TOWARDS HARMONISATION OF INTERNAL SHARIA AUDIT IN THE GULF COOPERATION COUNCIL'S ISLAMIC BANKS

By

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بسم الله الرحمن الرحيم

IN THE NAME OF ALLAH THE MOST COMPASSIONATE AND MOST MERCIFUL

قُلْ إِنَّ صَلَاتِي وَنُسُكِي وَمَحْيَايَ وَمَمَاتِي لِلَّهِ رَبِّ الْعَالَمِينَ

SAY, "INDEED, MY PRAYER, MY RITES OF SACRIFICE, MY LIVING AND MY DYING ARE FOR ALLAH, LORD OF THE WORLDS.

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Muhammad Saeed Fadloun
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LIST OF ABBREVIATIONS

AAOIFI: Accounting and Auditing Organisation for Islamic Financial Institutions

PBUH: Peace Be Upon Him

BCBS: Basel Committee on Banking Supervision

CBB: Central Bank of Bahrain

CEO: Chief Executive Officer

GCC: Gulf Cooperation Council

IFSB: Islamic Financial Services Board

IIA: Institute of Internal Auditors

QCB: Qatar Central Bank

QFMA: Qatar Financial Markets Authority

QAIP: Quality Assurance and Improvement Program

SGF: Sharia Governance Framework

SAMA: Saudi Authority Monetary Agency

UAE: United Arab Emirates

UK: United Kingdom

ABSTRACT

This research examines the critical role of internal Sharia audits in ensuring compliance with Sharia principles within Islamic banks, focusing on Gulf Cooperation Council (GCC) countries. While Islamic banks operate under both conventional corporate governance and Sharia governance frameworks, most previous studies have focused on the Sharia Supervisory Committee, which oversees compliance but is not involved in day-to-day operations, potentially leading to gaps in accurately assessing the Sharia compliance of Islamic banks. This study shifts attention to the underexplored internal Sharia audit department, responsible for providing assurance to the Sharia Supervisory Committee and other stakeholders on whether Islamic banks adhere to Sharia principles.

Through semi-structured interviews with 14 practitioners, significant gaps in internal Sharia audit practices across the GCC were identified. Additionally, interviews with a senior representative of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and a GCC regulatory advisor provided deeper insights into these shortcomings. The research also used documentary analysis, applying an index based on AAOIFI's internal Sharia audit standard to assess regulatory requirements for internal Sharia audit. The results revealed that no Sharia audit regulatory requirements in the GCC fully adhere to AAOIFI internal Sharia audit standard, with scores ranging from 7 to 17 out of 25. This points to a need for stronger regulatory enforcement, particularly as some GCC countries exhibit more significant deficiencies.

Key findings highlight that the internal Sharia audit is often viewed as a cost centre rather than a value-adding function, contributing to compliance weaknesses. Interviews with regulatory experts reinforce the need for a more robust regulatory approach to Sharia audits, akin to the European corporate governance model. The research suggests that regulators should treat Sharia compliance as seriously as other regulatory concerns, such as fraud or money laundering, to enhance Sharia governance and protect stakeholders.

The study offers recommendations for improving internal Sharia audit practices, with implications for regulators, Islamic banks, and standard-setting bodies, ultimately aiming to strengthen internal Sharia audit and integrity in the Islamic banking sector.

CHAPTER 1: INTRODUCTION

1.1 INTRODUCTION

This chapter outlines the research framework, beginning with the thesis chapters overview, followed by the background of Islamic banking and its significance. It details the research problem, motivation, and objectives, followed by the main research questions. The chapter also highlights the importance of internal Sharia audits, discusses the scope of the study, and presents the methodology used to explore audit practices in the GCC region. Finally, it addresses the limitations and challenges associated with the research and concludes with a conclusion.

1.2 THESIS CHAPTERS OVERVIEW

The research will include the following chapters:

Chapter One: Introduction - This chapter presents the research framework, the research problem, objectives, and main questions. It discusses the study's scope and methodology, and addresses limitations and challenges encountered.

Chapter Two: Corporate Governance and Audit in Banking: A Conventional Perspective - This chapter reviews corporate governance and audit practices in banking, emphasizing banks' role as financial intermediaries. It highlights the necessity of a governance framework to safeguard the interests of stakeholders, including management, shareholders, and depositors.

Chapter Three: Sharia Governance in Islamic Banking - This chapter consists of two sections: the first covers foundational aspects of Islamic finance, including key principles, contract types, and the need for a governance framework. The second section details specific components like the Sharia Supervisory Committee, compliance department, internal audit, and external audit, concluding with a summary of key findings on Sharia governance.

Chapter Four: The Internal Sharia Audit in Islamic Banking - This chapter examines the internal Sharia audit in Islamic banking, highlighting its essential role in ensuring compliance with Sharia principles. The chapter outlines AAOIFI's standard for Sharia audit functions, aiming to enhance stakeholder confidence, and is divided into five sections covering various related topics.

Chapter Five: The Regulatory Framework of The Internal Sharia Audit in The GCC - This chapter analyses the regulatory framework for internal Sharia audits in the GCC, emphasizing both practical applications and theoretical insights. It underscores the regulatory requirements for Islamic banks to implement the internal Sharia audits practices.

Chapter Six: Research Methodology and Methods - This chapter presents the research methodology and methods used in this study, addressing gaps in previous research on internal Sharia audits in Islamic banking. It highlights the originality of this empirical investigation in the largest Islamic banking market, offering new interpretations of data that provide valuable insights for stakeholders.

Chapter Seven: Perceptions of the Sharia Auditors: Interviews Analysis - This chapter examines Sharia auditors' perceptions of the internal Sharia audit function in Islamic banks, highlighting its importance for ensuring compliance with Sharia principles. It explores industry practitioners' views on audit practices, challenges, regulatory frameworks, departmental roles, and operational procedures.

Chapter Eight: Analysis of the Regulations of The Internal Sharia Audit in The GCC - This chapter analyses the regulations governing internal Sharia audits in GCC countries, highlighting variances and misalignments with AAOIFI standards. The chapter aims to evaluate the harmonization of GCC regulatory requirements with AAOIFI internal Sharia standard and rank the countries based on their internal Sharia audit regulations' robustness, supported by library research.

Chapter Nine: Enhancing Sharia Audit Standards in Islamic Finance - This chapter addresses practitioners' concerns about AAOIFI's internal Sharia audit standard. Perspectives from senior AAOIFI Governance Committee members and a regulatory advisor highlight the benefits of these standards, including alignment with Sharia principles and standardization.

Chapter Ten: The Findings and Conclusion - This chapter offers an overview of research findings and actionable recommendations to improve internal Sharia audit practices in the GCC.

1.3 RESEARCH BACKGROUND

Islamic banking, which emerged in the mid-1970s (Damak, 2022), has experienced rapid global growth, with the Islamic finance industry encompassing various sub-sectors, including Islamic banking, Islamic insurance (Takaful), microfinance firms, Islamic bonds (Sukuk), and Sharia-compliant funds (Abbas, 2015). Islamic banking, representing the largest sector, contributes to 69% (USD 1.992 trillion) of Islamic finance assets and encompasses over 500 Islamic banks worldwide, accounting for 6% of global banking assets (Mordorintelligence, 2022).

Islamic banks must comply with Sharia principles and the distinct feature of Islamic banking is the Sharia governance framework, which ensures compliance with Sharia principles and serves as the foundation for Islamic financial institutions (Sani and Abubakar, 2020). This framework enhances accountability, transparency, and risk management, thereby instilling confidence in investors, customers, and bank management that the Islamic banks are in line with Sharia principles (Ahmed and Bin Mohamad, 2019).

When Chong and Liu, M.-H. (2009) investigated the disparity between Islamic banking and conventional banking, they discovered that Islamic banking is theoretically believed to have significant differences from conventional banking. However, in practice, they found that the difference is not major. Therefore, while any bank can claim to be Sharia compliant, without a proper Sharia governance framework and controls, these banks may not truly be Sharia compliant.

To standardise and harmonise operations, the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) was established in 1991, issuing Sharia, accounting, Sharia auditing, and governance standards (Al-Sulaiti, Ousama and Hamammi, 2018). AAOIFI has developed 61 Sharia standards, 40 accounting standards, and 13 auditing and governance standards, setting guidelines for the industry.

While some Islamic banks claimed to be fully comply with AAOIFI's standards (AAOIFI.com, 2020b), these standards are not binding in many countries. Nevertheless, all Islamic banks are licensed and authorised to offer Sharia-compliant products and services, but there is no harmonisation in the way they provide assurance to their customers about their compliance with Sharia. Therefore, not providing proper assurance of compliance with Sharia principles means that Islamic banks are misleading customers, not treating them fairly, and indirectly that should be consider as a breach to regulatory requirements.

While there's been a fair amount of research into Sharia governance frameworks and Sharia Supervisory Committee, the internal Sharia audit hasn't received as much attention. For example, Hasan (2011) took a comparative look at Sharia governance in Malaysia, GCC countries, and the UK, pointing out various deficiencies and areas needing improvement. Hamza (2013) explored how Sharia compliance intersects with the effectiveness of governance structures. On the other hand, Abdul Rahim (2011) noted a significant gap in understanding current Sharia audit practices and the challenges they face in the Islamic banking sector.

The AAOIFI highlights the importance of the internal Sharia audit department. This department is crucial for ensuring that the products, services, and activities of Islamic banks align with Sharia principles (AAOIFI, 2020c). A solid internal Sharia audit is not just a regulatory formality; it addresses the concerns of stakeholders such as the shareholders, customers, or regulators about Sharia compliance.

1.4 RESEARCH PROBLEMS AND MOTIVATIONS

An additional risk is associated with the functional model of Islamic banks as opposed to conventional banks. Islamic banks must comply with the current regularity system and require additionally to comply with Sharia rules and principles.

The Islamic banking industry has developed rapidly over the past 50 years, with the oldest Islamic bank, Dubai Islamic Bank, established in 1975 (Amaroh & Masturin, 2018). While governments worldwide have supported the growth of this sector, considerable progress remains to be achieved, particularly when compared to the conventional banking system. For instance, the oldest bank still in existence, Banca Monte dei Paschi di Siena, was established in 1472 in Italy, which show a gap of over 500 years between the oldest conventional bank and the oldest Islamic bank. This significant time gap highlights the need for continued efforts to enhance and develop the Islamic banking industry and its compliance with Sharia.

This thesis will focus on a critical aspect of the Sharia governance framework: the internal Sharia audit, particularly in the GCC (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates). These countries collectively account for 44% of the global Islamic banking assets (Research and Markets, 2021). In some countries, such as Saudi Arabia, the Islamic finance industry is not regulated differently from conventional banking, and no additional requirements are legally mandated to be licensed as an Islamic bank (Dewar, 2021).

Conversely, in the UAE, there are specific regulatory requirements that any bank must comply with if it claims to be an Islamic bank (AAOIFI Secretariat, 2020).

Due to the differing practices among significant contributors to the Islamic finance industry, this research aims to investigate and analyse the current practices of internal Sharia audits in the GCC. The study seeks to identify the challenges, gaps, and issues associated with internal Sharia audits and to propose valuable guidelines and recommendations to main stakeholders for an effective internal Sharia audit framework.

Addressing this research problem will enhance the understanding of the current landscape of internal Sharia audit practices and provide insights into the challenges faced by Islamic banks in different GCC countries. This understanding will contribute to the development of a more harmonisation and robust framework for internal Sharia audits, ensuring consistency and reliability across the region.

1.5 OBJECTIVES AND RESEARCH QUESTIONS

This thesis aims to conduct an in-depth analysis of the existing practices of internal Sharia audit and examine the compliance of Islamic banks with AAOIFI's Internal Sharia audit standard by analysing the regulations and practices of internal Sharia audit in the GCC (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates) through the views and opinion of the practitioners and available documents. From the findings, the thesis attempts to highlight any needed improvement and to propose from the practices valuable guidelines and recommendations for an effective internal Sharia audit framework.

This thesis will be divided into several chapters, each containing essential information that will pave the way for a comprehensive understanding of the primary purpose of this thesis. The upcoming chapters will begin by examining corporate governance and auditing in conventional banking, followed by an exploration of Sharia governance and internal Sharia auditing in Islamic banking. Additionally will explore the regulatory framework of internal Sharia audits in the GCC. These chapters aim to provide a solid theoretical understanding and background of Islamic banking and its implementation in the GCC.

Then, it will propose the design structure of the semi-structured interview questions aiming to explore the current internal Sharia audit practices and the implementation of AAOIFI's internal Sharia audit standards at the GCC Islamic banks.

The following objectives will be accomplished in order to achieve the thesis's aims:

- To analyse and assess existing internal Sharia audit practices in Islamic banks across the GCC.
- To study the regulatory requirements associated with internal Sharia audit in the GCC's Islamic banking industry.
- To examine the roles and responsibilities of the internal Sharia audit department within the GCC's Islamic banks.
- To evaluate the levels of independence, competency, and confidentiality maintained by the internal Sharia audit department.
- To determine if internal Sharia audits comply with any ethical standards or have quality assurance measures in place.
- To critically examine the existing internal Sharia audit approach and operational procedures employed by the GCC's Islamic banks.
- To present valuable guidelines and recommendations to key stakeholders, based on the study's observational findings, that can be considered to strengthen internal Sharia audit practices.

The objectives of this research will be accomplished by addressing the following questions:

1. How do the regulatory frameworks and internal practices of internal Sharia audit differ among Islamic banks in the GCC countries?
2. What are the current practices, roles and responsibilities of the internal Sharia audit department within the Islamic banks in the GCC?
3. What measures are in place to ensure the competence, independence, confidentiality, ethical compliance, and quality assurance of the internal Sharia audit department within the Islamic banks of the GCC?
4. What would be the most suitable and effective approach to internal Sharia audit for Islamic banks in the GCC?

1.6 SIGNIFICANCE OF THE RESEARCH

Islamic banks operate within a unique environment where they face the dual challenge of complying with regulatory requirements and adhering to Sharia principles. Failing to uphold Sharia principles can expose these banks to significant risks, both in terms of reputation and finances. Instances of Sharia non-compliance risk have been observed in the Islamic finance industry, highlighting the critical role played by robust internal Sharia audit practices.

