

HALAL ASSURANCE MECHANISMS IN HALAL INDUSTRY: AN APPRAISAL ON ITS EFFECTIVENESS TOWARDS CONTINUOUS HALAL ASSURANCE AND THE WAY FORWARD

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Abstract

Shariah governance of halal industry duly relies on JAKIM (The Ministry of Islamic Development), the Islamic organ which aims to regulate the halal industry. JAKIM's guidelines for Halal Assurance Management System required the industry players to establish Internal Halal Committee meant for developing, monitoring, and controlling the effectiveness of the halal assurance system within their organization. The scope of halal committee members is restricted, without clear direction of reporting to higher authorities, for instance to the board committees and BOD. This may trigger conflicts among the members and the effectiveness of the halal policy is in questions. Current halal assurance mechanisms are also lacks of strategic halal monitoring elements as there are no prescribed shariah governance organs. It is argued that the shariah governance organs; BOD, the Management and Shariah Committee has to be guided on their roles and responsibilities and they are to be responsible and accountable for shariah breach incidences. The controversy in the food and beverages industry, for instance the Cadbury case in the middle of 2014 has tainted the consumer's confidence, affect the halal industry and has significantly challenged the credibility of JAKIM as the responsible organ in providing the halal recognition and in monitoring the halal industry operations. Therefore, this conceptual paper attempts to appraise the current halal assurance guidelines provided by JAKIM with the view to improve it. This paper recommends the guidelines to include the prescription of the roles and responsibilities of shariah governance organs; BOD, the Management and SC. Since SC's appointment was never made mandatory in the halal industry, this paper argues the need for that organ that provides independent advice on shariah compliance and monitors shariah compliance practice within the organization through the examination of shariah review and audit practice. This paper also argues the need for the establishment of compliance and assurance functions, namely shariah review and audit. These measures are aimed to improve halal assurance, in addition to the operation of Halal Integrity Committee currently practiced. It is hoped the proposed measures will strengthen the halal governance championed by JAKIM and internal control for halal within the halal certified organization. With both elements in place, consumers' confidence and investors' confidence will be ensured, which in turn help Malaysia to elevate its status as one of the most important Halal industry players in the world.

Keywords: Shariah Governance Mechanisms, Shariah Governance Organs, Shariah compliance function, Shariah assurance function, Halal Integrity Committee.

1. INTRODUCTION

World Halal Forum publication estimated that the total size of the food market globally was valued at US\$632 billion in 2009. This is due to the increased awareness of Muslim consumers on their religious obligations to consume halal food, non-food products as well as services such as finance. In addition to the demand of halal products by the Muslims, non-Muslims are also demanding them on the believe that that halal products are i) fresh, healthier and safer and infection free, ii) humane animal treatment and iii) confidence

toward the integrity of halal certification (Golnaz et al., 2010). Growth of Muslim population serves as the sustainable market for halal food and non-food products and services. The world's Muslims population is expected to increase about 35% in the next 20 years, rising from 1.6 billion in 2010 to 2.2 billion by 2030 (Pew Research Center's Forum on Religion & Public Life, 2012).

In Malaysia, halal industry has been developed and enters into global market over past few decades. The complete halal environment in Malaysia including raw materials, production, packaging, manufacturing, logistics, banking and certification reassures the exporters and boosts the status of Malaysia as the world's most important halal destination. This is in line with the Malaysia that recognized as Islamic countries in the world and toward global halal hub.

Jabatan Kemajuan Islam Malaysia-JAKIM (Department of Islamic Development Malaysia) is the body responsible to monitor and ensure that halal requirements are adhered to by the industries. In line with the development of halal industry, JAKIM has the aim to develop the awareness and understanding of industry as on their responsibility to the social, as well as to control the activities, by consistently conduct the operation in the proper manner. In this regards, JAKIM provide the procedure for halal assurance to ensure the overall operation based on JAKIM's requirement and MS 1500 for halal logo and certification auditing.

