

Sukuk Documentation and Legitimacy: The Role of Shariah Supervisory Board as a Moderator

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Abstract

This paper aims to investigate and detect the influence of *Shariah* documentation on legitimacy of *sukuk*. In addition, to determine the potential moderating effects of a *Shariah* Supervisory Board (SSB) on *Shariah* documentation in relation to *sukuk* legitimacy. A conceptual model is developed and tested using the data from 82 *Sukuk*'s listed in the Bursa Malaysia's exempt regime. The analysing data's obtained from *Shariah* reports between the years 2005 to 2015. An analysis of the quantitative data was then made using the Partial Least Squares (PLS). The research found that documentation has no significant effect on *Sukuk* legitimacy. In addition, this study found that there is empirical evidence showing the moderating effect of a SSB on relationships between *Shariah* documentation and legitimacy. This study uniquely enriches the literature by adding a new discussion that dealt with documentation and measurements that represent legitimacy level and through investigating SSB as a moderator on this relationship, which is unique as compared to previous studies.

Keywords: Islamic *Sukuk*, documentations, Legitimacy, *Shariah* Supervisory Board

1. Introduction

Islamic capital market (ICM) consists of the debt market and the equity market. *Sukuk* are the most active Islamic debt market financial instrument to date (Ahmad, Daud, & Kefeli, 2012; Maiyaki, 2013). *Sukuk* (plural of *Sakk* meaning a deed or check) can be defined as a trust document or investment certificates representing a contract of transference of rights and revenues or obligations earned in alignment with the Islamic *Shariah* law (Abdullah, 2011). The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has defined it as “certificates of equal value representing undivided shares (in ownership of) tangible assets, usufruct, and services or (in the ownership of) the assets of particular projects or special investment activities” (AAOIFI, 2008). *Sukuk* are asset-backed, stable income and tradable trust certificates. The primary condition for the issuance of *Sukuk* is the existence of assets on the balance sheet of the government, the monetary authority, the corporate body, the banking and financial institution, or any entity that wants to mobilize their financial resources (Tariq & Dar, 2007).

Malaysia is the pioneer in *Sukuk* issuance capturing global *Sukuk* market and has played an important role for the development of *Sukuk* (Ahmed, Islam, & Ku Ariffin 2015; Kamaluddin, Manan, Khadijah, Sufian, & Htay, 2012). According to Malaysian Rating Cooperation Berhad (MARC), the appeal of *Sukuk* as a funding source has grown tremendously with an increasingly larger investor base attributed to its appeal as a *Shariah*-compliant alternative to conventional fixed-income instruments. (Haron, 2012). It is anticipated that *Shariah*-compliant financial institutions’ assets, worldwide, will expand in the next few years from the current \$2 trillion to approximately \$3 trillion, despite the moderate level of growth of the Islamic finance industry forecasted in 2016 (Standard & Poor's Ratings Services). The Islamic financial institutions’ (IFIs) market share is expected to be 12 percent in Malaysia in comparison to 17 percent in the six Gulf Cooperation Council (GCC) countries of Kuwait, Saudi Arabia, Qatar, United Arab Emirates and Oman where the market share is growing at a faster rate than elsewhere in the world.

A number of strategic initiatives are in place for Malaysia to emerge as the ICM international hub. The intent is to introduce more services and products, for funds to be mobilized in an effective way and a comprehensive tax; accounting and regulatory framework founded on the *Shariah* principles can be established. *Sukuk*, in comparison to conventional bond, is different in terms of its very structure; its classifications of ‘asset-based’ and ‘asset-backed’ and the risk return mechanisms (Usmani, 2002; Kantakji & O’haj, 2010). *Sukuk* issuance involves global investors, issuers and intermediaries, and its transaction requires certain standards to be met in relation to governance, transparency and compliance (Laldin, 2013). Accordingly, there are efforts in Malaysia to ensure that *Sukuk* issuance is benchmarked with international standards and comply with *Shariah* best practices (Ginena, 2014). The standardization and coordination of the *Shariah* ruling is essential to minimize any divergence amongst *Shariah* scholars regarding *Shariah* interpretations (Securities Commission, 2003; 2007).

Following the *Sukuk* Guidelines issued by the Securities Commission Malaysia (2012), a *Shariah* Board has to be either a committee that meets the standards registered under the guidelines of *Shariah* advisors, or an Islamic institution or a bank approved by Bank Negara Malaysia to carry out advice from *Skim Perbankan Islam Shariah* advisors, or “The Islamic Banking Scheme.” In this respect, the procedures start from the inception of the *Sukuk* until such time as its issuance, such as the related part in directing to the intended product and then reviewing the product, and consequently the supervision of the product’s execution for the purpose of effectively ensuring that it is compatible with the standards and requirements recommended by *Shariah*.

In general, the members of SSBs are a group of experts in *Shariah* who are delegated to give guarantees that instruments and products used in the Islamic financial industry are comparable to the *Shariah* aspects, which usually consist of the capital market, Takaful and banking (ISRA, 2013). Organizations involved with the Auditing and Accounting for Islamic Financial Institutions (AAOIFI) would have noted the following definition of a Governance Standard in relation to a *Shariah* Board of an Islamic finance institution as: “specialized jurists, particularly in *Fiqh Muamalat* and Islamic Finance, entrusted with the duty of directing, reviewing and supervising the activities related to Islamic finance in order to ensure that they are in compliance with *Shariah* rules and principles”.