For example, the case of Dana gas brought attention to the potential consequences when Sukuk issuers attempted to avoid payments to Sukuk holders by declaring the Sukuk as unlawful due to non-compliance with Sharia principles, despite being approved by well-known Sharia scholars (Croft, 2017). Likewise, in South Africa, a prominent Sharia scholar resigned from the Sharia board of PSG Melrose Arch after the institution failed its periodic Sharia audit (Zawya, 2016). Also, the U.S. Securities and Exchange Commission charged Wahed Invest with misleading clients, breaching fiduciary duty, and compliance failures in its Sharia advisory business, resulting in financial penalty of $300,000 (U.S. Securities and Exchange Commission, 2022). These cases underscore the importance of effective regular internal Sharia audit in upholding Sharia compliance even in non-Muslim countries, protecting stakeholders, and promoting the integrity and sustainable growth of the Islamic finance industry.

Although some studies have explored Sharia governance and Sharia audits, such as the research by Khalid and Sarea (2018), Mohamad Puad et al. (2020), and Khalid et al. (2017), these investigations have primarily focused on specific aspects of Sharia audits and have not provided a comprehensive review of internal Sharia audit practices in the largest region offering Islamic banking. Additionally, the existing literature acknowledges limitations in research concerning Sharia audits, as highlighted by Shafi et al. (2014), Aribi et al. (2019), Muhammad and Mustafa (2017), Yazkhiruni et al. (2018), and Zakaria et al. (2019).

The findings of this research are expected to have significant implications for various stakeholders. Firstly, the comprehensive understanding of the regulatory frameworks and real practices of internal Sharia audit in the GCC will empower stakeholders to gain insights into the existing systems. This knowledge will enable them to identify areas for improvement within the Islamic banking sector and implement measures that enhance compliance and transparency. By addressing these aspects, the research aims to strengthen the overall integrity of Islamic banks operating in these countries.

Secondly, the study will attempt to highlight any needed improvement and to propose from the current practices valuable guidelines and policy recommendations for an effective internal Sharia audit framework. The recommendations will provide a standardised and effective framework for ensuring Sharia compliance across different institutions. By offering practical guidance to the industry, the research aims to facilitate the adoption of best practices and enhance stakeholders' confidence in the Sharia compliance of Islamic banks.

Thirdly, this research fills a notable gap in the academic literature on Islamic banking and internal Sharia audit in the GCC. While extensive research have been done on the overall Sharia governance framework and the conventional internal audit practices, the niche area of internal Sharia audit in the GCC remains under-explored.

The ultimate goal of this research is to contribute to the sustainable growth and development of the global Islamic banking industry. By bridging the existing research gaps and providing valuable insights, the study aims to create an environment of trust and accountability within the Islamic banking sector. This will benefit shareholders, Islamic banks' managements, customers, Sharia auditors, and regulators, as well as the overall reputation and stability of Islamic banks worldwide.

1.7 SCOPE OF RESEARCH

The research is focused on investigating the internal Sharia audit practices specifically within Islamic banks operating in the GCC. The GCC region is chosen due to its significant role in the global Islamic finance industry and the presence of a substantial number of Islamic banks that operate under varying regulatory and cultural contexts.

The study will include a diverse range of Islamic banks in the GCC to capture a broad spectrum of internal Sharia audit practices. Also the study will consider the role of regulatory bodies and standard-setting organisations, such as AAOIFI, in shaping and influencing Sharia audit practices. However, other types of Islamic banking institutions such as Islamic investment banks, Sharia compliance insurance, and external Sharia audit are not included in this thesis.

By analysing the results, the research aims to gain insights into the extent of internal Sharia audit implementation in the largest Islamic banking market. The findings will offer valuable recommendation for establishing robust and efficient internal Sharia audit departments in Islamic banks globally.

1.8 OVERVIEW OF THE RESEARCH METHODOLOGY

This research uses qualitative methods, including semi-structured interviews and documentary analysis, to explore internal Sharia audit practices in GCC Islamic banks. Semi-structured interviews with internal Sharia auditors provide diverse insights on audit practices across the region. Additionally, documentary analysis examines relevant regulations, such as AAOIFI governance standards, to understand their impact on current practices. Interviews with senior AAOIFI members and advisors to GCC regulators offer further perspectives. By combining these approaches, the study aims to propose recommendations for an effective internal Sharia audit framework in GCC Islamic banks.

1.9 LIMITATIONS AND DIFFICULTIES

The research, while aiming to contribute valuable insights to the field, is subject to certain limitations that provide opportunities for future researchers to address. Firstly, it is important to note that the data collected will be limited to Islamic banks, and will not include investment banks or other types of Islamic financial institutions, such as Takaful companies (Islamic insurance). This exclusion is necessary due to a different approach required for conducting internal Sharia audit reviews in these institutions. Therefore, future studies could focus on investigating the internal Sharia audit practices within these specific contexts.

Secondly, the recommendations and findings generated from this research will be primarily applicable to Islamic banks in the GCC region. While these findings may hold relevance for implementation in other Islamic banks across different countries, their generalisability may be limited due to different regulatory requirement in other countries. Further studies are encouraged to explore the transferability of these recommendations to a broader international context.

Furthermore, the use of quantitative approaches, like employing a survey questionnaire, has been excluded in this study due to the limited number of Islamic banks operating within the

GCC region. Many of these banks have either a sole internal Sharia auditor or none at all. Recognising the potential lack of participants for the survey and the potential limitations on the level of insights possible, this research is constrained to qualitative research methods.

Lastly, it is important to acknowledge that this thesis does not specifically focus on the external Sharia audit, as it is not widely practiced within the Islamic finance industry yet and many countries lack regulatory requirements for its enforcement. Consequently, the research findings and recommendations primarily relevant to the internal Sharia audit domain.

Overall, these limitations serve as opportunities for future researchers to explore additional contexts, expand the generalisability of the findings, explore the external Sharia audit domain, and ensure unbiased information disclosure in the field of internal Sharia audit within Islamic banks.

1.10 SUMMARY

This chapter provided a comprehensive overview of the research background, problems, and motivations related to internal Sharia audit practices in the Islamic banking industry in the GCC. The chapter also emphasised the importance of AAOIFI in standardising and harmonising operations within the Islamic banking industry. It outlined the research objectives and research questions that aim to address this gap.

Overall, this chapter has set the foundation for the subsequent chapters by providing a solid theoretical understanding and background of Islamic banking, Sharia governance, and the importance of internal Sharia audit. The following chapters will explore further into the specific aspects of internal Sharia audit practices and explore the research objectives in detail.

CHAPTER 2: CORPORATE GOVERNANCE AND AUDIT IN BANKING: A CONVENTIONAL PERSPECTIVE

2.1 INTRODUCTION

Banks' role in the economy is to work as financial intermediaries, collecting deposits from customers and using the funds to finance economic activities for other customers (Hopt, 2021). Protecting the interests of all stakeholders for banks is not an easy task without a proper framework (Wells, 2004, 29).

To address the separation between management and stakeholders, corporate governance was introduced. It ensures transparency, accountability, and a balance of interests among all stakeholders (F. Davis, 2005).

Based on the aforementioned aspects, this chapter provides an overview of the concept of corporate governance, its models and theories, the Basel Committee, the three lines of defence, types of controls, risk management and compliance, and the definition of auditing.

2.2 CORPORATE GOVERNANCE MODELS AND THEORIES

Cambridge English dictionary defines corporate governance as "*how a company is managed by the people who are working at the highest level in it*." According to Rouf (2011), corporate governance supports and increases the value of the company. The board of directors manages the public companies and provides the business plan and leadership to protect the shareholder value and interest.

Osei (2014) argues that corporate governance is founded based on the following reasons:

- The shareholders may have different interests.
- The segregation between the ownership and the company's control might raise a conflict of interest.
- A full review of the company's activity is expensive and cannot be done quickly.

There are numerous corporate governance models and theories associated with the field of corporate governance.

2.2.1. Corporate Governance Models

There are many corporate governance models such as the Anglo-Saxon model, the German model, the Confucian model, the Japanese model, the European model, and the Latin model (Nwanji and Howell, 2007). However, the most common ones in banking are the Anglo-Saxon model and the European model (Ahmad and Omar, 2016).

2.2.1.1. Anglo-Saxon Model

Supporters of the Anglo-Saxon model, also known as shareholder value model, highlight that this model is the best for institutions because the most important stakeholders for institutions are the shareholders. Other stakeholders have different means of protection: employees are protected by trade unions, customers can be protected by the regulators, while shareholders are not protected if management does something wrong (Charreaux, 2008). This corporate governance model was designed primarily to protect the interests of shareholders (Clark, 2009).

2.2.1.2. European Model

The supporters of the European model, also known as stakeholder-value model, approach argues that institutions should fulfil a social role within the community and protect the interests of all stakeholders, such as employees, customers, shareholders, and regulators. Therefore, this model suggests that institutions should balance the interests of all stakeholders rather than focusing solely on maximizing profits for shareholders (Charreaux, 2008).

A systematic review of corporate governance systems highlighted that while the shareholder model is implemented in Anglo-Saxon countries, the stakeholder model is prevalent in European countries and Japan. The latter is more suitable for banking institutions, as it considers both external and internal stakeholders, not just shareholders (Ahmad and Omar, 2016).

The emergence of various corporate governance models can be attributed to differing theories on human nature and corporate governance.

2.2.2 Corporate Governance Theories

The following are the two main theories associated with the Anglo-Saxon and European corporate governance models:

2.2.2.1. Agency Theory

This theory addresses the relationship between shareholders and executives within an institution. It is based on the concept that the shareholders give the authority to manage the institution to the executives which eventually will create conflict of interest. The main issue in this theory is the potential for agents (the executives) to prioritize their own interests over those of the principals (the shareholders), leading to agency problems (Jensen and Meckling, 1976).

The theoretical aspect of this theory is based on the assumption that both the shareholders and the executives are rational, with the possibility that the executives are aiming to take personal benefits that may not be in line with the shareholders interest. To manage this risk for shareholders, many governance mechanisms are recommended in this theory such as performance-based bonus and independent board oversight (Fama and Jensen, 1983).

The criticism of this theory is that it focuses mainly on the relationship between the principal (the shareholders) and the agent (the executives) which eventually may neglect the interest of other stakeholders such as the employees and the regulators (Hill and Jones, 1992). However, despite this criticism, this theory remains a dominant framework in corporate governance where Anglo-Saxon model is implemented (Shleifer and Vishny, 1997).

2.2.2.2 Stakeholder Theory

This theory presents an important framework in corporate governance, where companies are expected to take into account the interests of all stakeholders, not just the shareholders (Freeman, 1984). This theory contrasts with the Anglo-Saxon model and more relevant to European corporate governance model (Jurgens et al., 2010). On the other hand, this theory expects institutions to consider the interests of all stakeholders, including employees, customers, regulators, and the wider community (Donaldson and Preston, 1995).

Freeman (1984) highlighted that by focusing only on the interest of the shareholders, institutions may neglect critical relationships that could lead to long-term difficulties, including reputational damage, regulatory fines, or operational inefficiencies. Also, according to Jones (1995), taking into account the interest of all stakeholders can improve the decision-making processes, increased trust, and ultimately, improved the work of the institutions overall.

However, the stakeholder theory has faced criticism for being too difficult to be implemented. Critics argue that attempting to balance the interests of all stakeholders can lead to conflicts and ambiguity in decision-making (Jensen, 2001).

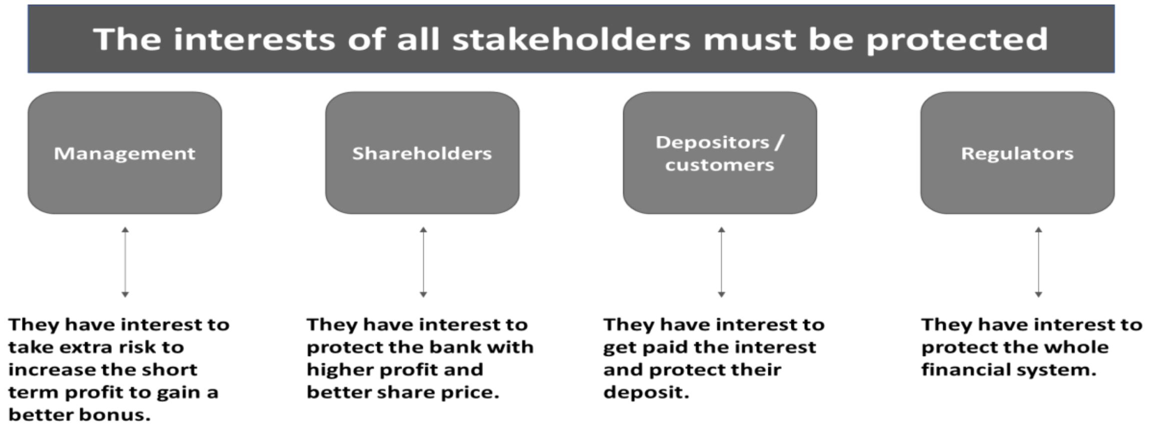
Despite the criticism of the stakeholder theory, the theory has gained considerable traction, particularly in European countries and Japan, where it has influenced the development of corporate governance models that emphasize broader responsibilities (Ahmad and Omar, 2016). The theory has also been reflected in international guidelines, such as those from the Basel Committee, which integrate aspects of both shareholder and stakeholder perspectives to create a more balanced approach to corporate governance (Charreaux, 2008).

2.3 CORPORATE GOVERNANCE IN BANKING

When it comes to banking, the primary parties involved with banks are the management, the shareholders, the depositors/customers, and the regulatory authorities. The management controls the bank's day-to-day activities and is interested in taking additional risks to increase the short-term profit to get a better bonus (Chiu and Mckee, 2015, 1-9).

On the other hand, the shareholders' main interest is increasing the dividend and having better share prices. Contrarily, the depositors' or customers' fundamental interest is to get paid the return and protect their deposit. Lastly, the regulators' interest is to protect the whole economy and the financial system (Chiu and Mckee, 2015, 1-9). Therefore, a corporate governance framework must be in place to protect all stakeholders' interests (Chiu and Mckee, 2015, 1-9).