Currently, the halal industry relies on JAKIM guidelines when applying for halal certification. In addition to certification guideline, JAKIM has issued a guideline to be observed by the halal certification holders for them to ensure continues halal integrity during the duration of halal certified operation. In this guideline, the institution has to observe several requirements such as the establishment of halal control points, proper documentation and halal internal committee. The current implementation that has been outlined by JAKIM in the guidelines stipulated the requirement for appointment of Internal Halal Committee shall be managers of department to ensure the effectiveness implementation of internal control system. However, the guidelines are silent about halal governance, reporting mechanisms and assurance mechanisms that ensures continuous halal integrity.

Thus, it is the objective of this paper to appraise the current halal assurance mechanisms in order to strengthen the halal governance championed by JAKIM and internal control for halal within the halal certified organization. This paper recommends the guidelines to include the prescription of the roles and responsibilities of Shariah governance organs; Board of Director (BOD), the Management and Shariah Committee (SC). Since SC's appointment was never made mandatory in the halal industry, this paper argues the need for that organ that provides independent advice on shariah compliance and monitors shariah compliance practice within the organization through the examination of shariah review and audit practice. This paper also argues the need for the establishment of compliance and assurance functions, namely shariah review and audit.

2. HALAL ASSURANCE GUIDELINES: SALIENT FEATURES

Halal governance broadly consists of external and internal measures. Halal certification by the regulator is a form of external halal governance measures. In addition to the halal certification status, the management of halal certified companies has to ensure continuous halal integrity. In order to do that, the companies benefit from the guideline issued by JAKIM that outlines the systems internal control for halal. The guideline is referred to as Halal Assurance Management System.

Principally, Halal Assurance Guidelines has provided by JAKIM as guidelines for Halal Assurance Management System to complement Malaysia's Certification Standard. This guideline prescribes the principles of halal assurance system and application by providing efficient arrangement for halal integrity of products based on concept of effective quality management system through the supply chain.

The guideline helps companies to develop, implement and improve effectiveness of control for halal. The development of Halal Assurance Management Systems focus on the minimizing and eliminating the non-conformance of halal requirement. The guidelines emphasize the halal assurance management from the Halal Critical Point (HCP) in the entire organization and its supply chain with consistent in controlling, monitoring and verification. It should include effective product recall procedures, effective documentation and proper filing system.

In addition to the observance of Halal Assurance Management System, the management has to practice an

assurance mechanism that consists of compliance review exercise, risk management function and internal audit exercise. Assurance Management System serves the following purposes:

- i. To promote the adoption of systems when developing, implementing, and improving the effectiveness of controlling halal purity and genuineness. This guideline shall be used by halal certificate holder to fulfill halal standard, regulations and requirements in halal certification.
- ii. This guideline sets out the principles of a halal assurance system and its application. It provides a systematic approach to ensure and preserve halal integrity of products. This is based on the concept of effective quality management system throughout the supply chain.
- iii. This guideline describes practical approach for organizations which have obtained or intend to obtain halal certification from competent authorities in Malaysia.
- iv. The systems supposed to be as an internal mechanism in halal monitoring, controlling, improving and preventing any non-compliance in producing halal products.
- v. The manufacturer is responsible for developing and managing the halal assurance system to ensure compliance of the entire supply chain process with the requirements set by the competent halal authority.

2.1 Documentations in Halal Assurance Management System

It is important that the IHC establishes and maintains an effective documentation and record-keeping system to provide evidence of conformity to the requirements and effective implementation of Halal Assurance Management System. All past records shall be kept for at least one (1) year for review and audit purposes and shall remain legible, identifiable and retrievable. All records and documents must be duly signed by the personnel in charge. The essential documentations and records pertaining to the management of the Halal Assurance Management System shall include the following:

- a) Manual halal assurance system
- b) The roles and responsibilities of the IHC and duties of all personnel in charge of HCP
- c) Minutes of the IHC meetings
- d) List of halal threats and HCP parameters
- e) Instructions on monitoring procedures and their corrective actions