2. *Sukuk* Legitimacy

Sukuk has several legitimacy (lawfulness or authenticity) determinants that are of interest to the investors, financial institutions, regulators such as pricing, rating, *Shariah* auditing, *Shariah* risk and *Shariah* documentation (Ahmed, Islam, & Ku Ariffin 2015; Lahsasna, Ibrahim, & Othman, 2014; Grassa, 2015b). Although there are other factors that may influence the legitimacy of *Sukuk*, these determinants are general in nature and are found in *Sukuk* reports that are available for review by IFI's, investors and regulators (Ahmed, Alabdullah, Islam, & Asmar, 2014; Haron, & Ibrahim, 2012; Hasan, & Sabirzyanov, 2015). However, the Chairman of AAOIFI, Mr. Taqi Usmani in 2007 criticized that most of the *Sukuk* products in the market were not fully compliant with *Shariah*, thus require an urgent review (Usmani, 2008). In reaction to that, the Muslim Council of Britain (2008) in co-operation with the Utrujj Foundation and the Islamic Finance Council released the Islamic Finance Transparency Standard, a consultative document with a threefold purpose to improve the level of consumers' understanding of retail products that are Islamic, to reduce consumers' skepticism about non-compliance of *Shariah* products and to enhance the protection of consumers (Ginena, 2014). A document entitled Guiding Principles on *Shariah* Governance Systems for Institutions offering Islamic Financial Services was released by the IFSB in December 2009. Bank Negara Malaysia (BNM) followed shortly thereafter in 2010 by issuing its own document on the subject, called the *Shariah* Governance Framework.

Acknowledging the requirements for a stringent measure to validate *Sukuk* legitimacy, numerous guidelines and rulings were put in place. In July 2011 the Malaysian Securities Commission amended its Islamic Securities Guidelines to provide a comprehensive direction regarding the subject, covering topics such as the applicable *Shariah* rulings, the approval process, disclosure requirements and ratings for *Sukuk* issuance. In addition, Malaysia has also listed *Sukuk* on Bursa Malaysia under exempt regime for *Sukuk* that are issued, offered or subscribed in accordance with section 229(1) and section 230(1) of the Capital Markets and Services Act 2007 (CMSA). Exempt regime is specifically meant for issuers who intend to list their *Sukuk* or debt securities on Bursa Securities for listing status and for profiling purposes only but not to be quoted or traded. This listing enables investors to participate in bonds trading in a transparent manner (Securities Commission Malaysia, 2009). Furthermore, Securities Commission (SC) under the Private Debt Securities (PDS) Guidelines (paragraph 32) requires the Islamic Private Debt Securities (IPDS) issuers to appoint an independent *Shariah* advisor, approved by the SC, to advise on all aspects of the IPDS including documentation, investment and structuring (SC, 2003). These advisors cum *Shariah* scholars play a crucial role to maintain and ensure public confidence in the ICM by guaranteeing that the *Sukuk* issued by the market participants are fully compliant with *Shariah* principles, both from the

accounting perspective with regards to *Sukuk* issuance process as well as in a complete and transparent disclosure on its determinants legitimacy limitations.

3. *Sukuk* Documentations

The documentation for *Sukuk* is often split into two categories: capital market documents; and *Shariah* transaction documents (Ahmed, Islam, & Ku Ariffin, 2015; Ali, 2011). The designation is, of course, imprecise because all *Sukuk* documents must be *Shariah* compliant and they can also all be said to be capital market documents, given the nature of the tool being issued (Mohamad & Razif, 2013). However, the terminology does serve to split the understanding of *Sukuk* documentation into documents which should follow the norms of the capital market in relation to custody, documents, payment and administration generally, which form the core of a *Shariah*-compliant transaction. It is assumed that the *Sukuk* documentation, will follow proper transparent processes and with the main contracts comprising clauses without any presence of ambiguity (Van Wijnbergen & Zaheer, 2013). Accordingly, it is crucial that all the documentation involved in the *Sukuk* issuance do not contain any inconsistencies or loopholes which could deprive the *Sukuk* investors of the rights promised to them in the offering circulars (Kaseb, 2010). In adopting the best business practices it will require the contracts to be transparent and enforceable in order to protect the interests of the parties involved. Similarly, *Shariah* endorses only those contracts which are free from excessive uncertainty and speculation in the contract or transaction (*gharrar*) (Van Wijnbergen & Zaheer, 2013).