Figure 1: The interest of different stakeholders in a bank



Chiu and Mckee, 2015

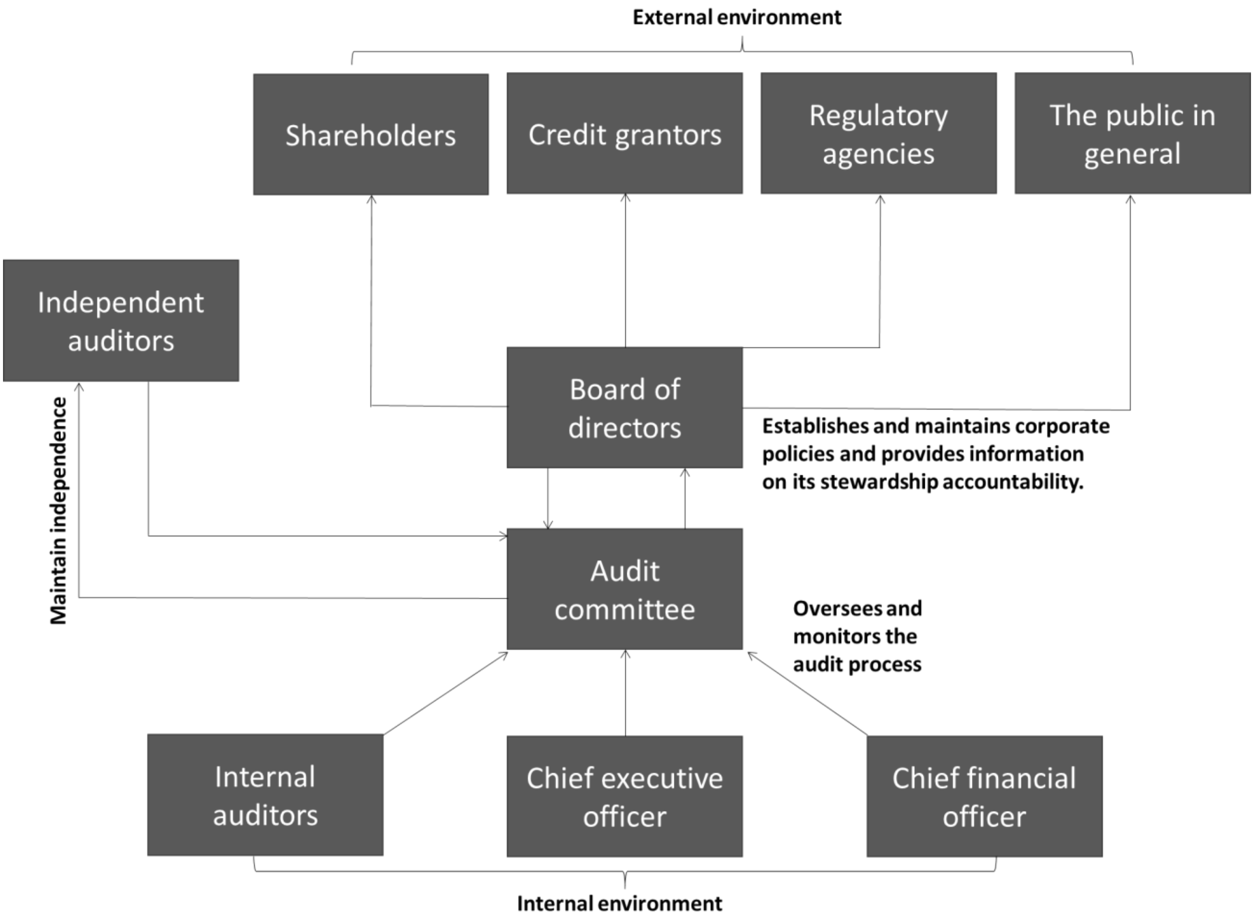
After the mass financial crisis, the governance systems have been strictly reviewed by the regulators and supervisors. The new mandate requires banks to organise their governance transparently. All banks must have an effective process to identify, assess, manage, and monitor all risk types (Battaglia and Carboni, 2018). On top of that, banks must have robust internal controls for audit, compliance, and risk management (Battaglia and Carboni, 2018).

Charkham (2003:15) points out that banks' strong corporate governance system is crucial compared to other companies. The bankruptcy of one bank might have a domino effect on other banks and might collapse the whole economy.

D. Hill (2012, 193 – 197) points out that the management of a bank is responsible for conducting and managing day-to-day operations, while the board of directors is responsible for setting the bank's objectives and strategy and providing leadership and supervision for the management and report to shareholders on their stewardship of the bank. The board of directors conducts its responsibilities by creating committees to inspect the performance of the management. Usually, these committees consist of the remuneration, nomination, and audit committee. Each of these committees will have its chair oversee part of the corporate governance and report directly to the board of directors (D. Hill, 2012, 193 – 197).

The audit committee is responsible for helping the board of directors achieve its overseeing responsibilities related to the financial reporting, control system, risk management framework, and internal and external audit functions. According to Asiriuwa, Joshua Aronmwan, Uwuigbe, and Ranti Uwuigbe (2020), the audit committee was obligatory before 1987. The audit committee is one of the mechanisms of corporate governance, and it is the arm of the board of directors. It is accountable directly to the board and is responsible for ensuring reporting accuracy and managing the agency obstacle between the management and the shareholders.

Figure 2: The board of directors and the audit committee's accountability relationship



Braiotta, Gazzaway, Colson and Ramamoorti, 2010, 33

According to Braiotta, Gazaway, Colson and Ramamoorti, 2010, 4, the audit committee (which should include a non-executive director) will achieve its goals by concentrating on the following areas: (1) accurate accounting skills and integrity of the management (2) reviewing the internal and external controls, (3) enough resources for all committees, and (4) awareness about the economics of every transaction.

Based on the above, appropriate corporate governance would probably protect all stakeholders' interests by providing policies, procedures, and rules for managing the company. Corporate governance is essential in banks compared to other companies to protect the interest of depositors, and failure in one bank might lead to a collapse in the whole financial system.

Each bank must have a board of directors responsible for protecting the interest of all stakeholders. To perform the duty well, the board of directors will appoint an independent audit committee to ensure the accuracy of the reporting and disclosures, suitability of the internal and external controls, oversight of the risk management framework, and work closely with internal and external auditors.

To ensure everyone in the bank fulfils their duties effectively, the audit committee and the management will nominate some roles to coordinate effectively and efficiently among everyone in the bank. These roles might be risk managers, regulatory compliance managers, and internal and external auditors. Each of these roles will work in a specific line of defence to improve controls' effectiveness and enhance the risk management framework.

2.4 THE BASEL COMMITTEE

The Basel Committee on banking supervision was formed in 1974 as an international platform by the central banks (Amayrah & Al-Afeef, 2022). Its main goal is to bolster global financial stability by establishing international standards, including corporate governance norms, for banking regulations and supervisory practices. These guidelines are highly regarded and adopted by central banks and financial regulators worldwide (Miljković et al., 2013).

The Basel Committee places strong emphasis on the importance of having strong and effective corporate governance in banking. They believe that good governance plays a crucial role in ensuring that financial institutions are well-managed and stable. It starts its 2015 Guidelines on Corporate Governance Principles for Banks with the phrases: "*Effective corporate governance is critical to the proper functioning of the banking sector and the economy as a whole*" (BCBS, 2015).

The guidelines of the Basel Committee related to corporate governance started to become more important after the global financial crisis in 2007, as there have been efforts to strengthen corporate governance in banks. These efforts include better board oversight, rigorous risk management, strong internal controls, and improved engagement between boards and management (BCBS, 2015). This is crucial because, in practice, banks are recognised as unique entities compared to non-banking institutions. The unique characteristics of banks include their relatively low capitalisation, complex and unclear business activities, fundamental reliance on trust, and their critical macroeconomic function in the overall economy. These attributes lead to extensive legislation and state regulation affecting banks, often resulting in recurring banking crises and the perception of being "too big to fail" or "too interconnected to fail.

Early studies, mainly in the US, focused on the principal-agent dilemma, but more recent empirical research has shed light on the unique governance challenges specific to the banking context. Research conducted by Fahlenbrach and Stulz (2011) reveals that bank CEOs who prioritise shareholder interests tend to achieve worse results. Similar findings by Beltratti and Stulz (2012) indicate that banks with shareholder-friendly boards also experience significantly poorer outcomes. Several studies have shown that the composition and characteristics of bank boards have notable effects, with boards having higher shareholder representation being more willing to take greater risks. Based on these studies, it is clear that the management and the shareholders might share the same financial goal of increasing profitability. However, this goal might not be in line with the goals of the depositors and the regulators.

It appears that bank boards’ often steer their decisions in line with the preferences of shareholders, particularly when shareholders have diverse holdings and are more open to embracing risk compared to other stakeholders like a bank's creditors. As a result, the notion that poor corporate governance significantly contributed to the financial crisis has been supported by Beltratti and Stulz (2012).

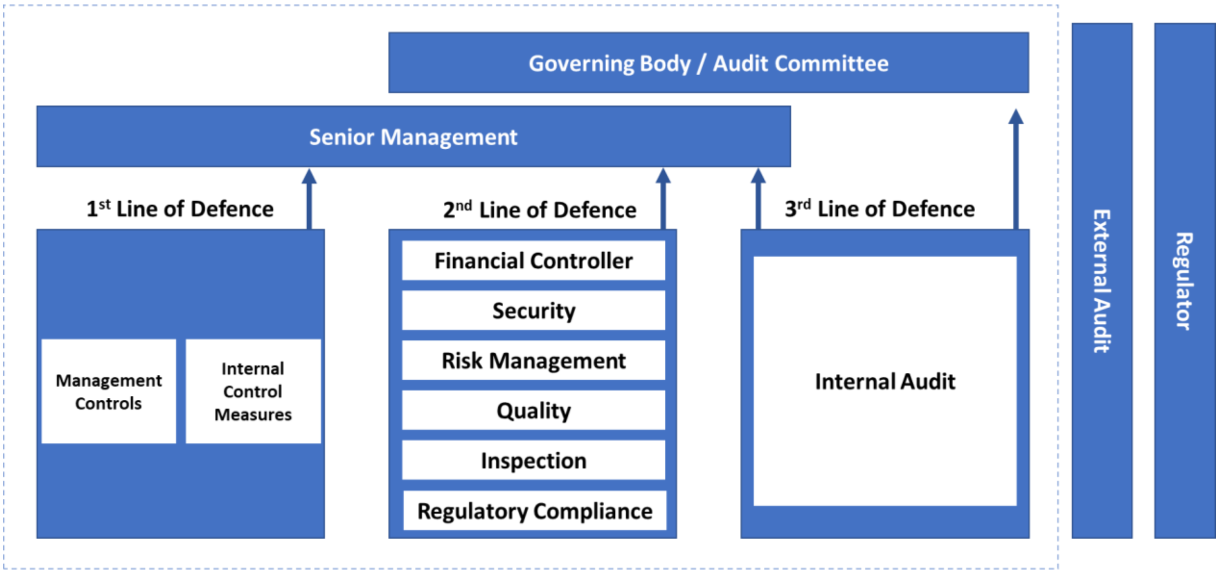
To improve the corporate governance framework at banks, the 'three lines of defence' model was recommended and highlighted in the Basel Committee's Guidelines on Corporate Governance Principles for Banks. Additionally, the board and senior management are expected to define conduct risk based on the bank's business context and set the tone at the top to foster a sound corporate and risk culture (BCBS, 2015). Written codes of ethics or conduct are also encouraged to promote honesty and accountability for the benefit of customers and shareholders (BCBS, 2015). Based on these requirements, the Basel Committee improved corporate governance for banking by incorporating the best aspects of both Anglo-Saxon and European corporate governance models, as well as agency and stakeholder theories.

2.5 THE THREE LINES OF DEFENCE

In line with the corporate governance requirements, the board of directors will delegate their responsibilities to the CEO and senior management. After this delegation, the management's job is to maintain leadership and provide guidance to all staff within the company regarding appropriate controls, risk management, and the approved risk appetite (D. Hill, 2012, 193 - 197).

According to the internal auditors' institute, the company's three lines of defence will ensure the effectiveness and efficiency of the company's risk management framework. The three lines of defence differentiate between three parts of risk management (figure 3). The first line includes departments that provide internal controls and manage risks, and the second includes departments that oversee risks. In contrast, the third line contains the independent assurance that everything is working correctly and in line with the policies and procedures (Chartered Institute of Internal Auditor, 2019a).

Figure 3: The three lines of the defence model



Adopted from ECIIA/FERMA Guidance on the 8th EU Company Law Directive, article 41
CIAA Website
Three lines of defence model from the institute of internal auditors

As shown in the above figure, the first line of defence represents the "boots on the ground" or the business unit that conducts the day-to-day operations. This line manages the risk by ensuring adequate controls are in place, and everyone in this line follows the standard procedure (such as sales, IT, and marketing departments). The second line of defence includes risk and compliance functions. Their responsibility is to build processes and procedures to ensure controls are implemented correctly in the first line of defence. The third line of defence is an internal audit department. This department reviews all departments' controls and risk management procedures in the second and the first lines. This department is independent and reports the findings to the audit committee and senior management (Lim, 2017, 160).

Accordingly, the management's responsibility is to create and ensure controls are in place for every process and activity. If all rules are implemented and working correctly 100%, there would be no need for the second and third defence lines. However, according to Weatherford and P. Ruppert (2016), the first line of defence has historically been less than 100% effective and efficient. Hence, the board of directors and the management must ensure the first line is working as required.

2.6 RISK MANAGEMENT AND COMPLIANCE

For each process related to the first line of defence, there must be internal control to mitigate the risk associated with the relevant process. Internal control is usually documented in the processes, guidelines, and procedure manuals that include the managers' responsibility and the team responsible for the relevant process. These processes, guidelines, policies, and procedure manuals must be updated regularly as these documents' efficiency and effectiveness are fundamental to the risk manager, compliance officers, and auditors (king and R Khan, 2012, 161).

