, for its investment and increment. In support of this objective, there are several verses in the *Qur'an* and *Sunnah* which address the issue of necessity and obligation of continuity of the investment of the wealth as they call upon all Muslims to earn, strive and extend themselves to the corners of the earth, in search of the bounty of Allah (s.w.t.).
- iii. Achieving comprehensive communal prosperity: This objective is directed at fulfilling the basic material needs of the society by achieving personal satisfaction and social tranquility

and security. The achievement of this objective will also lead the society to get rid of negative social attributes like stratification of the population into privileged and non-privileged classes: a stratification that is almost certain to lead to animosity and hatred among members of the society. The verses and *ahadith* that call upon Muslims to pay alms (*zakah*), and cooperate and help each other in business transactions, uphold the objective of achievement of prosperity in society as evidence of this objective.

- iv. Financial transparency: This objective causes Islamic finance to get rid of misuse and squandering and helps to prevent the disputes, arguments and grudges among the community in financial matters. The Qur’anic verses and *ahadith* about this point concentrate on issues like the imperatives of having witnesses in financial transactions and the qualities necessary for those who engage in the management of finance. One of the examples of transparency is evident in the contracts of *mudarabah* and *musharakah*, in which both contracting parties are required to agree on the ratio of profit to be shared between them. It has to be done proportionately rather than the actual amount, as both are required to share the profit and loss in the case of *musharakah* (partnership) and *mudarabah* (profit and risk sharing) contracts where the capital provider shall bear the loss. However, even though transparency in such transactions, particularly in the pricing is required, in some cases, secrecy is allowed.
- v. Validation of financial ownership: This objective makes the authentication of the right of lawful financial ownership a basic aspect of Islamic transactions. This objective is emphasized by several verses and *ahadith*, as they underline the right of lawful ownership and spending. The Qur’anic injunction which prohibits illegal ways in acquiring property explains the meaning of this objective of the *Shari’ah*. Allah (s.w.t.) said:

يَا أَيُّهَا الَّذِينَ ءَامَنُوا لَا تَأْكُلُوا أَمْوَالَكُمْ بَيْنَكُمْ بِالْبَاطِلِ إِلَّا أَنْ تَكُونَ تِجَارَةً عَنْ تَرَاضٍ مِّنْكُمْ وَلَا تَقْتُلُوا

أَنفُسَكُمْ إِنَّ اللَّهَ كَانَ بِكُمْ رَحِيمًا ﴿٢٩﴾

O ye who believe, eat not up your property among yourselves unjustly except it be a trade amongst you, by mutual consent. And do not kill yourselves (nor kill one another). Surely, Allah is Most Merciful to you (Q.S. an-Nisa’ [4]: 29).

Among the important *ahadith* on this objective is the saying of the Prophet (p.b.u.h.): “Do not sell what you do not possess”. The scholars reiterate the above objective when they concluded that only parties that have the ability to deliver the object of sale should undertake selling transactions. Otherwise, it might lead to uncertainties and disputes among the

contracting parties. An example of such a requirement is obvious in the contract of *murabahah* (cost plus) to the purchase buyer (al-Tirmidhi, no. 1232 and Ibn Majah, no. 2187). In this transaction, the financial institution is prohibited from selling any item before having acquired the item. Therefore, it is not valid for the institution to conclude a *murabahah* sale with the customer before concluding the purchase from the supplier of the item (Daud Bakar, 2008, 65-68).

These are the main objectives of the *Shari'ah* for the enactment of financial transactions and activities in Islam. These objectives are intertwined and linked to each other as they serve the purpose of safeguarding Islamic economic activities. Moreover, all objectives of *Shari'ah* mentioned earlier are devised in order to prevent harm and bring benefits, not only to individuals, but also to the whole community, even Muslims or non-Muslims. However, this will ensure that Muslims are in a position to provide an excellent example to non-Muslim communities on the benefits of Islamic business activities and dealings (Ibid).

C. CONCLUSION

Two models of microfinance system -Islamic institutions and conventional ones- have been presented broadly and discussed considerably. The study indicates that there are some important similarities and differences between two systems. Both advocate entrepreneurship, profit and risk sharing; both believe that the poor should take part in such activities, and developmental and social goals; both function as institutions which offer particular services, such as micro credit, micro equity, micro savings, micro transfers, micro insurance and so forth. These similarities, however, are too broad and too superficial to be regarded as an argument to equate both types of microfinance institutions.

As for the most essential difference is the commitment of Islamic microfinance to obey Islamic law of financial transactions (*fiqh al-mu'amalat al-maliyyah*) in its operations. Hence, interest (*riba*) the most important concept in conventional microfinance is totally avoided by Islamic microfinance besides other prohibited elements. Islamic microfinance institutions adopt the Islamic economic values or ethics. This particular difference has led to many other differences in products and services, organizational structure and management of the microfinance institutions, the customer groups and even to some extent in microfinance theory and practices. All differences have shown that Islamic microfinance is not comparable to conventional style.

In respect to the foundation of Islamic economics and financial theory, it seems that different authors set different formula because this system is strongly based on the basic principles of *tawhid* (God's unity and sovereignty), *rabbaniyyat al-masdar wa al-hadf* (divine source and objective), *tazkiyyah* (purification), *ukhuwwah* (brotherhood) and accountability (*mas'uliyah*). Accordingly, these

two types of microfinance institutions must be seen as different industries with different objectives. A question that has not been answered through this part is whether the Western concept of microfinance which have been adopted and practiced by Muslims in Muslim countries at present, should be rejected and avoided, or not?

Nevertheless, one privilege of Islamic microfinance system that will never exist in conventional system is the protection of faith, lives, intellect, posterity and wealth of the people. These are highly valued concepts and have become the main objectives of the *Shari'ah*. The rules underlying the Islamic financial system including Islamic Islamic microfinance sectors are derived from Islam. These rules govern the conduct of all financial transactions and economic activities under the Islamic financial system.

However, a strong financial system needs to be supported by a strong regulatory and legal framework that can effectively discourage undue risk-taking behavior, particularly in the Islamic microfinance to prevent it from being harmful or disobeying *Shari'ah* commercial law. It must also have adequate standards for effective risk management, financial disclosure standards and governance. These are areas for development to bring Islamic microfinance to the next level of exponential growth. Despite these challenges, the Islamic microfinance industry has grown to become aviable alternative for many, whether for reasons of personal faith or on economic grounds.

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² AAOIFI was established in accordance with the agreement of association signed by Islamic financial institutions on 1 Safar, 1410H, corresponding to 26 February 1990, in Algeria. It was registered on 11 Ramadhan 1411H, corresponding to 27 March 1991 in the Kingdom of Bahrain as an international autonomous not-for-profit corporate body. AAOIFI is responsible for developing accounting, auditing, ethics, governance and *Shari'ah* standards for the international Islamic banking and finance industry. AAOIFI is supported by over 160 institutional members from around 40 countries. It has its corporate office in Kingdom of Bahrain. <<http://www.aaoifi>>(accessed March 2nd, 2012).

³ The Arabic word "zakah" in the *Qur'an* appears with the word "salah" thirty times, according to Yusuf Qaradawi. See, al-Qaradawi, *Fiqh al-Zakah: Dirasah Muqaranah li Ahkamiha wa Falsafatiha fi Daw' al-Qur'an wa al-Sunnah*, (Cairo: Maktabah Wahbah, 2003), 34.