There have been a few ill-fated attempts to standardize the *Sukuk* documentation (Ali, 2011) and the lack of success has been predictable. This is because *Sukuk* are structured instruments and, as such, several considerations invariably arise when structuring *Sukuk* (Khniifer, 2013). As previously indicated they also need to be *Shariah* compliant and pronounced as such by *Shariah* scholars, and the difficulty is that the scholars can have differing views on what is and is not permissible. A set of responsibilities ought to be carried out by a SSB, including advising on documentation, structuring, and all aspects of *Sukuk*, such as matters dealing with *Shariah* pronouncement made on the basis of the reasoning for the pronouncement, in addition to the structure and mechanisms of the *Sukuk* issue (SC, 2014). Moreover, the *Shariah* principles and its concepts used in the *Sukuk* issue should be complied with, as recommended by the *Shariah* Advisory Council (SAC) (BNM, 2007). Furthermore, *Shariah* matters should be compatible with the documentation of the *Sukuk* issue. Finally, there is a requirement for an assurance that all conditions related to *Sukuk* are complaint with *Shariah* on the one hand, and matters that are not consistent with the concepts and principles are raised and do not receive endorsement by the SAC on the other hand until such time as the inconsistencies are remedied (ISRA, 2013). Ideally, IFIs are expected to disclose the following information in their *Shariah* pronouncement:

- i) Structure and mechanism;
- ii) Documentation (including purchase agreements, lease agreements, servicing agency agreements, purchase undertakings, substitution undertakings, declaration of trusts, cost undertakings, agency agreement and certificate purchase agreement (Ahmed, Islam, ariffin, halim, & moniruzzaman, 2013).
- iii) *Shariah* approval in that the SSB ought to grant approval for the issuance of a *Sukuk* in accordance with the conditions including a time limit of 14 business days for offering or inviting to subscribe or purchase a *Sukuk* (SCM, 2011).

In addition, the form related to the approval issued by the SSB programmers should be granted and comply with the guidelines that refer to the terms and conditions provided by the issuer. In the event of non-compliance with the terms and requirements required by the SAC, here the SSB can impose further conditions and obligations that to be undertaken until such time as the non-compliance is satisfactorily rectified and obtain approval from the SSB (Lahsasna, 2014).

4. The Relationship between Shariah Documentation and Sukuk Legitimacy

The literature in relation to *Sukuk* puts forward a proposition that IFIs through the promotion of the effectiveness of the legitimacy of *Sukuk*, and this action it might help alleviate the *Shariah* non-compliance problems by monitoring and controlling *Sukuk* structures in order for a variety of *Shariah* documentation to meet all the requirements of *Sukuk* (Kaseb, 2010; Ali, 2011; Khnifer, 2010; Van Wijnbergen & Zaheer, 2013; Ahmed et al., 2013; & Lahsasna, 2014).

Accordingly, there ought to be compliance with *Shariah* principles and its concepts for the issue of *Sukuk*, as recommended by the *Shariah* Advisory Council (SAC) (BNM, 2007). Additionally, an endorsement should be given that all conditions related to *Sukuk* issuance are in compliance with the principles of *Shariah*. However, any matters not found to be consistent with the concepts and principles should be noted and not receive endorsement by the SAC (ISRA, 2013). A thorough examination of the documentation should be made to ensure their compatibility and compliance with *Shariah* principles (ISRA, 2013). Thus, any mistake or even negligence might lead to difficulties in issuing the *Sukuk* due to the incompatibility with such compliance. Therefore, through the mechanism of the SAC, the compatible *Shariah* matters can be determined to ensure legitimacy of the documentation of the *Sukuk* issue. Haniffa and Hudaib (2007) and Maali et al. (2006) claimed that IFIs can make use of improved levels of disclosure in the *Shariah* board reports and this disclosure is an important Islamic financial tool. It is through an increased level of disclosure of *Shariah* documentation in these reports that important elements emerge and they are that there is a decrease in the level of problems of non-compliance with *Shariah* and an enhancement in legitimacy of the Islamic financial instruments (Haniffa & Hudaib, 2007; Maali et al., 2006; Ahmed et al., 2013; & Lahsasna, 2014).

Kaseb (2010) examined the relationship between the *Shariah* guidelines and the practices in the Malaysian *Sukuk* market. The result found there should be regulation of effective legal documentation on the products in the Islamic capital market. He also noted the regulators ought to review and improve the current guidelines and facilitate and strengthen the *Sukuk* issuance in a concrete manner. This finding indicates that effective legal documentation has a positive effect on *Sukuk* issuance. Lahsasna and Idris (2008) argued that the implications of the AAOIFI pronouncement on the *Shariah* compliance issues of *Sukuk* structuring have an impact and, therefore, there are implications for future issues. They also noted that the SSBs have a role in the documentation and implementation of *Sukuk*. Ali (2011) examined the *Sukuk* market by referencing the structures and documentation. The findings indicated that the *Shariah* documentation is the key document for *Sukuk* investors because it discloses all material information that an investor needs to inform their decision as to whether to invest in the *Sukuk* or not. Thus, the *Shariah* documentation is considered to form the core of the *Shariah*-compliant products and having this core of information increases the clarity of compliance of the *Shariah* documentation and, therefore, its legitimacy. Van Wijnbergen and Zaheer (2013) examined the recent major defaults in relation to *Sukuk* in the aftermath of the worldwide credit crisis that engulfed the world in 2007. They argued that all the

documentation concerning *Sukuk* issuance (*Musharakah* and *Ijarah*) were without any inconsistencies and loopholes which could deprive the *Sukuk* investors of the rights promised. Ahmed et al. (2015) examined the relationship between *Shariah* documentation and *Sukuk* in the IFIs. Their study indicated that there is a good relationship between the *Shariah* documentation and *Sukuk* legitimacy as evidenced by the positive value in the results. Therefore, improved levels of disclosure of *Shariah* documentation in the *Shariah* Board reports of the Islamic *Sukuk* are very useful for IFIs. Therefore, the present study predicts that increasing the level of disclosure of *Shariah* documentation will be associated with increased levels of *Sukuk* legitimacy. Accordingly, the study hypothesizes that: *H1: There is a positive relationship between Shariah documentation and Sukuk legitimacy.*