Risk defines as "*the possibility of incurring misfortune or loss*," and risk management is "*the sum of all the actions taken by the organisation to manage the risk that could occur (BPP, 2015, 157 - 180).*" The risk management function works in the second line of defence and does not aim to eliminate the risk, but it pursues highlighting the potential risks and providing controls to manage these risks. Several types of risks may face banks. These risks could be credit, market, liquidity, reputational, regulatory, operational, and Sharia non-compliance risks for Islamic banks (BPP, 2015, 157 - 180).

One of the main risks that banks may face is the regulatory non-compliance risk. It is the risk of material loss and reputational damage arising from failure to comply with the rules and regulations (Ghirana and Bresfelean, 2012). The term compliance means obeying or working per rules, standards, and regulations. In banking, non-compliance is a type of risk and will adversely impact the shareholders and the whole economy (P. Ramakrishna, 2015, 67 - 84).

The compliance department's goal (the head of compliance usually reports directly to the Chief Risk Officer) is to prevent, detect, and provide resolution of violations of rules and regulations. Therefore, the responsibility of a compliance department in a bank is to collect and evaluate the laws and regulations, determine the risk, provide efficient control and proactively manage the risk, and report any breaches to the management and/or regulators when needed (P. Ramakrishna, 2015, 67 - 84).

According to the Basel Committee on banking supervision, compliance with regulations starts at all management levels, particularly at the top, where the board members and the executives' team lead by example (Basel Committee on Banking Supervision, 2005). The committee defines the regulatory compliance risk as "*the risk of legal or regulatory sanctions, material financial loss, or loss to reputation a bank may suffer as a result of its failure to comply with laws, regulations, rules, related self-regulatory organisation standards, and codes of conduct applicable to its banking activities*." Therefore, by having a compliance department, the bank ensures that they are an excellent corporate citizen in the country they are operating in, avoids exposure and liability, and protects the bank, employees, assets, and revenue (Basel Committee on Banking Supervision, 2005).

To summarise, banks may face many types of risks, including credit, capital, market, reputational, and regulatory risk. Banks usually have a compliance department responsible for ensuring all bank activities are compliant with the rules and regulations to mitigate regulatory risk. The compliance department works in the second line of defence and reports directly to the Chief Risk Officer. The non-compliance issues will be reported to the management and the regulators when needed. However, the compliance department focuses mainly on regulatory non-compliance risk and is not designed to review the bank's internal controls environment, which is the audit function's responsibility.

2.7 AUDITING IN THE BANKING SECTOR

The compliance and audit functions may seem similar at first glance, as both work cooperatively to ensure the bank's effectiveness and efficiency. However, they have distinct roles and responsibilities.

The concept of audit was utilised in many ancient countries and can be traced back to Mesopotamia, where signs were used to count shipped goods and authenticate financial deals (CIAa, 2017, 14). In ancient Rome, the term "audit" originated from the Latin word "auditus," meaning a hearing. During that era, an auditor's role involved listening to and verifying the accounts read by an accountant. Over time, auditors' responsibilities evolved and gained recognition from shareholders, the board of directors, and management (CIAa, 2017, 14).

Currently, audits serve various purposes, including reviewing financial information, ensuring compliance with regulations, assessing the processes and procedures of operational departments, evaluating information technology, and managing risk and control (CIAa, 2017, 14).

The auditors in a bank report directly to the audit committee, which is an integral component of corporate governance. The audit committee serves as an objective intermediary between management, auditors, shareholders, lenders, and regulators. Its responsibilities include assisting the board of directors in overseeing financial reporting, internal controls, compliance with regulations, and reviewing the results of both internal and external audits (Braiotta, Gazzaway, Colson, and Ramamoorti, 2010, 57).

Both internal and external auditors are essential monitoring tools, ensuring the effectiveness and efficiency of banks' operations. Proper communication between internal and external auditors, including joint planning and coordination, has been argued to significantly enhance the audit's effectiveness and efficiency (Pilcher et al., 2011).

The Institute of Internal Auditors (IIA) defines the internal audit as: "*An independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes* (International Professional Practices Framework, 2019)".

On the other hand, external auditors verify to the internal controls based solely on the bank's financial reports and information. These auditors are not employees of the bank, and therefore, they have no vested interest in the bank's activities (CIA, 2017, 1). According to the Association of Certified Fraud Examiners, the external auditors' role is to review the bank's accounting records and assess whether the information in the financial reports is accurate and fair. The main differences between internal and external audits are illustrated in table 1.

Table 1: The distinct roles of internal and external audit

Items	Internal audit	External audit
Objective	Internal auditors provide additional assurance to the board of directors and management regarding the critical risks associated with management activities. They also offer advice to the management to assist them in fulfilling their duties and responsibilities	Provide an extra assurance to the shareholders that the financial reports are accurate and fair
Purpose	To evaluates the activities of the bank and provide controls for improvement	To review and verify the financial reports of the bank
The report	The audit report will go to the audit committee and senior management	Board of directors, shareholders, investors, regulators. Their report will be part of the company's annual report.
Employment	Internal auditors are employees of the bank and appointed by the management, and report directly to the audit committee or the board of directors	From outside the bank (third party), they are appointed by the shareholders (or the board of directors) and report directly to shareholders.
The frequency of the audit	Ongoing	Annually

Timing	Present/future, ongoing	Past, point in time
Responsibility for improvement	Essential	None
Independence	Independent as they report directly to the audit committee. However, the internal auditors are salaried employees of the bank	An independent 3rd party conducts the audit for the bank
Outcome	Help the bank to improve its controls and accomplish its objectives	Opinion on financial statement

Note: Adopted mainly from (Chartered Institute of Internal Auditors, 2020)

In brief, the internal and external audits share a common word in their names, but they are different and work well together. Both functions are independent and involve reviewing and checking numerous transactions. However, internal auditors provide an opinion on the efficiency of the risk system, the effectiveness of internal controls, and the capability of the governance process. In contrast, external auditors aim to express an opinion on the actual value of the financial accounts.

2.8 SUMMARY

This chapter has provided a foundational understanding of corporate governance and its models, theories, components. The core elements of corporate governance in banks encompass the board of directors and essential committees, such as the audit committee. The Basel Committee emphasises the importance of strong governance in ensuring well-managed and stable financial institutions.

Furthermore, effective risk management is crucial for all banks, necessitating the establishment of three defence module lines. The first line involves internal control departments responsible for managing various risks across departments. The second line comprises departments overseeing daily business operations and risk management, ensuring continuous review and regulatory compliance. Lastly, the third line comprises independent assurance departments, like the internal audit function, providing objective evaluations to the board of directors and executive committee.

By understanding these principles, the next chapter will explore the Sharia governance framework at Islamic banks.

CHAPTER 3: SHARIA GOVERNANCE IN ISLAMIC BANKING

3.1 INTRODUCTION

The Sharia governance framework is vital for Islamic financial institutions to effectively and efficiently manage Sharia non-compliance risk. This extra layer of governance enhances the accountability and transparency of Islamic banks to shareholders, regulators, customers and help the management to manage associated risks related to Sharia non-compliance (Ahmed and Bin Mohamad, 2019).

This chapter aims to provide an overview of Sharia governance in Islamic banks. To this end, the first section provides a basic understanding of Islamic finance and banking. It gives an overview of the banking Sharia rules and principles, the types of Islamic contracts and instruments available in the market, and the components of the Islamic finance industry. It further explores the supporting institutions for Islamic finance and the need for the Sharia governance framework.

The second section discusses the Sharia governance framework. It covers the Sharia governance component that includes the central Sharia Supervisory Committee, the Sharia Supervisory Committee at the institutional level, the Sharia compliance department, the internal Sharia audit, and the external Sharia audit.

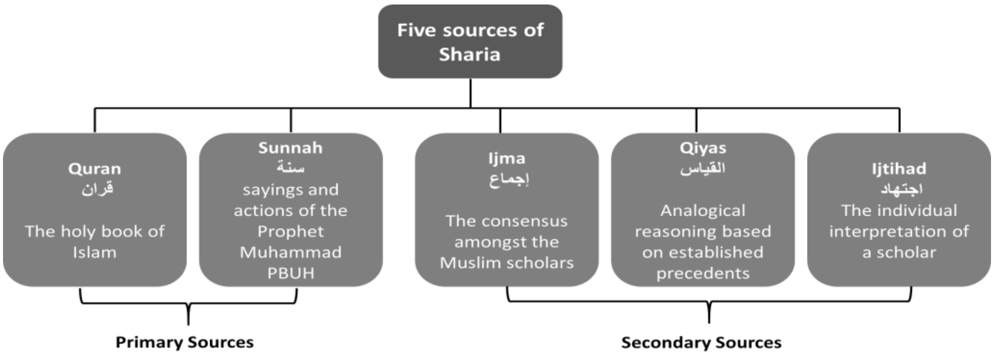
3.2 BANKING SHARIA RULES AND PRINCIPLES

3.2.1. Sharia and its Objectives

In linguistic terms, Sharia refers to the straightforward, well-trodden path of water where people come to drink from it and fill their buckets (Lisaan Al-Arab 8.175). In legal terminology, Sharia refers to the Islamic law where God has defined and explained what is permitted (Halaal) and prohibited (Haraam) for the Islamic religion's followers. Therefore, Sharia includes the rules and principles governing all Muslim people's behaviours, from their relationship to the global Muslim community (Alashari, 2019).

The primary sources of Sharia are the Quran (the holy book of Islam) and Sunnah (sayings and actions of the Prophet Muhammad PBUH) (Rowley, 2014). Derived from these two sources, Muslim scholars developed the secondary sources that include the Ijmaa (the consensus amongst the Muslim scholars), the Qiyas (analogical reasoning or estimating something in terms of another), and the ijtihad (the individual interpretation of a scholar) (Abdelaal, 2012: 156). AUF (2016) argues that these five sources of Sharia regulate all aspects of Muslims' lives. These aspects can be divided into three main realms: the political governance of the state, legal, and economical.

Figure 4: The five sources of Sharia



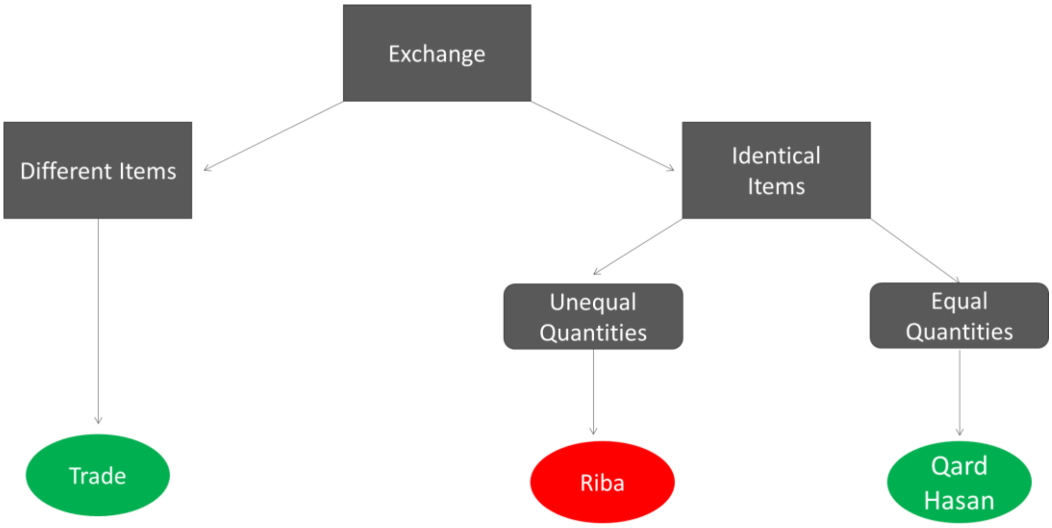
Abbas (2015) points out that the outcome of any financial transaction must achieve Maqasid al-Sharia. Maqasid al-Sharia refers to the Sharia principles' purpose, aim, and objective. According to Imam Al-Ghazali, Maqasid al-sharia is to protect the welfare and the health of all humans, which includes the preserve their faith (din), their life (Nafs), intellect (Aql), posterity (Nasl) and wealth (Mal) (Chapra 2000, p.118). Therefore, the protection of faith and wealth are one of the main objectives of Sharia principles. The Islamic economic system principles have been studied by many researchers (Lewis and Algaoud, 2001; Abdul-Gafoor, 1999; Iqbal, 1997).

The fundamental principles of the Islamic economic framework encompass:

3.2.1.1. Avoidance of Riba

Most Muslims commonly known Riba as "usury" or "interest"; however, its literal meaning is "to grow" or "expand" or "increase". From a Sharia perspective, any contract that includes an element of Riba is considered a void contract and not allowed for Islam followers. Elasrag (2010) asserts that, in accordance with Sharia, currency serves as a unit of valuation rather than a trade commodity. Based on that, money in Islam can be used only as a medium of exchange, not as a commodity by itself, and the profit generated must be based on Profit and Loss Sharing (PLS). Figure 5 below illustrates the Riba in an exchange contract:

Figure 5: The Riba in an exchange contract



Faruq Ahmad and Hassan (2007) point out that Muslim scholars have divided Riba into two types:

3.2.1.1.1. Riba al Nasiyah (Nasiyah means 'defer' or 'wait')

It is also known as Riba al-Quran, and it is considered the primary form of Riba. This type of Riba is identical to the additional money paid to lenders to compensate them for waiting to get their money back. Most Sharia scholars agree that this type of Riba is similar to the current interest charged by banks. The prohibition of this Riba is stated mainly in the Quran and Sunnah.