2.2 General Principles in Halal Assurance Management System

The following are important principles when implementing the Halal Assurance Management System:

- i. **Determination of Halal Critical Points**
The IHC shall determine all possible sources of contamination (halal critical point) throughout the supply chain that can lead to non-compliance to halal standard requirements.
- ii. **Development and Verification of Flow Chart**
The IHC shall develop appropriate flow chart which consists of all steps involved in the entire supply chain process. The committee shall verify the steps in the flow charts against the actual operations by conducting on-site inspections. The flow charts can be used as tools for the IHC to identify the potential halal threats and implement the appropriate control measures to ensure compliance with shariah requirements.
- iii. **Implementation of Control Measures**
In the event halal threats are found at any stage of the Halal supply chain process, the IHC shall determine appropriate control measures to be taken. The control measures taken shall be in accordance with Malaysian Standard or any relevant halal requirements, where applicable.
- iv. **Development of Corrective Actions**
Corrective actions have to be developed whenever monitoring indicates non-compliance has occurred. Corrective actions taken shall preserve the halal integrity of the products or processes. The IHC shall ensure that the corrective actions are implemented as planned and goods produced during which period the corrective actions are not implemented are to be handled according to established procedures. Appropriate procedures must be established to prevent recurrence of similar incidence and to bring the process or system back into control.
A proper record shall be maintained to document the non-compliance incidence which includes the product description, description of the non-compliance and the corrective actions/control measures taken. This record may include:
 - a) Review of non-conformities
 - b) Review of trends in monitoring results that may indicate trend of loss of control

- c) The cause(s) of non-conformity
- d) Forward action to ensure that non conformities will not recur
- e) Record of the results of corrective actions taken
- f) Assessment on the effectiveness of the corrective actions taken

v. Documentation System and Management of Records

It is important that the IHC establishes and maintains an effective documentation and record-keeping system to provide evidence of conformity to the requirements and effective implementation of Halal Assurance Management System.

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vi. Process Verification

The process verification by the IHC shall include checking records and operational compliance of the following:

- a) Monitoring systems
- b) Personnel compliance to the HCP operations
- c) Audit reports

2.3 Specific Principles in Halal Assurance Management System

Halal Assurance Guidelines issued by the regulator of halal industry in Malaysia focuses on the operational aspect of halal compliance with the requirement of the establishment of halal control points, product recall procedures and establishment of halal committee. The required measures to ensure internal halal control system are the requirement for the establishment of Internal Halal Committee (IHC), Halal Assurance Management, Halal Control Points (HCP) identification and Halal Recall Procedures. In addition to general principles of Halal Assurance Management System, salient specific features are:

- i. The establishment of IHC in the organization.
- ii. Focus on minimizing and eliminate the non-conformance of halal requirement.
- iii. The emphasis of the Halal Assurance Management System is via the identification of HCP within the entire supply chain with constant control, monitoring and verification.
- iv. The Halal Assurance Management System should include:
 - a) Effective product recall procedure
 - b) Effective documentation to enable traceability
 - c) Proper filing system for halal applications, documents, procedures and records which shall be made available for audit by competent authorities.

3. EMPOWERING HALAL GOVERNANCE VIA THE ESTABLISHMENT OF GOVERNANCE ORGANS AND ADOPTION OF HALAL ASSURANCE FUNCTIONS

Halal Assurance Guidelines issued by the regulator of halal industry in Malaysia focuses on the operational aspect of halal compliance with the requirement of the establishment of HCP, product recall procedures and establishment of halal committee. As briefed, the required measures to ensure internal halal control system are the requirement for the establishment of Internal Halal Committee (IHC), Halal Assurance Management, Halal Control Points identification and Halal Recall Procedures. However, it is not successful to provide guidelines to the organization of the oversight, strategic and internal control on halal compliance at the level of policymaking. It is also lacks of coherent in term of practicality and reporting accountability. Thus, the regulators have to examine the halal assurance mechanisms currently in practice and identify the improvements that could take place to ensure continuous observance of halal integrity of the products certified as halal. The improvements to the halal assurance mechanisms could be done by identifying the measures of Shariah Governance Framework (2010) that is compulsory to be adopted by Islamic Financial Institutions (IFIs) in Malaysia as a reference point.