5. *Shariah* Supervisory Board as Moderator

There has been tremendous development witnessed in the field of *Sukuk* during the last decade or so. It is also during this time period that attention started to be paid to it as a discipline and different areas are now being researched. However, it is also a fact that the discipline of Islamic *Sukuk* and its issuance has not been given proper attention so far by the regulators as well as the practitioners and academicians (Lahsasna, et al., 2014). As a result of this situation, there is lack of literature examining the legitimacy of *Sukuk*. The literature available has shown the *sukuk* documentation deemed as variable when examining *Sukuk* as a dependent one (See Wilson, 2004; Tariq & Dar 2007; Lahsasna & Idris, 2008; Wilson, 2008; Rahman, 2008; Yean, 2009; Usmani 2009; Kaseb, 2010; Ali, 2011; Van Wijnbergen & Zaheer, 2013; Ahmed et al., 2013; El Shazly & Tripathy, 2013; Abdullah et al., 2014; Ginena, 2014; Ahmed et al., 2014; Lahsasna, 201 Ahmed et al., 2015). However, to date no previous study has investigated nor chosen the role of the SSB as a moderating variable on the relationship between the *sukuk* documentation and the legitimacy. The current study has two main justifications for a new area of examination. The first is related to the reason why the current research has chosen a moderating variable, while the second justification shows why the SSB is suitable to be a moderating variable on the relationship between the *Shariah* documentation and the legitimacy of *Sukuk*.

The first reason for selecting a moderating variable is that, as argued by Baron and Kenny (1986), Holmbeck (1997) and Frazier Tix, and Barron (2004), when the relationship between an independent variable and a dependent variable is poor or inconsistent, a moderating variable can be established in such a case to strengthen or weaken such a relationship and to explain when or for whom an independent variable affects a dependent one.

Secondly, the rationale for determining the SSB as being suitable to be a moderating variable is that the SSB is one of the most important governance mechanisms of IFIs to ensure there is compliance with the principles of *Shariah*. Therefore, the role of the SSB as a moderator on the relationship between *sukuk* documentation and legitimacy could be used to enhance and strengthen the role of the SSB towards *Sukuk* legitimacy. Furthermore, the choice of the SSB as a moderating variable for the current study is justified as the SSB has a positive impact as assured by several studies in the literature. For example, Yean (2009); Laldin (2008); Lahsasna (2010); Usmani (2002); Kantakji and O'haj (2010) all demonstrated that a SSB is an important variable that has its significant effect on the documentation of legitimacy. In summary, this study selected a SSB as a moderator for two reasons: firstly, based on the literature, it can be considered that the SSB has a high influence on *Sukuk*, and secondly, there is a lack of studies about the relationship between *Shariah* advisory boards and *Sukuk*. Thus, the current research chooses the SSB as a

moderating variable on the relationship between the *Shariah* documentation and disclosure of *Sukuk* legitimacy.

6. Methodology

The quantitative method is the basic design for this study. The population size in this study consists of 82 *Sukuk* approved by the SC and registered in the Bursa Malaysia, and this represents a full sample for eleven consecutive years. The quantitative data were collected from the *shariah* reports of the identified *sukuk*. The analysing data's obtained from secondary data between the years 2005 to 2015. An analysis of the quantitative data was then made using the Partial Least Squares (PLS).

6.1 Variables Measurement

Dependent Variable (*Sukuk* Legitimacy): To analyse the disclosure of *sukuk* legitimacy the basic design is underpinned by the method of content analysis. A definition of content analysis is that it is "*a research technique for the objective, systematic, and quantitative description of manifest content of a communication*" (Cooper & Schindler, 2003). When examining a *Shariah* disclosure many scholars have adopted the method of content analysis for their study. Content analysis has been utilized to examine the nature and the quantity of *Shariah* disclosure (Rahman, Hashim, & Bakar, 2010; Maali *et al.*, 2006; Gray, Kouhy, & Lavers, 1995).

This study comprises three parts: firstly, the structure and mechanisms of *Sukuk* legitimacy; secondly, the *Shariah* ruling and considerations; and the thirdly, the *Shariah* compliance. This is further to the adoption of the *Shariah* report (pronouncement) and this relates to all information concerning the *Sukuk*'s legitimacy evaluation and measurement of the level of information relating to the disclosure of the legitimacy of *Sukuk* legitimacy by way of an indexing procedure of *Shariah* pronouncement in Malaysia's IFIs. Measurement by way of index to analyze the level of legitimacy disclosure is supplementary to the requirement for specified items of information that is predictably provided in the *Shariah* pronouncements. In order to attain this study's objectives, each of the specified items will be obtained from the *Sukuk* *Shariah* pronouncement solely by weight. Indeed the weighting of each item will be on the basis of the absence or the presence of each of the items in the *Sukuk* *Shariah* pronouncement. If the item was indeed disclosed, then the weighting of the *Sukuk* received a value of one, and if not disclosed then a value of zero was given.