Qur'an 2:278-279:

> *"O you who believe, fear Allah and give up what remains of your demand for Riba if you are indeed believers. If you do it not, take notice of war from Allah and His Messenger." Also, the Prophet PBUH said: "Every loan that draws interest is Riba."*

3.2.1.1.2. Riba al-Fadl (it is also known as Riba al-Hadith)

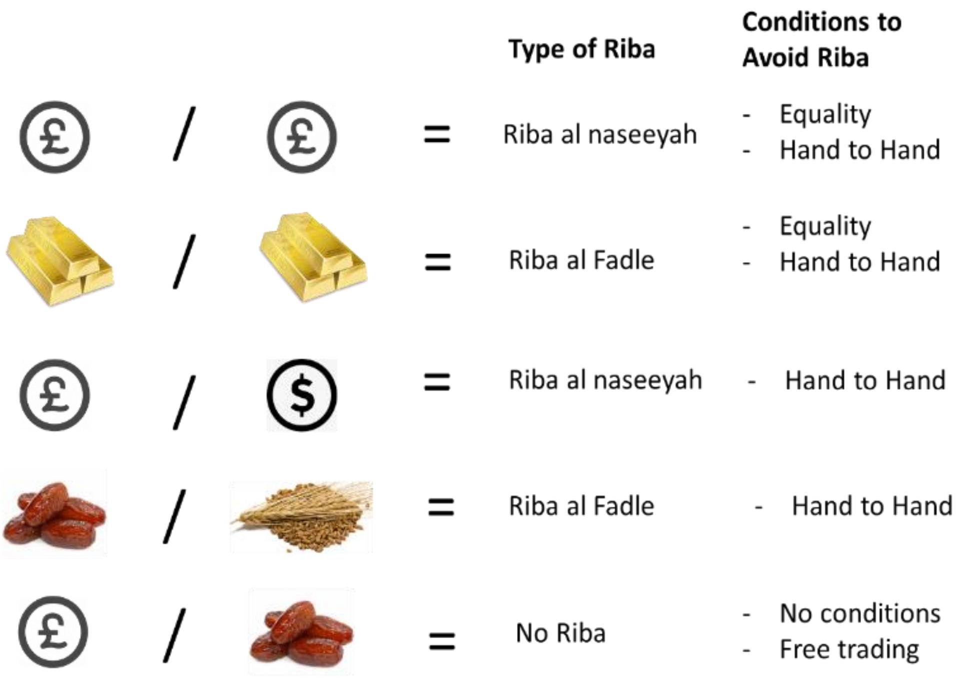
This type of Riba is more related to commodities. The Prophet Mohammad PBUH said:

> *"Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates and salt for salt, the like for the like, hand to hand (i.e., immediate sale), (but) if the kinds differ, then sell as you may like it from hand to hand."*

Therefore, the above commodities' exchange can differ in characteristics (like gold with silver). Otherwise, the exchange of these commodities with itself (such as gold for gold) must be equal in the type, quantity, quality, and at spot price. It is prohibited to exchange these commodities in differing amounts to stop and avoid the hidden Riba. That to not allow one party to get unjustifiable benefits under the name of the sale (Ashraf Usmani, 2020). More evidence about the prohibition of Riba in the Quran and Sunnah is highlighted below.

Figure 6 illustrates the differences between Riba al-Naseeyah and Riba al-Fadle and the conditions to avoid both kinds of Riba:

Figure 6: Riba al-Naseeyah and Riba al-Fadle



Siddiqi (2004) argues that usury includes taking extra money from needy people without compensation. Therefore, this type of contract results in injustice to the borrower, and the wealthy party will get richer while the poor party will get poorer. Also, the party charging usury will earn money without going out to work. Also, when charging money on the money, the lender is not generating anything new in the economy. The consequences will be corruption in society and negative growth in the whole economy.

El-Gamal (2003) argues that most Sharia scholars agree that interest charged and paid by banks is prohibited. However, very few scholars argued that banks' interest paid and charged is not identical to the Riba mentioned in Quran and Sunnah. As the ex-grand Mufti of Egypt (Sheikh Mohammed Tantawi) issued a Fatwa (Sharia certificate), the fixed interest rate offered by conventional banks on deposit is permitted and not the same as the Riba prohibited in the Quran Sunnah. However, Fatwa contradicted most Islamic scholars' consensus that all types of interest rates offered by banks are forbidden under Sharia.

In 1965 a conference was held in Egypt, and it included eighty-five Sharia scholars from thirty-five countries; and they resolved in that conference the following "*Lending money with Riba is forbidden, and no need nor necessity makes it permissible; borrowing money with Riba is also forbidden, and its sin not removed unless there is a necessity for it*" and during that conference, they stated that "*Banks' interest on deposits is a form of Riba that forbidden in the Quran and Sunna*" (Alsalous et al., 2010, p.94).

Also, the first international conference on Islamic economics held in Saudi Arabia in 1976 and attended by more than 300 Islamic scholars and financial experts concluded that the interest paid by banks was prohibited under Sharia (Hasan, 2016).

Likewise, the Pakistan council of Islamic ideology which held in 1980, and concluded its report the following: "*The term Riba encompasses an interest in all its manifestations irrespective of whether it relates to loans for consumption purposes or productive purposes, whether the loans are of a personal nature or a commercial type, whether the borrower is a government, a private individual or a concern, and whether the rate of interest is low or high*" (See the Council's Report, 1980, p.1).

Additionally, the Riba or interest is confirmed to be prohibited in the following years: a statement from the International Islamic Fiqh Academy in 1985, a decision of the Council of the Islamic Fiqh the Muslim World League held in 1986, a report from many Azhar Sharia Scholars about the in 1991 (Alsalous et al., 2010, p.27).

The Sharia scholars reach their decision about the prohibition of Interest (Riba) from Quran and Sunnah:

a- Evidence from Quran

- *That is because they say, "Trade is [just] like interest." But Allah has permitted trade and has forbidden interest. Quran 2:275*

- *Allah destroys interest and gives increase to charities. And Allah does not like every sinning disbeliever. Quran 2:276*
- *you who have believed, fear Allah and give up what remains [due to you] of interest if you should be believers. And if you do not, then be informed of a war (against you) from Allah and His Messenger. Quran 2:278*
- *O you who have believed, do not consume usury, doubled and multiplied, but fear Allah that you may be successful. Quran 3:130*

b- Evidence from Sunnah

- The Messenger of Allah (PBUH) cursed the one who accepts Ar-Riba (the usury) and the one who pays it [Muslim, Book 18, Hadith 105].
- Jabir said that Allah's Messenger (PBUH) cursed the accepter of interest and its payer, and one who records it, and the two witnesses, and he said: They are all equal it [Sahih Muslim 1598].
- On the authority of his father: I heard the Messenger of Allah (PBUH) say in the Farewell Pilgrimage: "Lo, all claims to the usury of the pre-Islamic period have been abolished. You shall have your capital sums deal not unjustly, and you shall not be dealt with unjustly [Sunan Abi Dawud 3334].
- It was narrated from Ibn Mas'ud that the Prophet (PBUH) said: "There is no one who deals in usury a great deal (to increase his wealth), but he will end up with little (i.e., his wealth will be decreased)." [Book 12, Hadith 2365].

Based on the above, in Islam, the concept of money differs from conventional views. It is considered to have no intrinsic value and is primarily utilised as a store of value rather than being treated as a commodity in its own right. This perspective leads to a unanimous agreement (Ijma) among Sharia scholars that the charging of interest, known as Riba, is strictly prohibited. The Quran emphasises the seriousness of dealing with interest, as it attracts severe consequences. Muslims are urged to approach this matter with great caution, as it is considered in Quran as an act of defiance against God and His messenger, prompting a declaration of war.

In summary, Islamic principles guide the perception and use of money, rejecting the notion of money being a commodity and strictly forbidding the practice of charging interest to ensure a just and ethical financial system in accordance with Islamic teachings.

3.2.1.2. The prohibition of Gharar

"Gharar" literally means "deceit," "fraud," "cheat," or "uncertainty". In financial contracts, it refers to elements that are unclear or contain errors, leading to uncertainty about the outcome (Usman, 2022). Therefore, for any contract to be considered valid from a Sharia point of view, its outcome must be clear, fair, and not misleading.

According to Akther (2015), Gharar can be divided into two types: substantial Gharar, which involves buying a house with a price specified in the future, and minor Gharar, which may be acceptable in a contract – for example, buying a property and its furniture without knowing the exact condition of the furniture yet. Gharar is prohibited in the Quran, although it is not explicitly mentioned in any verse. It is also discouraged in the Sunnah, and many Sharia scholars agree that Gharar is a form of Maysir (gambling).

The Quran:

> *"Eat not your property among yourselves unjustly by falsehood and deception, except it be a trade amongst you by mutual consent (Al-Bakarah, 2:188).*

Additionally, in the Sunnah, the Prophet Muhammad (peace be upon him) mentioned that it is not allowed to purchase the unborn animal in the mother's womb or sell the milk in the udder without a measurement (Rahman, 2010; p.71). The well-known Sharia scholar, Zamakhshari, argues that the following actions are forbidden from a Sharia perspective: theft, dishonesty, gambling, and Gharar.

Gharar might be present in the subject matter (when the specifications of the asset or service are unknown), in the price (when a financial transaction takes place without mentioning the price), and in the time (if the payments are deferred for an unknown period). Accordingly, there are three conditions under which the contract will be invalid due to Gharar. First, when the Gharar is substantial. Second, when the Gharar occurs in a bilateral agreement. Third, if it is affected by the subject matter (CISI, 2013: 40 - 41).

Likewise, Maysir (literally meaning gambling) is also prohibited. It is translated as "games of chance in which one of the parties might make substantial gain without any effort or suffer a total loss based on mere luck only" and includes substantial Gharar (Maysir has an element of

Gharar, but not every Gharar is Maysir) (Vogel and Hayes, 1998). According to Brenner (1990), gambling is done by the anticipation of gaining money based on luck. In financial transactions, speculation, conventional insurance, and derivatives are considered prohibited due to the element of Maysir in these transactions.

The Maysir prohibited in the Quran and Sunnah

> *“they ask you about wine and gambling. Say: 'In them, both lies grave sin, though some benefit, to mankind. But their sin is more grave than their benefit.” Quran 2:219.*

Narrated Abu Huraira: The Prophet said:

> *"Whoever swears saying in his oath. 'By Al-lat and al-Uzza should say, 'None has the right to be worshipped but God; and whoever says to his friend, 'Come, let me gamble with you,' should give something in charity."Sahih Bukhari, Book 78 (Oaths and Vows), hadith 645.*

The following table summarises the types of Gharar and how they compare with Maysir:

Table 2: The differences between Gharar and Maysir

Type	Outcomes	Conditions	Sharia position
Maysir	Win-lose, lose-win	No mutual gain	Unacceptable
Major Gharar	Win-win, win-lose	Win-win is not dominant Win-lose is significant	Unacceptable
Minor Gharar	Win-win, win-lose	Win-win is dominant Win-lose is insignificant	Acceptable

Based on the above, Islamic banks should be clear, fair, and not misleading their customers. Otherwise, these banks will not be in line with Sharia principles.

3.2.1.3. The investment in ethical activities

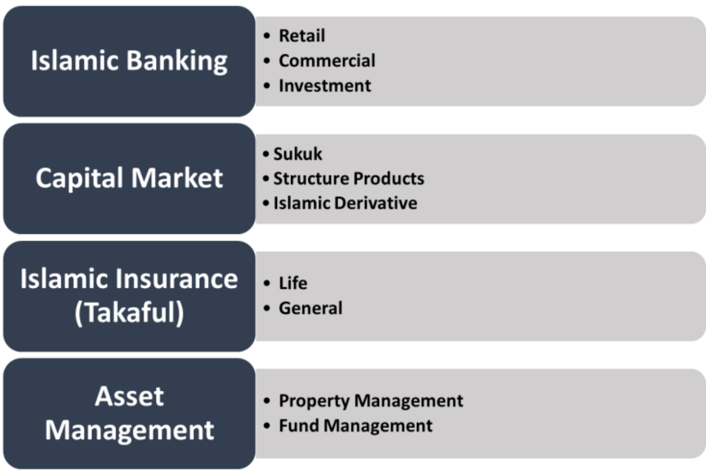
Sharia-compliant banks were established with the aim of promoting ethical outcomes for all involved parties. Their funding sources and transactions must align with Sharia principles, ensuring that they adhere to ethical standards. As a consequence, Islamic banks are restricted from investing in businesses related to alcohol, casinos, pornography, tobacco, weapons, pork, and other activities considered unlawful according to Sharia rules and principles (Usdeldi et al., 2021). Additionally, they steer clear of engaging in future trading, short selling, and options, as these practices are viewed as extremely risky and are outright prohibited (Chenguel, 2014).

Given these three prohibited elements, they are safeguarded under the concept of protecting wealth in Maqasid al-sharia. Consequently, any financial transactions conducted by Islamic banks are deemed permissible from an Islamic perspective as long as they avoid Riba (interest), Gharar (uncertainty), and non-ethical investments. Upholding ethical and moral values is ingrained in all aspects of Islamic banking operations.

3.2.2 ELEMENTS OF THE ISLAMIC FINANCE SECTOR

The primary constituents of the Islamic finance sector comprise Islamic banking, the Islamic capital market, Takaful (Islamic insurance), and Islamic asset management, as outlined by Abbas (2015).

Figure 7: Components of the Islamic finance industry



The banking system serves as the lifeblood of the modern economy, acting as an intermediary between savers and investors. Its primary functions include aggregating funds, investing money, generating profits, and providing various services to customers (Khaki and Sangmi, 2011). One of the foundational principles of the current banking system is the charging and paying of interest. However, as stated in this section, the interest is strictly prohibited in Islam, which means that a banking system in accordance with Islamic principles cannot be based on interest (Khaki and Sangmi, 2011).

This thesis primarily focus on Islamic banks and their approach to internal Sharia audit to assess and oversee the products and activities offered by these banks.

3.2.3 TYPE OF ISLAMIC CONTRACTS AND INSTRUMENTS

The consequences of the prohibition of interest (Riba) entail that the generation of wealth or profits must be directly tied to actual economic activities, such as selling or manufacturing a product. As a result, Islamic banks employ various contracts and instruments to adhere to Sharia rules and principles. The primary nature of these contracts is based on assets-based financing (like Murabaha and Ijarah), profit and loss sharing financing (such as Musharaka and Mudaraba), and capital market financing (like Sukuk) (Hanif, 2016).

An overview of the contracts and instruments utilised by Islamic banks is provided briefly in Table 3 below.