3.1 Duties and Responsibilities of Governance Organs as Oversight Parties Ensuring Halal Integrity

The Shariah Governance Framework (2010) is so far, argued to be the most comprehensive framework addressing the compliance, risk and audit mechanisms that, together they serve the role of shariah assurance. The framework spells out the roles and responsibilities of shariah governance organs, namely The Board, Management and Shariah Committee in relation to shariah governance in IFIs. Specific accountability for each of the organs enhances overall commitments towards shariah compliance.

Hasan (2011) highlights that Shariah Board is an independent body responsible as advisory and supervisory authorities toward Islamic product. Shariah Board in organization could develop the consumer's confident on the product and its function not only to attract the stakeholders and public (Ghayad, 2008). Similar to the nature of the halal industry, the mechanism is important for the industry to attract and develop the consumer's confident towards the religious requirement. In Islamic Financial Institution, Shariah Committee member shall appoint the person with relevant qualifications and experience in Shariah. Similar in the halal industry, it is vital to oversee the shariah related matter and to monitor the supply chain in the entire business operation. To provide the oversight function on shariah compliance, Shariah Committee could provide advice, reviews, give opinion and make decision independently to the Board on shariah issues in the halal industry. In addressing the issues, Shariah Committee plays their roles to boost up the consumer's confident according to the market misunderstanding.

JAKIM's requirement of the establishment of Halal Committee states that it must consist of at least two muslims at management level including one (1) person must be handling on procurement. While, for the industry dealing with the animal sources, they have to appoint a coordinator of slaughter house. This requirement, although is helping towards the fortification of internal halal governance within the organization, lacks authority and clear reporting structure to higher authorities in the organisation, namely BOD, top management members and board and management committees that play the role to ensure continuous halal integrity. The gap leaves the operation of Halal Committee as lacks of authority, thus leading to effectiveness to ensure internal halal control. Without the support by top management and BOD, functions within the organisation will not pay much attention to the initiatives required and monitored by Halal Committee. This is because the initiatives are not overseen by the highest authority.

Our suggestion for the regulators to adopt the shariah governance measures is based from the practice in Islamic Financial Institutions (IFIs) in Malaysia. Bank Negara Malaysia as the regulator of Islamic financial industry, had issued Shariah Governance Framework on 1st January 2010 to serve as the guide to each of the main organs of shariah governance, namely BOD, the Management and the Shariah Committee.

Following the framework, the organisation may introduce the requirement for the Halal Committee to be directly reporting to BOD so that the latter could monitor the activities, and direct the committee members to report operational activities and halal compliance. To operationalize the reporting to BOD, the planning, operation and reporting of Halal Committee should be escalated to risk management, compliance and audit committee. Clear communication of duties and responsibilities with regards to maintaining shariah compliance (or halal integrity) will result to better communication of strategic planning, halal control measures and compliance reports from the operational functions to the oversight functions.

The following sections are dedicated to discuss the roles and responsibilities of shariah governance organs, namely Shariah Committee, Board of Directors (BOD) and the Management.

3.1.1 Shariah Committee

The current setting of the establishment of Internal Halal Committee as one of the measures of internal halal control is not adequate. This is because it lacks the independent shariah advisory from the external party, unlike the practice in the IFIs. In IFIs, Shariah Committee members act as the independent oversight function that advises the BOD and the Management on shariah issues. Specifically, the role of Shariah Committee related to the review of product features to be issued to the customers as well as to guide and review the operations of the IFIs. The Shariah Committee's approval is needed for all legal contracts, agreements and documentations. In addition, all marketing materials, sales illustrations, advertisements and brochures are to be presented to Shariah Committee for approval or review, in the cases where these documents were approved by shariah officers with authority delegated by the Shariah Committee.