Furthermore, this study's indexing method is based on Bursa Malaysia's Islamic *Sukuk* listed reports (pronouncements) to measure and evaluate the disclosure level of information relation to *Sukuk* legitimacy from the specified items of information outlined in the *Sukuk* pronouncements. From the information gathered, the index list comprised 14 items of information relating to the disclosure of *Sukuk* legitimacy information, in the Malaysian context, as accepted by previous studies (Maali *et al.*, 2006; Haniffa & Hudaib, 2007) and by the AAOIFI (2014) and the SC (2014), as outlined in Table 1.1. In relation to the structure of the disclosure index, the index was checked against a sample of *Sukuk*. Furthermore, as Table 1.1 demonstrates the index was categorized into three classifications: *Shariah* ruling and considerations (5 items); mechanism and structure (4 items); and *Shariah* approval (5 items) as adopted from SC (2014).

In examining the *Sukuk* a maximum number of items were set aside and this number totaled 14 and this number covered off on the broad themes. To obtain a score for the *Sukuk*, each item's score was first added and then the total was divided by the maximum of the likely scores, and to obtain the percentage scores the number was multiplied by 100. For this study, the 14 broad theme items corresponded to the maximum possible score for disclosure of the combined number of items. For instance, in the event a *Sukuk* reported 5 out of a possible maximum of 14 items, then the dependent variable score was approximately 36 per cent. Accordingly, a variable score of 50 per cent would be attained in the event that 7 of the 14 items were reported. Through the examination of a specified item, through the process of division of the number of disclosures of *Sukuk* of that specified item by the total number of items, a calculation was attained for the average score.

Table 1:1 Categorization of the List of Items Included in the Classification Index (Legitimacy disclosure of *Sukuk*)

	Items	Sources			
		Structure and Mechanism of <i>Sukuk</i> Issue Based on the <i>Shariah</i> Principle	SC, (2014)	AAOIFI, (2012)	Maali <i>et al.</i> (2006) Haniffa & Hudaib (2007)
1	<i>Shariah</i> opinion on the lawfulness of the purchase of assets.		√	√	√
2	View of the <i>Shariah</i> Board on lease of assets.		√	√	√
3	Present details of purchase, substitution and redemption undertaking.		√	√	
4	Appointment of a Servicing Agent <i>Shariah</i> Ruling and Considerations (Important Highlights)		√	√	
5	Financial Ratio Test (Islamic market index)		√	√	
6	Utilization of proceeds.		√	√	
7	Waiver of interest and exchangeable <i>Sukuk</i> features.		√		
8	<i>Wakalah</i> Agreement		√	√	
9	Business Activity Test (non <i>Shariah</i> -compliant) alcohol, tobacco, pork-related products, Conventional financial services (banking, insurance, etc.), weapons and defence, and entertainment (hotels, casinos/gambling, cinema, music, pornography etc.) <i>Shariah</i> compliant (Approval)		√	√	√
10	The view of the <i>Shariah</i> Adviser in relation to the prevailing circumstances, the structure and mechanism.		√	√	

11	Agreement of the <i>Shariah</i> Adviser to approve the documents for the <i>Sukuk</i> structure.	√	√
12	The legal constraints under which the proposed <i>Sukuk</i> is being developed.	√	
13	View of the <i>Shariah</i> Adviser to develop the Islamic <i>Sukuk</i> issuance.	√	√
14	View of the <i>Shariah</i> adviser for the removal of <i>riba</i> .	√	

Independent variable (Sukuk Documentation): Following on from this study's objectives, each specified item was acquired from the *Sukuk*-related *Shariah* reports. The weighting of each item was made on the basis of the absence or the presence of each item examined in the report. In the event there was disclosure of the item, then a weighting of "one" was attributed to the *Sukuk*; however, in the event there was no disclosure, then the value of "zero" was given. As mentioned previously, for this current study a method of indexing was employed to measure and evaluate the *Sukuk*-related documentation in the *Shariah* reports with the index measuring the required documentation from the specified items of information as outlined in the *Shariah* reports. As Table 1.2 indicates, the index list comprised 13 items of *Sukuk* documentation as adopted from the prior literature (SC, 2014 & AAOIFI, 2012). Accordingly, a maximum possible score of the items for each *Sukuk* was 13.

To calculate the average score, it was attained through the division of the number of disclosure of documents in relation to a specified item by the total number of items.

Table: 2 List of Documentation Items Disclosed

	Item Documentation	SC (2014)	AAOIFI (2012)
1	<i>Wakalah</i> Agreement	√	√
2	Sale and Purchase Agreement	√	√
3	Closing Date Deed of Surrender	√	√
3	Cash Settlement Purchase Right Deed	√	√
4	Commodity <i>Sukuk</i> Investment Agreement	√	√
5	Purchase Order	√	√
6	Issuer Undertaking	√	√
7	Form of Letter of Acceptance and Offer	√	√
8	Buyer Agency Letter	√	√
9	Obligor Undertaking	√	√
10	Purchaser Undertaking	√	√
11	Lease Agreement	√	√
12	Grant of Rights to Services Agreement	√	√
13	Sub-Grant of Rights to Services Agreement	√	√