Table 3: The most used contracts and instruments in Islamic finance

Contract name	Definition	Application in the industry
Mudarabah (a special type of partnership)	It is a form of partnership in which one party supplies the capital (referred to as the Rab al-Mal or the investor). The other party provides the expertise (the Mudarib or the business manager).	Savings accounts Financing projects Sukuk
Wakalah (agency)	It is an agency agreement in which one party designates another to perform a specific task, typically for a pre-agreed fee.	Saving accounts Sukuk
Qard Hassan (benevolent loan)	It is an interest-free contract signed by a lender and a borrower based on benevolence. Therefore, the borrower should return the same initial value of the loan without anything extra or less.	Current account, Credit cards

Murabaha (cost plus a mark-up)	It is a sale contract at cost plus an additional profit. The seller should disclose both the cost and the profit margin to the buyer.	Trade finance, Working capital finance, Sukuk
Musharakah (partnership)	It is a joint venture contract where two partners or more share the profit and loss and contribute capital to establish a company or project.	Home finance, Commercial finance, Sukuk
Ijarah (lease)	It is a usufruct contract whereby the lessee pays rent to the lessor over an agreed period.	Home finance, Car finance, Sukuk
Sukuk (Islamic bonds)	It is a Sharia-compliant with equal value certificate that links to ownership of commodities or assets. The Sukuk holder gets returns generated from the commodities or assets based on a pre-agreed profit ratio.	Sharia-compliant bonds alternative

Based on the above, each of the products offered by Islamic banks must be structured based on an Islamic contract or instrument. To structure the products, Islamic banks must obtain guidance and advice from Sharia scholars, and regular review and internal Sharia audits must ensure continued compliance with Sharia principles. Further details about the Sharia scholars and the internal Sharia auditors are covered in the next section.

3.2.4 PRIMARY DISTINCTIONS BETWEEN ISLAMIC AND CONVENTIONAL BANKS

As indicated above, the avoidance of interest, Gharar (uncertainty), unethical investments, and the requirement to adhere to Sharia principles in structuring Islamic banking products have shaped the main differences between Sharia-compliant and conventional banks. To clarify these differences, Table 4 below provides a summary of the key distinctions

Table 4: The difference between Islamic and conventional banks

	Conventional Banks	Islamic Banks
Operating models	Based mainly on human-made laws	Based on Sharia rules and principles
Aim	Maximise profit without any restrictions	Also, aim to maximise profit, however, must be in line with Sharia principles
Risk	Transferring risk from one party to another	Based on sharing risk between all parties
Functions	Based on lending and borrowing relationship and must charge interest	Based on participation in partnership business and must avoid charging interest
Relationship	Lenders and borrowers The most important aspect is the creditworthiness of the customers	Could be as: - Partners - Seller and buyer - Investor and trader The most important aspect is the feasibility of the project
Guarantee	Fixed interest rate and the return is guaranteed	The return is not guaranteed
Transparency	Do not have ethical requirements to treat its customers fairly. They do not explain to customers how they invest their money	Must treat all customers fairly. Must inform their customers how they invest their money

Late payment charges	Any penalty charges will apply to the profit. They take benefit from customers suffering	Any penalty charges above direct cost must be donated to charities (if any)
Corporate Governance	They do not have an ethics/Sharia committee, Sharia compliance department, and they do not do Sharia compliance audit review	Must have Sharia supervisory committee, the Sharia compliance department and must do Sharia compliance audit review
Use of customers deposits	They do not have any restrictions, and money can be invested in anything if they can generate an income	Cannot invest in the following businesses: alcohol, casinos, pornography, tobacco, weapons, pork, and any other activities consider unlawful under Sharia rules and principles

Note: Adopted mainly from Abdul Aris et al., (2013)

As can be seen, one of the main differences between the Islamic and conventional banks when it comes to corporate governance is the existence of the Sharia Supervisory Committee, the Sharia compliance department, and the internal Sharia audit. They are the Islamic finance industry's safety valve, and without a proper Sharia governance framework, the whole Islamic finance industry might collapse.

3.2.5 SUPPORTING INSTITUTIONS FOR ISLAMIC FINANCE

Like other conventional banks, Islamic banks are authorised and regulated by the same authorities in the country where they are incorporated. Nevertheless, on the other hand, many Islamic standards-setting bodies were established to ensure the integrity and stability of Islamic financial institutions and assist these organisations in safeguarding the concerns of every party involved.

5.2.5.1. The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI)

AAOIFI is an independent not-for-profit organisation based in Bahrain and founded in 1991. It is responsible for issuing global standards in Sharia, accounting, auditing, ethics, and governance (Abdallah & Bahloul, 2022). These standards encourage the harmonisation of

Islamic financial institutions, improve auditing practices' quality, and increase transparency and ethical practices in financial reporting. AAOIFI published so far more than 100 standards (including five auditing standards) and is supported by all types of Islamic financial institutions from over 45 countries (AAOIFI.com, 2020a).

AAOIFI Sharia standards and accounting standards are followed in the following countries: Afghanistan, Bahrain, Iraq, Jordan, Kyrgyz Republic, Lebanon, Libya, Mauritius, Nigeria, Oman, Palestine, Pakistan, Qatar, Sudan, Syria, UAE, and Yemen. On the other hand, AAOIFI auditing, governance standards, and code of ethics are followed fully, partially, or as guidance in the following countries: Bahrain, Jordan, UAE, Kyrgyz Republic, Mauritius, Nigeria, Qatar, Oman, Pakistan, Sudan, and Syria, and Yemen. (AAOIFI.com, 2020b).

El-Halaby and Hussainey (2016) argued that it should be compulsory for all members of AAOIFI to follow the standards, and regulators should encourage adopting AAOIFI standards where Islamic banks incorporated. On the other hand, it turns out that the adoption of AAOIFI standards severely impacts the Islamic banks' image. These banks will have competitive advantages when implementing these standards when announced their compliance to their customers.

Al-Abdullatif (2007) highlighted the lack of knowledge and awareness about AAOIFI in one of the GCC countries. This led to a delayed implementation of these standards and regulations. Despite this lack of knowledge and delay, the majority of practitioners favour using AAOIFI standards. Additionally, participants show support for harmonising standards in Islamic banks to enhance the comparability of Islamic banks.

AAOIFI, in some essence, is similar to the Basel Committee as both play important roles in the financial industry. While both issue standards related to governance, AAOIFI focuses on Sharia governance framework for Islamic banks, while the Basel Committee promotes stability in the global banking system, encompassing both Islamic and conventional banks.

5.2.5.2. The Islamic Financial Services Board (IFSB)

IFSB is an independent not-for-profit organisation based in Malaysia and founded in 2002. It is responsible for issuing standards to enhance the soundness and stability of Islamic financial institutions. So far, IFSB has issued 32 standards, guidance, and technical notes for all types of

Islamic financial institutions, such as banking, capital market, and insurance (Takaful) companies. In addition, the IFSB works closely with the Basel Committee on Banking Supervision, the International Organisations of Securities Commissions, and the International Associations of Insurance Supervisors. IFSB consists of 184 members, such as regulatory authorities, inter-governmental organisations, and other market payers (such as professional firms and financial institutions) (IFSB.org, 2020).

Ullah, Khanam, and Tasnim (2018) concluded that non-compliance with AAOIFI standards and IFSB guidelines could increase the operational risk for Islamic financial institutions. The difference between compliance with these standards and guidelines between countries may be because of the regulatory differences between countries. However, compliance with these standards and guidelines gives a clear message to all stakeholders (including customers) that the financial institution takes the Sharia compliance very seriously and managing the Sharia non-compliance risk effectively and efficiently.

In 2022, the IFSB and AAOIFI issued a Sharia governance framework for institutions offering Sharia-compliant products. The joint IFSB-AAOIFI standard aims to provide a sound and practical Sharia governance framework, with the internal Sharia audit being one of its main components (IFSB, 2022). However, the IFSB has not issued specific standards related to internal Sharia audit. Therefore, IFSB standards and guidelines will not be used as benchmark in this thesis, considering they do not have a standalone standard or guidelines related to internal Sharia audit to be used in the assessment.

3.2.6 THE NEED FOR SHARIA GOVERNANCE FRAMEWORK AT ISLAMIC BANKS

Based on the above, the need for an additional governance framework is crucial due to the specific requirements that apply to these banks. Such a framework is essential to ensure transparency, accountability, and adherence to Islamic principles. Islamic banks must ensure that no interest payments are charged, no Gharar (uncertainty) is involved, investments are conducted ethically, and products are based on Sharia principles (such as Musharaka or Mudaraba). These requirements make the operations of Islamic banks distinct not only in their terminology but also in their contracts, operations, procedures, and Sharia-compliant training for staff.

Therefore, these Islamic banks require an additional layer of governance to protect the interests of all stakeholders. This includes appointing qualified Sharia scholars, establishing supervisory bodies, and developing policies and procedures aligned with Sharia principles. A crucial aspect of this framework is the internal Sharia audit, which plays a vital role in regularly assessing and ensuring compliance with Sharia principles

3.3 SHARIA GOVERNANCE FRAMEWORK

3.3.1 Introduction

The previous chapter provided an in-depth exploration of corporate governance structures, its models and theories, within banking, highlighting its role in overseeing operations and balancing the interests of various stakeholders, such as shareholders, management, depositors, and regulators. Corporate governance frameworks typically include mechanisms such as the board of directors and the audit committee to manage risk and ensure compliance.

In the context of Islamic banking, this conventional governance structure is complemented by a distinct Sharia governance framework. This framework addresses Sharia non-compliance risk, a unique challenge for Islamic banks, which must adhere to both regulatory and Sharia principles (IFSB, 2005; Calder, 2020). As such, Islamic banks must have an additional layer of governance to ensure that all products and services comply with Sharia principles, maintaining stakeholder confidence and safeguarding the integrity of the Islamic finance industry.

3.3.2 Sharia Governance Framework and Corporate Governance Models

Islamic financial institutions are expected not just to comply with legal and regulatory requirements but also with the very important additional aspect of Sharia compliance, which might be important for some stakeholders and not at all for others. Therefore, when integrating Maqasid al-Sharia with conventional corporate governance models and theories, many aspects are involved, particularly when it comes to ethical behaviour, accountability, and social responsibility, which could share important aspects with the Anglo-Saxon and European models and their associated theories.

3.3.2.1 Anglo-Saxon Model and Sharia Governance

The Anglo-Saxon corporate governance model's focus on shareholders and the profit maximization can be aligned with the Maqasid al-Sharia objective of preserving wealth (mal) (Shleifer and Vishny, 1997). However, Maqasid al-Sharia extends this objective beyond mere profit maximization, also focusing on the ethical use of wealth and the protection of stakeholders' rights (El-Hawary, Grais, & Iqbal, 2004).

Agency theory, which is align with this model, addresses conflicts between shareholders (principals) and executives (agents), advocating for mechanisms such as performance-based incentives and independent board oversight to align interests (Jensen and Meckling, 1976). The principle of Hisbah (accountability and oversight) in Islamic governance can complement agency theory by providing an Islamic ethical dimension to the monitoring and control of management activities (Iqbal & Mirakhor, 2007).

Based on the above, while the Anglo-Saxon model's focus on shareholder interests aligns with the principle of financial aspects, it is complemented by the Sharia governance framework's requirement to ensure compliance with Sharia principles. This dual focus creates a complex governance environment where Islamic banks must balance shareholder interests with adherence to Sharia. The Sharia governance framework incorporates additional mechanisms, such as the Sharia Supervisory Committee, to ensure that the Islamic bank's operations are in compliance with both shareholder expectations and Sharia requirements (Ahmed and Bin Mohamad, 2019).

3.3.2.2 European Model and Sharia Governance

As seen in the previous chapter, the European corporate governance model often emphasizes a stakeholder approach, incorporating the interests of a broader group, including employees, customers, and the community (Ahmad and Omar, 2016). The requirements of this models are also aligned with Maqasid Al-Sharia related to preserving life (nafs), intellect (aql) and posterity (nasel).

This model aligns with stakeholder theory, which argues that institutions should consider the needs of various stakeholders beyond just shareholders (Freeman, 1984). The integration of

Maqasid al-Sharia into stakeholder theory can enhance corporate governance practices by emphasizing the ethical obligation to protect and promote the welfare of all stakeholders.

The Sharia governance framework also comply with this stakeholder-focused perspective, as it requires Islamic banks to consider not only shareholder interests but also the broader community and societal values as dictated by Sharia principles. By incorporating additional layers of governance such as the Sharia supervisory committee, Islamic banks ensure that their operations align with both the stakeholder-centric approach of the European model and the ethical mandates of Sharia (Donaldson and Preston, 1995). This alignment supports ethical business practices and social responsibility, reflecting the holistic approach found in European corporate governance models.

3.3.3 The Three Lines of Defence for Islamic Banks

As seen in the previous chapter, banks acted as fiduciary trustees with customers' funds and confronted numerous risks such as liquidity, capital, credit, regulatory, etc. Therefore, banks have many controls to ensure everything is conducted as agreed in the plan and is compliant with the rules and regulations. Each bank has three defence lines to ensure the effectiveness and efficiency of controls and the risk management framework. The first line of defence includes departments that provide internal controls and manage the risk associated with their activities (such as sales, IT, and marketing). Internal control is a continuous process established to offer acceptable assurance that the management can accomplish the bank's mission, targets, and objectives.

The second defence line includes departments that oversee the risks (such as the risk department and regulatory compliance department). The departments in this line aim to eliminate the risk but highlight the potential risks and provide controls to manage the risks. The risk department helps to protect the bank from all types of risks. The compliance department helps protect the bank from regulatory risk by ensuring all activities align with the rules and regulations (P. Ramakrishna, 2015, 67 - 84). Finally, the third line of defence includes the internal auditors responsible for providing independent assurance about the departments' activities in the first and second lines of defence (Lim, 2017, 160).

The situation is the same for Islamic banks, they face the same types of risks, and they must have a corporate governance framework and three lines of defence to protect all stakeholders' interests. However, Islamic banks must have an additional system and controls to manage the Sharia non-compliance risk (Ahmed and Bin Mohamad, 2019).

The Sharia non-compliance risk is "*the risk that arises from the bank's failure to comply with the Sharia rules and principles determined by the relevant Sharia regulatory councils* (IFSB, 2005). Sharia compliance is the "raison d'etre" of any Islamic bank, and it is as essential as regulatory compliance (Calder, 2020). Therefore, Islamic banks' products and activities must comply with the rules, regulations, and Sharia principles highlighted in the previous section.