In the authors' opinion, it is timely for JAKIM to consider requiring the institution to appoint Shariah Advisory

Committee to independently advise the BOD and management of the halal certified institutions. The appointment of the committee will provide control and monitoring of the relevant functions within the organization in an independent manner. Most importantly, it will provide oversight function to the BOD in the matters related to shariah compliance to ensure halal integrity.

In this regards, Shariah Committee shall observe entire operation to ensure the activities meet the halal requirement. Thus, periodically reviewing and auditing shall be implemented by the Shariah Committee. These reports to be extended to the Board for any issue that needed attention.

3.1.2 Board of Directors (BOD)

The involvement of BOD as part of shariah integrity is to supervise the whole structure of the shariah governance towards halal compliance. Board plays the crucial roles in supervising the operation to meet the halal requirement. Board members are responsible to develop the framework with comprehensive understanding on governance and control functions such as shariah risk, shariah review and shariah audit. The Board has to be accountable, transparent and responsible on the overall structure towards shariah compliance in halal industry. Board also shall engage with the Shariah Committee to meet the requirement on shariah matter and considering the policy to be implemented.

The appointment of Shariah Committee could be done by BOD and advised by Remuneration Committee. This appointment shall ensure the Shariah Committee has strong knowledge in handling the issue and proactively carrying out their duty. In addition, effective communication and cooperation in the entire supply chain shall develop in order for Shariah Committee to discharge their duties.

3.1.3 The Management

The Management becomes the intermediaries amongst the governance organs. They are responsible in managing the resources such as supplying the manpower to support the activities towards implementation of governance on halal assurance. They are responsible to observe and implement the policy that made by the Shariah Committee as agreed by the Board.

To develop competency and exposure on the nature of shariah governance that to be practiced within the organisation, the management shall provide relevant training programs for continuous learning. It is also necessary for the management to ensure the policy and procedure of halal compliance to form Halal Assurance Management System. In conjunction of systematic arrangement, management also shall ensure the accurate policies and procedures. The management shall be alert with the nature if in case of unexpected event against of shariah compliance, the management immediately shall apprise the Board and Shariah Committee (BNM, 2011).

3.2 Shariah Assurance Functions

Halal JAKIM's certification requirement is enforced by the way of routine and surprise audit. In addition to halal certification, producers are to observe the requirements from various authorities. Other relevant authorities issued guidelines related to their jurisdictions; Department of Islamic States Malaysia (JAIN) which provide helping hands towards certification in each of the states in Malaysia, Ministry of Health department and Department of Veterinary Services which facilitates monitoring of halal poultry and pharmaceutical production, Ministry of Domestic Trade, Cooperative and Consumerism (KPDNKK) that provide assistance towards the enforcement of halal certification logo and Halal Development Corporation that is in charge of halal training. However, the lack of structure at the internal level poses risks for halal breach.

In order to ensure continuous halal integrity of the operation of halal certified organisations, it is imperative for the assurance functions to be established within the organisation. Shariah assurance functions include shariah research, shariah review, shariah risk and shariah audit. The shariah functions in the halal industry could be adopted so that the risk of breach of halal specifications could be minimised.

3.2.1 Managing Risks in Halal Certified Organisations

Three lines of defense model is a common model adopted in risk management. This model ensures continuous halal integrity to form Halal Assurance Management System which consists of Business Unit, Shariah Compliance/Review/ IHC and Shariah audit.

i. First lines of defense: Business Unit

First lines of defense emphasize the business and management unit which require the proper managerial and supervision control to ensure the process continuously comply with halal requirement guidelines by monitoring daily activities such as controlling the practice, justify the insufficient and sensitive with unexpected event. This control and monitoring covers the handling and management of risk in day to day activities in the entire business operation towards halal integrity.