Moderator variable (SSB): The size of a board is likely to impact on its capacity to monitor, review and control all of the IFIs' transactions to ensure their operations are in compliance with *Shariah* rules and

principles (Nathan, 2012; Rahman & Bukair, 2013; Grassa, 2015a). Empirical evidence in corporate governance suggests that the size of a board can affect controlling, monitoring and the level of disclosure (Akhatruddin Hossain, & Yao, 2009; Chaganti, Mahajan & Sharma, 1985). Whilst there is no restriction on the number of members appointed to a SSB, the ideal number should be in the order between three and seven members. Indeed, the common number of SSB members in IFIs is three members, and this number is in line with the BNM and AAOIFI standards. A greater number of members appointed to a SSB or to *Shariah* committees would provide more effective monitoring and would be more consistent with the principles of *Shariah*. According to several researchers (Chen & Jaggi, 2000; Grais & Pellegrini 2006; Farook Hassan, & Lanis, 2011), a larger size of the committee may reduce the possibility of information asymmetry. Therefore, in appointing more members to a committee there is an expectation of a reduction in the level of ambiguity and a reduction in the lack of information. Thus, measurement of this moderating variable is based on the numbers of members appointed to the SSB.

Table 3: Operationalization of the Moderating Variable of the SSB

SSB	Operationalization
Number of members	Dichotomous; 1 for the number of SSB members above the median of 3, 0 otherwise

7. Results

7.1 Descriptive Statistics

Based on the results of descriptive statistics, the dependent variable, which is *Sukuk* legitimacy, showed that the level of legitimacy of *Sukuk* was 62% representing the average of *Sukuk* with *Shariah* disclosure, with a standard deviation of .189. Furthermore, the minimum and maximum value indicated that *Sukuk* legitimacy is 33% and 89%, respectively. In addition, the descriptive analysis for variable shows that *Shariah* documentation having an average of 46.7% with standard deviation of .283.

For the moderator variable (SSB), the descriptive analysis (mean = 2.56, SD = 1.68), the minimum and maximum reported that SSB is 1.00 and 8.00, respectively. Table 1.4 shows a summary of the descriptive statistics of the dependent, independent, and moderator variables.

Table 4: Descriptive Statistics of all Variables

Variables	Mean	Std. Dev	Minimum	Maximum
Legitimacy	.620	.189	.33	.89
Documentation	.467	.283	1.00	9.00
SSB	2.56	1.68	1.00	8.00

7.2 Descriptive Statistics (Frequency) SSB

Table 1.5 describes the percentage of SSB members in IFI for *Sukuk* issuance. The descriptive statistic showed that only 49 *Sukuk* have less than 3 members of SSB which equals to 59.8%, while 33 *Sukuk* (40.2%) had 3 and above members of SSB. The descriptive statistic showed that most of the *Sukuk* in Malaysia IFIs have SSB members of less than 3.

Table 5: Statistics (Frequency) SSB

SSB	Frequency	Percent (%)
Less than 3	49	59.8
Above 3	33	40.2
Total	82	100.0

7.3 Descriptive Statistics on *Sukuk* Legitimacy

Table 1.6 reports *Sukuk* legitimacy in Islamic institutions. The analysis shows that the percentage of *Sukuk* legitimacy was between 0.33% - 0.89%. Whereas, the descriptive statistics revealed that 0.33% represents the lowest level of *Sukuk* legitimacy that appeared in *Shariah* report. On the other hand, the table also revealed that the highest level was 0.89. The current study divided *Sukuk* legitimacy into three levels; low (0.33 – 0.49), medium (0.50 – 0.75) and high (0.76 – 0.89). These levels converted from real data to the form of index in order to determine the level of legitimacy. These levels represent the legitimacy disclosure in *Shariah* report that was approved by SSB. There were 27 *Sukuk* that had legitimacy between 0.33 - 0.49 percent, 31 *Sukuk* which had legitimacy between 0.50 -0.75 percent and 24 *Sukuk* had legitimacy between 0.76 % - 0.89 %. Based on the content analysis, 29.3% of *Sukuk* issued from 2005 - 2015 conformed to *Shariah* principles. The rest, which stood at 32.9%, was found to have been lacking in *Shariah* conformity.

Table 6: Statistics of *Sukuk* legitimacy

Legitimacy	Level	Frequency	Percent (%)
Valid .33 to .49	Low	27	32.9
.50 to .75	Medium	31	37.8
.76 to .89	High	24	29.3
Total		82	100.

7.4 Assessment of Structural Model

Structural model assessment was performed only after measurement model analysis has passed all the recommended criteria. The starting point for judging the structural model was to examine the determination coefficient (R^2). In this study, endogenous variable appear to have R^2 value 0.710 (substantial) suggesting that 71% of the variance in legitimacy can be explained by *shariah* documentation. As the table 5.6 shown that the endogenous variable has high R^2 value of 0.772 with moderator (SSB). In that, the existence of moderator (SSB) will lead to strengthen and increase the level of legitimacy. According to Cohen (1988), R^2 value of 0.26 and above considered substantial, which means that the estimated model fits the data very well. Thus, it could be concluded that this study considerably meets this criteria. The variance explained for endogenous construct is shown in the next Table 1.7.

Table 1:7 Variance Explained

Endogenous Construct	Variance Explained (R ²)
Exogenous Variables -> Endogenous (Legitimacy)	0.710
Exogenous Variables * Moderator (SSB) -> Endogenous Variable	.0772

7.5 Hypotheses Testing

The result showed that the documentation has a negative relationship with *Sukuk* legitimacy where it was $P < 0.05$, $t = -0.591$. This result indicates that the number of documentation has negative impact on *Sukuk* legitimacy. This could be attributed to the fact that there is lack of documentation details provided in the *Shariah* pronouncement. Therefore, H1 is not supported.