Consequently, Islamic banks have an additional layer of Sharia governance framework and dual board structure (IFSB, 2005, 33). Over the last few decades, Islamic finance standards-setting bodies such as AAOIFI and IFSB (both discussed in the previous section) issued many standards and guidelines on the Sharia governance framework (Sheikh Obid and Naysary, 2014).

From a Sharia perspective, all human is God's steward (Khalifa) on this earth. The Qur'an Says:

> *"I will create a steward on earth" (Quran 2:30).*

This verse confirms that God owns everything on this earth, and he entrusted humans with roles and responsibilities to develop the world by God's will (Sheikh Obid and Naysary, 2014). Accordingly, all personal wealth belongs to God, with humans having the "stewardship" to act and use this wealth. For that reason, Muslims believe that they will be asked on the Day of Judgment about how they earned and spent their money throughout their entire lifetime (Haider Naqvi, 2013, 76).

Consequently, in banking, all stakeholders must fulfill their responsibilities as stewards, looking after the Islamic bank they work for, along with society, the economy, and the environment. Therefore, the stewardship concept in Islam can be better adopted within the European corporate governance model and its stakeholder theory, as it emphasizes that all stakeholders should be considered by everyone working in Islamic banks. However, accountability in this context is ultimately to God.

The Qur'an says:

> *"It is not for a believing man or a believing woman, when Allah and His Messenger have decided a matter, that they should [thereafter] have*

> *any choice about their affair. And whoever disobeys Allah and His Messenger has certainly strayed into clear error" (Qur'an, 33: 36).*

In another chapter, Quran Says,

> *"The only statement of the [true] believers when they are called to Allah and His Messenger to judge between them is that they say, "We hear and we obey." And those are the successful" (Qur'an, 24: 51).*

To ensure compliance with Sharia rules and principles, corporate governance in Islamic banks has an additional layer of Sharia governance, and it is the backbone of any Islamic bank. The IFSB-10 defines the Sharia governance system as "*the set of institutional and organisational arrangements through which an Islamic Financial Institution (IFI) ensures that there is effective independent oversight of Sharia compliance over the issuance of relevant Sharia pronouncements/resolutions (through Sharia Board or a Central Sharia Authority), dissemination of information (by monitoring day-to-day compliance with Sharia through a Sharia compliance department), and an internal Sharia compliance review (by having a Sharia internal auditor)((IFSB, 2009, 10).*"

Hence, the Sharia governance framework will increase the stakeholders' confidence (including shareholders, customers, and the public) that all products, services, and activities of the bank are compliant with Sharia principles. The non-observance of Sharia principles would expose Islamic banks to Sharia non-compliance risk that leads to operational risk, loss of profit, and eventually damage to the whole Islamic banking industry.

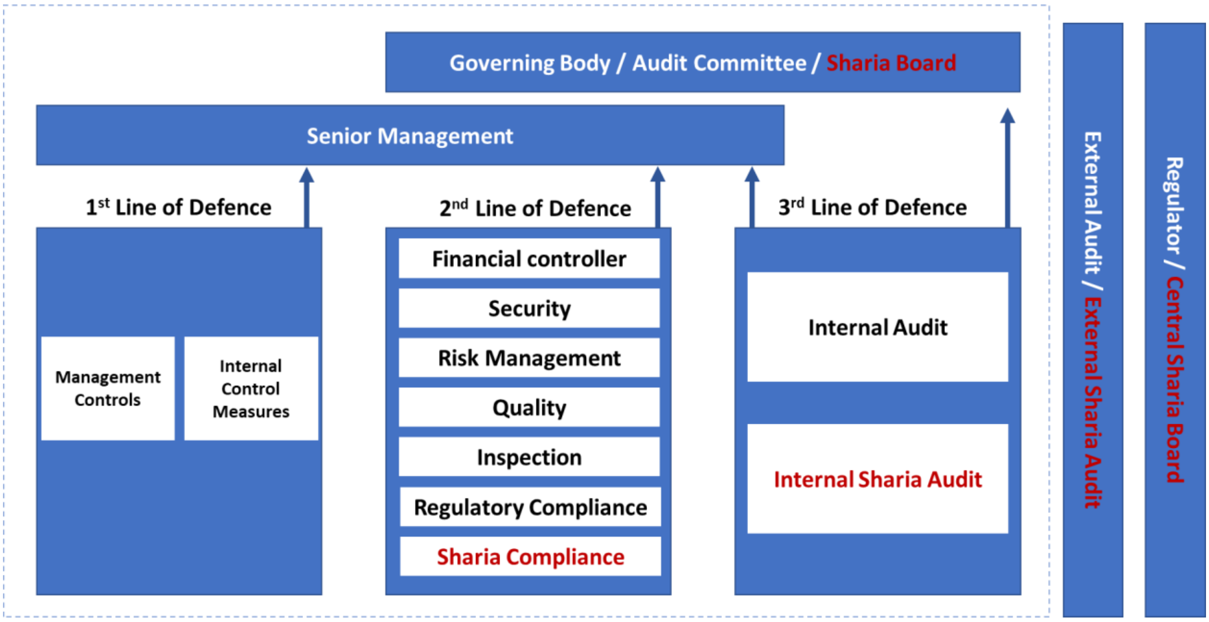
Haqq (2014) points out that the Sharia governance framework is vital in ensuring the Islamic finance industry's integrity and honesty. He argued that it is crucial for Islamic banks to harmonise the Sharia governance framework like its counterpart in the conventional corporate governance framework. The harmonisation will increase trust and enhance transparency for all stakeholders.

Islamic banks must have a dual governance framework, where the Sharia governance system complements the usual governance framework, compliance, and controls. To accomplish this goal, Islamic banks must have a Sharia Supervisory Committee alongside the board of directors (Farag, Mallin and Ow-Yong, 2017). Islamic banks must also have regulatory compliance and a

Sharia compliance department to ensure compliance with the regulations and the Sharia principles in the second line of defence. Finally, in the third line of defence, Islamic banks should have internal Sharia auditors along with internal auditors (Kasim, Nu Nuhtay and Salman, 2013).

Therefore, the three lines of defence for Islamic banks will be as follows:

Figure 8: The three lines of the defence model for Islamic banks



Adopted from ECIIA/FERMA Guidance on the 8th EU Company Law Directive, article 41 AAOIFI, 2022

The Sharia governance standards issued by AAOIFI and IFSB highlight five main features of Sharia governance, some at the global level and others at the national and institutional levels. The table below outlines the functions that exist for conventional banks and their equivalents for Islamic banks.

Table 5: The required governance framework at Islamic banks

Functions	Key Functions for Typical Financial Institutions	Key Functions Exclusive to Islamic banks
Standards-setting Bodies at Global Level	International Accounting Standards Board (IASB) and Bank for International Settlements (BIS)	Accounting and Auditing Organisation for Islamic Financial Institution (AAOIFI)

		and Islamic Financial Services Board (IFSB)
Regulators at National Level	The central bank and other authorities	Central Sharia Supervisory Committee
Governance at Institutional Level	Board of directors	Sharia Supervisory Committee
Compliance at Institutional Level	Regulatory Compliance Department	Sharia Compliance Department
Control at Institutional Level	Internal and External Auditors	Internal and External Sharia Auditors

Note: Adopted mainly from (IFSB, 2009, 12) and AAOIFI Governance Standards

As seen in the above table, the Sharia governance framework is divided into three levels. The first one is the global level, which is accountable for issuing industry standards and guidelines to be implemented by any country worldwide (it consists of AAOIFI and IFSB). The second one is at the national level, responsible for providing guidance and oversight of all Islamic financial institutions within the country (the Sharia supervisory committee works within the central bank). Finally, the institutional level is responsible for issuing fatwas, and providing supervision and advice to a specific financial institution (this level consists of the Sharia Supervisory Committee, Sharia Compliance Department, and Internal and External Sharia Audit). These three levels will provide a sound governance structure, lead to a more robust industry, and achieve Sharia's objectives.

3.3.4 AAOIFI and IFSB

Both AAOIFI and IFSB were discussed and explained in the previous section. They are not-for-profit organisations and are based in Bahrain and Malaysia, respectively. They are standards-setting bodies, issued more than 100 standards and guidelines, and contributed to the Islamic finance industry's standardisation.

The role of AAOIFI is similar to the International Accounting Standards Board (IASB), with whom it co-operates closely. The IASB oversees the International Financial Reporting Standards (IFRS Standards). It is the most widely accepted general financial reporting framework applied by most financial institutions worldwide (including Islamic financial institutions). Due to the differences in accounting treatments and Muslims' information needs (or Sharia-conscious stakeholders), the AAOIFI issued and developed financial accounting standards to be used by Islamic financial institutions. Also, AAOIFI issued and developed Sharia, auditing, ethics, and governance standards (Ansari and Tabraze, 2018).

Both AAOIFI and IFSB play roles similar to the Bank for International Settlements (BIS), and they maintain a close cooperative relationship with the BIS. The BIS guidelines mainly focus on several aspects, including the responsibilities of boards of directors, handling conflicts of interest, the role of auditors, and the involvement of bank supervisors in promoting and assessing the effectiveness of corporate governance frameworks.

On the other hand, AAOIFI concentrates on governance standards that pertain to the Sharia Supervisory Committee, the Sharia compliance department, internal Sharia audits, and external Sharia audits. These elements are crucial for ensuring compliance with Islamic principles in financial operations (Fakhruddin & Jusoh, 2018).

As for the IFSB, its members consist of central banks and regulators who voluntarily aim to adopt the IFSB guidelines. These guidelines are not mandatory but serve as a reference for guiding the practices of Islamic financial institutions. Additionally, the IFSB engages in research and organises sessions and conferences, providing a platform for regulators and industry stakeholders to share insights and knowledge (Saidi, 2009).

It's essential to note that neither AAOIFI nor IFSB possess the authority to enforce their standards and guidelines on Islamic financial institutions. While they play critical roles in setting best practices and promoting adherence to Islamic principles, the implementation of their guidelines ultimately relies on the voluntary cooperation of the institutions (Malkawi, 2013).

Ullah, Khanam, and Tasnim (2018) demonstrate that it is essential for Islamic banks to comply with AAOIFI and IFSB standards. Inadequate compliance with the standards showed higher Sharia non-compliance risk and higher operational risks. Compliance with these standards will provide the stakeholders with more information about the bank and thrive the Islamic banks' image. The best way to increase compliance with the standards is when regulators push for improving compliance with these standards. Furthermore, the research highlights that specific legislation should be issued for Islamic banks to make these banks more answerable and accountable by regulators.

3.3.5 Central Sharia Supervisory Committee

Due to the rise of conflicting in the opinion and practices of some Islamic banks in the same country, many regulators and government authorities introduced the concept of Centralised Sharia Supervisory Committee (Malaysia adopted this concept, Pakistan, Sudan, Bahrain, Jordan, UAE, and Oman) (AAOIFI, 2018). Two approaches govern Islamic banks' work worldwide, the Centralised Sharia Supervisory committee alongside the Sharia Supervisory Committee at the individual institution level and a non-centralised committee with only individual institutions' Sharia committee (such as the case of Saudi Arabia). AAOIFI encourages the centralised Sharia Supervisory Committee (but it is not mandatory). The centralised Sharia Committee will increase the consistency in Islamic banks' products and services and increase the harmonization and accountability of the Sharia Supervisory Committee at the institutional level (AAOIFI, 2018).

According to AAOIFI's governance standards for Islamic financial institutions No.8, the Central Sharia Board "*the Central Sharia Board is a board-level board or a similar body of specialised jurists in Fiqh al-Malmalat (Islamic Commercial Jurisprudence) and experts in Islamic banking, finance, economics, law, accounting, etc. providing guidance and advice on Sharia matters, with limited supervision, that is established in specific country or jurisdiction for providing uniformity and harmony in the products and practices concerning Islamic finance through Fatwas, rulings and guidelines. The Centralised Sharia board decisions are applicable on a border base in the jurisdiction rather than a single institution* (AAOIFI, 2018)."

According to AAOIFI, the board should consist of Sharia scholars and expert members. These members' responsibilities are to increase the harmony between Islamic banks in the same country by providing rulings, guidelines, and Sharia standards to Islamic banks. Moreover, the central Sharia board should validate product structures, and the board should oversight the work of Islamic banks and have a limited level of supervisory authority. This board can also advise regulators, advise on the court's law, and resolve and settle complaints raised by Islamic bank customers regarding the Sharia aspects of the products (AAOIFI, 2018).

Meshal (2005) argues that the central Sharia supervisory committee is part of the external controls and supervision system. It reviews the overall suitability of the internal control system in financial institutions. It also conducts periodic visits to ensure compliance with the Sharia principles and Central Bank circulars and to evaluate the adequacy of the internal Sharia control system in light of the guidelines approved by the Central Bank.

To sum up, having a central Sharia board will create consistency in offering Sharia-compliant products and services in the same country and help the regulatory authorities supervise and oversee the activities of Islamic banks. On the other hand, the board will provide consultations to the regulatory authorities and resolve the disputes related to Sharia principles by acting as the ultimate arbitrator in Sharia understanding. Overall, the central Sharia board will improve reliability and raise confidence in Islamic banks' products in the country.

3.3.6 Sharia Supervisory Committee

According to AAOIFI governance standards for Islamic financial institutions No.1, "*a Sharia Supervisory Committee is an independent body of specialised jurists in Fiqh al-Muamalat (Islamic commercial jurisprudence). The Sharia supervisory committee is entrusted with the duty of directing, reviewing and supervising the activities of the Islamic financial institution in order to ensure that they are in compliance with Sharia principles and rules. The Fatwas and rulings of the Sharia supervisory board shall be binding on the Islamic financial institution* (AAOIFI, 2010a)"

According to AAOIFI, all Islamic financial institutions must appoint a Sharia Supervisory Committee, and shareholders should select the committee members based on the proposal from the Board of directors. The committee should consist of a minimum of three members, and the committee might request a consultation from experts in finance, law, IT, and others. The Board should approve the Sharia Supervisory Committee remuneration, and the shareholders must authorise the dismissal of a member in their general meeting. The Sharia committee's role covers issuing Fatwas and approving products, ensuring that the products and services comply with the issued Fatwas, calculating the Zakat and disposing of the non-Sharia compliant income to relevant charities, and providing advice to the management of the bank regularly (AAOIFI, 2010).