ii. Second lines of defense: Shariah Compliance/Review/IHC

This line of defense monitors the function of risk management by reviewing and monitoring the operation and the entire of supply chain are complying with shariah. The functions also facilitate and advise on the risk management and report to the board. Second line of defense assists risk owner on first line of defense in defining the possible risk throughout the organization.

iii. Third lines of defense: Shariah Audit

Third lines of defense represent the group who will responsible for assurance on the managing risk. The group focuses on audit which carrying out the duty independently for on consists of the shariah audit in both internal and external with highest level of independent to be reported to the management. It developed in regards of responsibility towards halal assurance of the entire entity, operation and function. This line of defense covers the operations, assets, reposting process and compliance with shariah or any other regulations.

4. INTERNAL HALAL CONTROL ACTORS AND FUNCTIONS: PROPOSED FRAMEWORK

Following the discussions on the organs of governance and assurance functions, we are proposing a governance framework for the halal industry. The framework consists of guidelines to include the prescription of the roles and responsibilities of shariah governance organs; BOD, the Management and SC. Since SC's appointment was never made mandatory in the halal industry, this paper argues the need for that organ that provides independent advice on shariah compliance and monitors shariah compliance practice within the organization through the examination of shariah review and audit practice. This paper also argues the need for the establishment of compliance and assurance functions, namely shariah review and audit. These measures are aimed to improve halal assurance, in addition to the operation of Halal Integrity Committee currently practiced. It is hoped the proposed measures will strengthen the halal governance championed by JAKIM and internal control for halal within the halal certified organization. With both elements in place, consumers' confidence and investors' confidence will be ensured, which in turn help Malaysia to elevate its status as one of the most important halal industry players in the world.

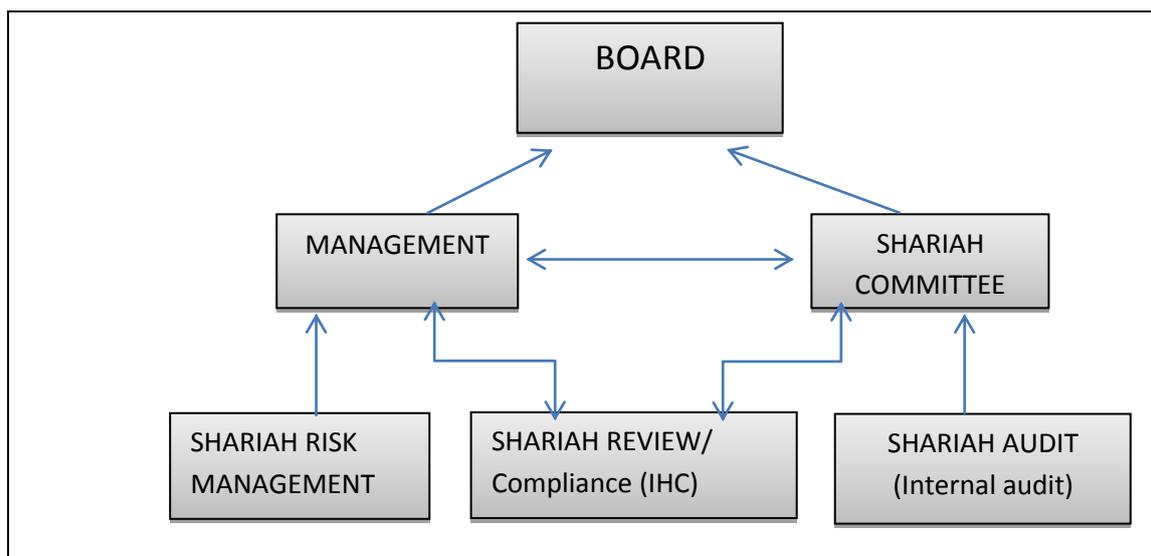


Diagram: Proposed Governance Framework for Halal Industry

Source: Adopted from Shariah Governance Framework for Islamic Financial institution, BNM (2011)