Table 8 Path Coefficients (Without Moderator)

Hypotheses	Path	Path Coefficient	Standard Error	t-value	Results
H1	SHD -> LG	-0.039	0.066	0.591	Not supported

Note: Significance levels: *** $p < 0.001$ ($t > 3.33$), ** $p < 0.01$ ($t > 2.33$), * $p < 0.05$ ($t > 1.605$) (based in one-tailed test)

7.6 The Moderating Effect

In testing the possibility of such effect, factors (predictor) and SSB (moderator) were multiplied to create an interaction construct (factor x SSB) to *Sukuk* legitimacy. The estimated standardized path coefficient for the interaction (path c) is 2.175 ($t = 1.1205$) which is significant at $p < 0.05$ with a R^2 of .0772; this is slightly higher than the R^2 of the main effect model which is 0.710. The effect size of the interaction is calculated as follows:

$$f^2 = \frac{R^2 \text{ model with moderator} - R^2 \text{ model without moderator}}{1 - R^2 \text{ model with moderator}}$$

$$= \frac{.0772 - 0.710}{1 - .0772}$$

$$= 0.271$$

The result shows that the size of the moderator is small effect ($f^2 = 0.271$) (Cohen, 1988). However, Chin (2010) stated that small f^2 does not imply that the moderating effect is insignificant because “even small interaction effects can be meaningful under extreme moderating conditions, if the resulting beta changes are meaningful, then it is important to take these conditions into account”. Therefore, the study accepts that SSB does moderate the relationship between factors (*shariah* documentation) with legitimacy.

An assessment on the path coefficients for interaction terms shows that SSB moderate the relationship only between documentation and *Sukuk* legitimacy at $p < 0.05$, $t = 1.650$. The introduction of the terms made significant increases in model value and raises R^2 around 6%. As such, the study confirms that SSB does moderate the relationship between documentation and *Sukuk* legitimacy.

Table 9: Moderating Effect of SSB

Path	Path Coefficient	Standard Error	t-value	Results
SSB -> LG	-1.120	0.515	*2.175	Supported
SH-DOC -> LG	-0.351	0.144	2.431	Supported
SH-DOC * SSB -> LG	0.550	0.333	*1.650	Supported

Note: Significance levels: ***p < 0.001, **p < 0.01, *p < 0.05

8. Discussion

8.1 The Impact of Documentation on Legitimacy

The findings show that there is a negative relationship between documentation and *Sukuk* legitimacy. This result indicates that the number of documentations has negative impact on *Sukuk* legitimacy. These results are not in line to what has been proposed in the objective of the current study (there is a positive relationship with *Sukuk* legitimacy), which shows a negative and significant direction ($t = -0.040$, $P < 0.05$). This could be attributed to the fact that there are lacks of documentation details provided in the *Shariah* pronouncement. Furthermore, Maali et al. (2006) stated that the mistakes and negligence of disclosure in reports will leads to backfire. This result is not in line with what has been set in the objectives of the current study. The study cannot deduct significant relationship between documentations and disclosure of *sukuk* legitimacy. However, the study found the existence of significant relationship between documentations and disclosure of legitimacy when moderating variable was considered.

8.2 The Moderating Effects of SSB on the Relationship between Documentation and *Sukuk* Legitimacy

The current study examined the moderating effect of SSBM on the relationship between *Shariah* documentation and *Sukuk* legitimacy. The study revealed that there is a positive relationship between the documentation and legitimacy of *sukuk* when SSB exists ($t = 1.650$, $p < 0.05$). This shows that when SSB moderate, numbers of documentation are higher thus has a positive impact on *Sukuk* legitimacy (which is identical to the proposed hypothesis). In general, increasing disclosure in documentation in the *Shariah* reports is an important element that enhances level of legitimacy in *Sukuk*. The result showed that SSB has been significant in having a moderating effect on the relationship between documentation and *Sukuk* legitimacy. The figures in Figure 1.1 reveal that when SSBM size is higher, number of documentation or disclosure is also higher, thereby having a continuous positive impact on *Sukuk* legitimacy. In retrospect, the trend documentation's impact on the level of *Sukuk* legitimacy is seen increasing for *Sukuk* with higher involvement of SSB. In summary, these results indicate that positive relationship between documentation and *Sukuk* legitimacy is noted when SSB involvement is higher. In the light of this finding, it becomes more important for *Sukuk* to improve the level of legitimacy by increasing the members of SSB so that the *Sukuk* does not lose its legitimacy with external power in Islamic capital markets. The graph shows that *Sukuk* that has more documentation has higher legitimacy when SSB numbers are higher. The SSB should ensure that all *Sukuk* issuers of the IFIs (management, shareholders, employees, suppliers,