In addition to the organs of governance discussed in Section 3, the proposed model discusses the shariah assurance functions that could be established within the halal certified organization. The assurance functions are following the risk management 3 lines of model as discussed. The shariah assurance functions are as

follows:

i. Shariah Compliance Function (Shariah Review)

Shariah review could be the function to assess the activities and operations so that do not contravene with shariah principles. Scope of shariah review may include site evaluation and assessment of the business operation and support units of the company with regards to shariah compliance. This observation will be reported in the Shariah Review Reports and the function will continuously monitor the any breaches until closures to the issues are made. Shariah Review Unit shall highlight the outcome of any non-compliances involvement to the Shariah Committee and management as well as to improve any non-compliance that was identified for deliberation and notification (BNM, 2011).

ii. Shariah Control function (Shariah Risk Management)

Shariah risk management function is to identify the non shariah compliance risk that may arise from the entire operation especially in production. The risk also may occur from the managing the entire supply chain. In this regards, the function of shariah risk management take place to identify the possible risk, measure the level of risk, monitor to facilitate the effective risk management, and control the recurrences of non-compliance risk. Risk ultimately cannot be avoided, but the function of shariah risk management to deal and mitigate the risk. This have to be perform by the knowledgeable and experience officer in handling the risk combination with the Shariah or Halal background to ensure the person in charge possess deep understanding and able to manage the risk in line with the Shariah requirement. Hence, the proper guidelines shall be developed to facilitate and assist the committee on managing the risk (BNM, 2011).

iii. Shariah Assurance Function (Shariah Audit)

Shariah audit unit plays the crucial roles in serving the public assurance on the products. Shariah audit activity engages with periodic assessment with objective to meet the effectiveness of internal control system towards Shariah Compliance System. This function will be performed by internal shariah auditor that was appointed based on their knowledge and understanding on shariah related knowledge. This knowledge is significant to identify the critical issues and in evaluating the operation and management satisfy with shariah principles. The auditing scope shall consist of supply chain, raw material and operation on the factory, the organization structure, management and people, and review the accuracy of the shariah governance application.

This function provides independent assurance to the stakeholders to ensure that the shariah compliance in the entire activities that involved in the organization. This function shall be performed by internal auditors that have knowledge related to halal operations. The aim of this function is to ensure the systematic and effectiveness of the internal control system to ensure halal integrity. To accomplish this goal, the internal auditor and shariah unit may cooperate to seek their expertise in executing the auditing duty as long as aligned with the objective and may appoint the external party to conduct the shariah audit.

5. CONCLUSION

In conclusion, this paper discusses the needs for systematic internal shariah governance in the halal industry. The proposed framework attempts to close the gap of the lack of governance oversight function and structures. It is designed to meet with the objective of the halal governance in the industry. The framework produced as a step for the halal industry to set out their assurance mechanism as governance structure to ensure the operation complies with shariah at all time by involvements of boards as a part of the organ in the governance structure, which enable the Halal industry to strengthen the entire of business operation which consisting of the accountability, honesty and transparency of reporting and independent auditing.

In addition, this framework becomes the guidelines to the each governance organs with clear governance function in the Halal assurance mechanism in Halal industry. This to promote the systematic halal integrity committee in the industry in order performing the duties effectively related on the shariah compliance system in the business operation and day to day activities. The duties and responsibilities of the Board, Management and Halal committee are represented in the framework as proper guidelines for the halal industry development and positive attraction to the public. While, the framework has emphasis the function of shariah risk, shariah review and shariah audit to ensure the clear direction for each of the functions to discharge their duties.

The improvements to the halal governance could benefit establishments that produce halal products and

services in a way that it identifies the measures that needed to be in place to ensure internal halal control within the organization, given that the current guidelines lack of framework and explanations on the interrelationship and mechanics on how to perform the internal control tasks. In addition, this kind of study impact the regulators in the halal industry so that the regulator could pay greater attention to providing clearer guidelines on halal assurance measures that mitigate the risk of shariah breach in the halal industry.

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