community and depositors) have full confidence in reading *Shariah* reports about *Sukuk* structure (Farook et al., 2011; Haniffa and Hudaib, 2007; Maali et al., 2006). Farook et al. (2011) mentioned that the existence of SSB in IFIs will improve monitoring and controlling of the Islamic securities. Numerous studies have suggested that board size can affect monitoring controlling, and the level of disclosure (Akhatruddin et al., 2009; Mahajan Chaganti, and Sharma, 1985). Rahman, and Bukair (2013) recommended to have between three and seven SSBM member; three being common number of SSB's in IFIs which is compatible with AAOIFI standards. The more the number of SSB members, the more effective and holistic the monitoring to ensure consistency with the principles and rules of *Shariah*. Likewise, Birnbaum (1984) stated that a higher number of members of the board implies that they would be willing to reduce the lack of information and uncertainty. The SSB board's size is also predicted to affect its ability in conducting audit and review all transactions and operations of *Sukuk* to ensure their structures are in compliance with the rules of *Shariah*. In addition, SSB members' ability to audit *Sukuk* would investors' confidence if more members are on the board. In addition, the collective experience and knowledge of SSB will increase with more members on board, consequently leading to greater legitimacy for *Sukuk*.

The results of the current study suggests that *Sukuk* that has higher SSB involvement are characterized by an adequacy of SSB ensuring legitimacy and compliance that may encourage IFIs to provide greater monitoring over their Islamic securities. SSBs must give more attention to their tasks and ensure all *Sukuk* documentations are verified to validate their adherence with *Shariah* compliance. Any negligence or mistake might lead to difficulties in *Sukuk* issuance, due to the non-compliance with *Shariah* requirements. The *Shariah* operation documents will need to be reviewed and audited by the SSB providing the fatwa for *Sukuk* legitimacy because those documents form the essence of *Sukuk* for *Shariah* compliance (Rahail, 2011). This study has found that constant SSB monitoring may enhance the number of documentation and contribute towards increased compliance and legitimacy for *Sukuk*. That is to say, that *Sukuk* which has active involvements from SSB would have increased documentations which ultimately increase the legitimacy of the *Sukuk*.

9. Implications

The current study takes into consideration two important things when choosing the disclosure index as measurement of legitimacy level (dependent variable). It chooses a new structure that consists of the *Shariah* board report and using an indexing procedure to measure and evaluate the disclosure level of *Sukuk* legitimacy information, which is adopted from SC and AAOIFI. In doing so, this study can be considered as a response to calls for new research into the area of Islamic financial instruments because as admitted by (Haniffa & Hudaib, 2007; Maali et al., 2006) that the index of legitimacy still needs more contributions to recover and overcome the lack in disclosure index of legitimacy. Thus, the present study globally contributes to the legitimacy measurement by choosing disclosure index to measure and evaluate the *Sukuk* legitimacy in *Shariah* reports.

This study utilized SSB as moderating variable, which is a powerful tool that can be used by IFIs to address the non-*Shariah* compliant or conflicting with *Shariah* tenets problems. The existence of the SSB influences the governance mechanisms in IFIs. It enhances and strengthen the role of the SSB towards ensuring that the Islamic financial operations is *Shariah* compliant and in line of the interest of the *Sukuk*-holders and investors who invest after taking into consideration the *Shariah* risks reported. IFIs would

tend to follow stringent guidelines set by SSB in order to protect their financial products; therefore SSB can influence IFIs to follow the instructions related to *Shariah* rules. In doing so, this will enhance the purity of the income earned of the *Sukuk*-holders and promote the legitimacy.

The current study uniquely enriches the literature by adding a new discussion that dealt with *Sukuk* and its legitimacy area. Especially through its two measurements that represent legitimacy of *Sukuk* (disclosure index) and through investigating SSB as a moderator variable on this relationship, which is unique as compared to previous studies. Furthermore, the study is intended to increase public awareness on *Sukuk* legitimacy and the importance of *Shariah* compliance not only in the form but also in substance. In addition, this study will give more benefits for IFIs in the sense that they should amend some of their regulatory frameworks to push the *Sukuk* market investors to move towards asset-backed structures. Finally, this study contributes to both academic and practitioner individuals. The findings may have some policy implications with regards to *Sukuk* legitimacy and governance policy (*Shariah* advisory council, IFI management). This study may help standard makers in central banks in general, and Malaysia in particular, to set wise and deliberate policies related to *Shariah* risks and to promote SSB members' commitment toward aggressively monitor *Sukuk* issuers by applying *Shariah* compliant criteria's. Ultimately such procedure will enhance *Sukuk* governance mechanisms' practices and legitimacy to be *Shariah* compliant.

10. Conclusions

This study has made a unique contribution to the body of literature concerning the influence of *sukuk* documentation on the legitimacy by using the population of *Sukuk* listed under exempt regime in Bursa Malaysia for the period of 2005-2015. Furthermore, it seeks to examine the effect of SSB as a moderator of the relationship between documentation and the *Sukuk* legitimacy. The results of this study have found that the level of legitimacy of *Sukuk* in Islamic financial institutions in Malaysia is generally high. The findings confirmed that there is a negative relationship between *sukuk* documentation and the legitimacy. The current results also indicated that SSB was found to have partial moderating effect on the relationship between *sukuk* documentation with legitimacy. The research found that the selected documentation influence legitimacy which could be used as one of subjects of reference in determining the existence of legitimacy in *Sukuk*. This is significant for at least three parties, i.e. investors, IFIs and the relevant authority bodies, to strategize on increasing the legitimacy of *Sukuk* by controlling the selected documents, thereby producing IFI securities that are in compliance with *Shariah* principles and tenets.

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