According to IFSB, the Sharia board member is "*jurists specialising in contemporary transactional jurisprudence, who are well acquainted with and experienced in the Islamic financial system in particular and the Islamic economic system in general. They issue binding Sharia pronouncements and recommendations and oversee the task of supervising and* *auditing the institution*." Therefore, the Sharia board must work independently, and they have the role of oversight of the work of the Islamic bank (IFSB, 2009).

As the Sharia committee members are independent and do not work daily, they have the right to appoint an internal Sharia auditor (AAOIFI, 2010a). The internal Sharia auditors will report to the committee about products, activities, and transactions that comply with Sharia principles (Al-Mahmoud, 2007). Therefore, the Sharia committee can request whatever is needed to ensure that everything related to the Islamic banks' activities complies with Sharia.

Failure to comply with the Sharia committee's decisions would inevitably lead to severe consequences such as loss of income due to the transaction is completed not in line with Sharia, and customers may lose confidence and trust in the Islamic banks. Moreover, subsequently, they will withdraw their funds and move back to conventional banks (Malkawi, 2013).

3.3.7 Sharia Compliance Department

The Sharia compliance department is one of the core elements of the Sharia governance framework at Islamic banks. Most of the other parts of the Sharia governance framework in the Islamic banks (such as the Sharia Supervisory Committee and the internal and external Sharia audit) are independent of the management. Simultaneously, the Sharia compliance department works under the management's supervision to ensure regular compliance with Sharia principles. According to AAOIFI's governance standard No.9, "*the Sharia compliance department is an integral part of an Islamic financial institution's governance and control structure, catering the certain crucial objectives of the Islamic financial institution related to its compliance with Sharia principles and rules* (AAOIFI, 2020)."

According to AAOIFI, the bank's management is responsible and accountable for ensuring compliance with Sharia principles and rules. Therefore, as a part of preventive controls, the management must establish a Sharia compliance department in the second line of defence (it is concerned with the ex-ante work). That ensures that all products, services, activities, and documentation (including policies, procedures, guidelines, third-party agreements, marketing collateral, etc.) are compliant with Sharia principles (AAOIFI, 2020).

The Sharia compliance department report directly to senior management under the chief risk officer. The department has other responsibilities, such as reviewing some transactions before executing and providing Sharia compliance training to all new starters joining the bank. Also, coordinate with the risk management department to identify, assess, manage, and monitor the Sharia non-compliance risk related to the banks' activities (AAOIFI, 2020).

On the other hand, IFSB also recommends that Islamic banks have an independent internal Sharia compliance department separate from the other bank's departments. The staff of this department are not Sharia scholars, and therefore they cannot issue a Fatwa. Instead, their primary responsibility is to support the management in ensuring that the Fatwa issued by Sharia Supervisory Committee is implemented correctly. Hence, this department is the first point of reference for Sharia compliance matters, provides advice to the management of Sharia principles, and manages the relationship between the administration and the Sharia supervisory committee (the head of Sharia compliance shall be the secretariat for the Sharia committee) (IFSB, 2009).

3.3.8 Internal Sharia Audit

Despite being subject to various audits and accounting standards, including financial, management, and regulatory audits by relevant governmental institutions, the internal Sharia audit remains underdeveloped in the Islamic banking market. Even in countries where regulations do not mandate it, the lack of progress in implementing the Sharia compliance audit poses significant challenges. A study by Yaacob and Donglah (2012) revealed that improvements are necessary in this area, as Islamic financial institutions worldwide have not adequately prioritised the enhancement of the Sharia audit.

According to the AAOIFI Governance Standard No. 11, the internal Sharia audit function is "*a function as a part of the governance organs of an Islamic financial institution with a primary objective to ensure that the management of the Islamic institution discharges its responsibilities in relation to the implementation of the Sharia principles and rules*." This function's objective is to assure the adequacy of the Sharia governance structure, the strength of internal Sharia controls, and to ensure the soundness of the Sharia non-compliance risk management system. The internal Sharia audit function must be independent of the management and have unrestricted access to all documents, records, etc. The internal Sharia audit function should not conduct any operational activities independent of product development and Sharia compliance functions (AAOIFI, 2020c).

According to AAOIFI, the audit committee should provide its input and oversee the internal Sharia audit performance. The head of the internal Sharia audit should report directly to the audit committee. On the other hand, the head of the internal Sharia audit should have a dotted-line reporting to the Sharia supervisory committee, and the committee should provide input when needed. Both the internal sharia audit and the sharia compliance department are essential and practical components of a robust Sharia governance framework. However, both functions should be separated from each other. The internal Sharia audit should ensure the overall Sharia controls periodically. Simultaneously, the Sharia compliance department provides an ongoing assurance and provides feedback to the management on a day-to-day basis about compliance with Sharia principles (AAOIFI, 2020c).

Unlike AAOIFI, the IFSB does not offer extensive information about the internal Sharia audit department. Consequently, this research did not include IFSB in the analysis and did not assess the bank's compliance with its guidelines. As per IFSB's requirements, all Islamic financial institutions are mandated to establish an internal Sharia audit function. This department is responsible for verifying compliance with Sharia principles and reporting any instances of Sharia non-compliance to both the management and the Sharia committee.

A study conducted by Ghani and Abdul Rahman (2015) revealed that in Malaysia, the establishment of an internal Sharia audit function is mandatory for all Islamic banks to ensure an effective internal control system for Sharia compliance. However, this is not the case in the GCC countries. The study also highlights that most Islamic banks in Malaysia have well-established Sharia audit objectives, Sharia governance structures, and audit processes. However, some Islamic banks lack clear specifications for the internal Sharia audit scope and charter.

In another study conducted by Ahmed and Khatun (2013), it was pointed out that none of the Islamic banks in Bangladesh are fully compliant with the Sharia governance framework of AAOIFI. This deficiency is primarily attributed to the absence of an internal Sharia audit. The research suggests the need to enhance Sharia compliance levels across all banks by implementing measures to ensure uniformity and transparency in the Sharia report.

Based on the above, the Sharia compliance audit serves as a cornerstone for Islamic banks, as it reinforces the trust and confidence of stakeholders. Its absence could lead to a crisis of confidence, prompting customers to withdraw their funds or terminate their contracts with Islamic banks. This, in turn, could create difficulties for all Islamic financial institutions and hinder the growth and development of Islamic finance on a global scale.

3.3.9 External Sharia Audit

According to the AAOIFI Governance Standard No.6, "*the external Sharia audit is a firm having professional knowledge and competence of auditing and relevant Sharia principles and rules, duly fulfilling the fit and proper criteria laid down by the respective regulator (the central Sharia board if applicable) for appointment as an external Sharia auditor, who, at the request of the Islamic financial institution, provides an independent assurance report on the state of compliance by* an *Islamic financial institution with the 'Sharia principles and rules'. The external auditor may also be appointed as the external Sharia auditor of the Islamic financial institution."*

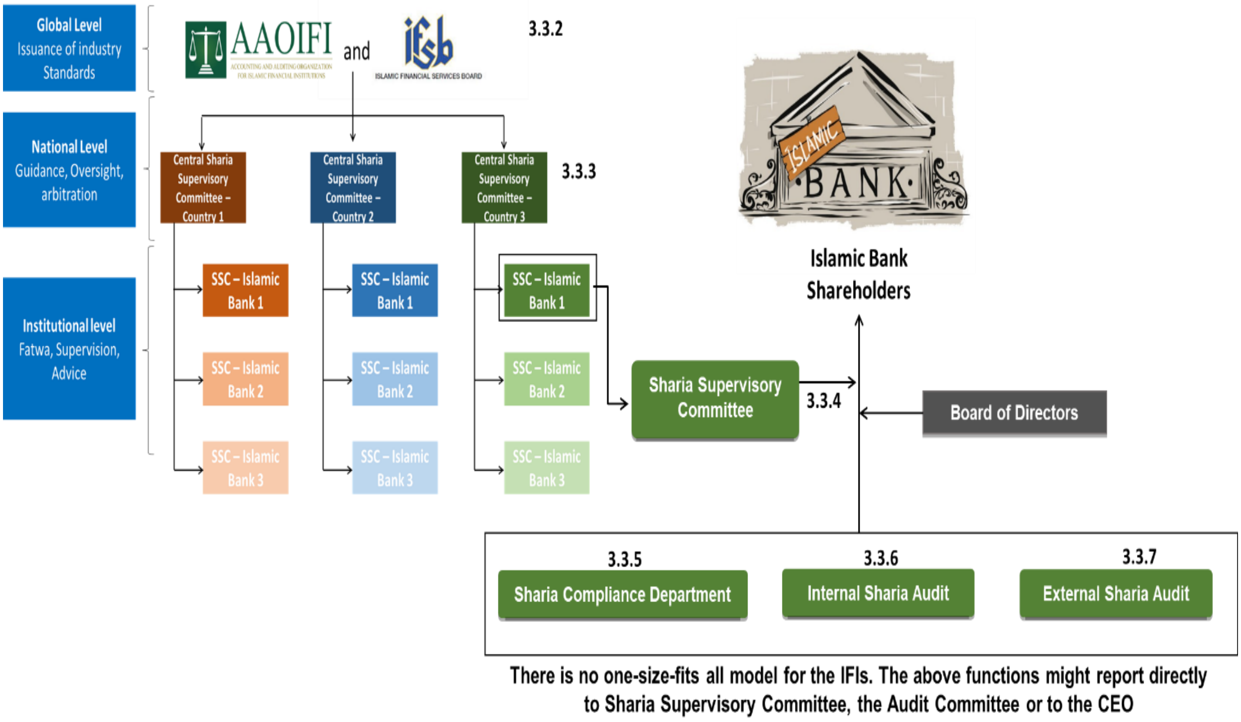
The external Sharia auditors' objective is to provide reasonable assurance that all activities of the Islamic banks are compliant with Sharia principles. In addition, the external Sharia auditors should review and assess the effectiveness of the Sharia governance framework, including but not limited to the work of the internal Sharia audit department, the Sharia compliance department, and the independence of the Sharia Supervisory Committee (AAOIFI, 2019). On the other hand, the IFSB mentions in their guidelines that the external Sharia audit should be conducted but does not discuss any aspects of this type of audit.

Yasoa et al. (2021) argue that given the current underdeveloped state of the Islamic finance industry, the industry is not ready to enforce external Sharia audit practices and it is not widely practiced. This conclusion is based on the fact that external Sharia audits would require additional costs to be paid by management without providing any additional actual benefit, especially since that external Sharia audit is not a regulatory requirement. Additionally, management might be concerned about the reputational risk to the institution if Sharia breaches are identified and leaked to customers. Therefore, considering that external Sharia audits are not widely implemented in Islamic banking, the focus of this research will be solely on internal Sharia audits.

According to IFSB, there is no one-size-fits-all model that all Islamic financial institutions can implement. If it is not mandatory by regulation to follow the AAOIFI and IFSB standards or guidelines, each institution may develop its own Sharia governance framework (IFSB, 2009).

The following figure illustrates the industry's Sharia governance model, prepared by the researcher based on the standards issued by AAOIFI to date

Figure 9: Industry Sharia Governance Model



The table below also prepared by the research which provides a comparative analysis between AAOIFI and IFSB based on their issued standards and guidelines.

Table 6: Comparative analysis between AAOIFI and IFSB

No.	Discussion	AAOIFI	IFSB
1	Definition of the Sharia Governance Framework	Not provided	Provided
2	Central Sharia Supervisory Board	Discussed and issued a designated standard	Discussed
3	Sharia Supervisory Committee	Discussed and issued a designated standard	Discussed
4	Sharia Compliance Department	Discussed and issued a designated standard	Discussed

5	Internal Sharia Audit	Discussed and issued a designated standard	Discussed
6	External Sharia Audit	Discussed and issued a designated standard	It should exist but is not discussed in any guidelines

Note: Adopted mainly from AAOIFI governance Standards & IFSB guidelines, 2009

3.4 SUMMARY

This chapter has provided an extensive overview of the key aspects of banking Sharia rules and principles, emphasising the prohibition of Riba (interest) in the Quran and Sunnah. It has also highlighted the differences between Islamic and conventional banks, with a focus on avoiding Riba and other non-compliant practices in financial transactions.

Moving on to the subsequent section, the chapter covered corporate governance and the Sharia governance framework. Islamic banks must have a Sharia supervisory committee reporting directly to shareholders, in addition to the standard corporate governance framework that includes relevant committees like remuneration, nomination, and audit committees. The establishment of three defence module lines is essential to ensure effective risk management within banks.

At the national level, the central Sharia board serves as the highest Sharia authority for Islamic financial institutions within the country. Meanwhile, the Sharia Supervisory Committee operates at the institutional level and plays a vital role in advising banks on Sharia principles and ensuring compliance. Various departments, including the Sharia compliance department and both internal and external Sharia auditors, also function at the institutional level to uphold Sharia compliance.

Crucially, Islamic banks must establish an independent internal Sharia audit department, which forms an integral part of their governance structure. This department's primary objective is to provide assurance to all stakeholders—management, the board of directors, the Sharia Supervisory Committee, shareholders, and customers—regarding the bank's compliance with Sharia principles. In the forthcoming chapter, more detailed insights into the internal Sharia audit will be explored.

CHAPTER 4: THE INTERNAL SHARIA AUDIT IN ISLAMIC BANKING

4.1 INTRODUCTION

As seen in the previous chapter, the Sharia governance framework for Islamic banks necessitates an additional function, which is an internal Sharia audit, aimed at ensuring Sharia compliance. However, in the absence of mandatory laws in most countries to enforce AAOIFI's governance standards, Islamic banks have innovatively introduced their own structure of Sharia governance, which may not always operate in the right way or manner and in line with the best industry practice.

As per AAOIFI's Sharia governance standards, every Islamic financial institution is mandated to establish a Sharia audit function. The primary objective of this internal Sharia audit is to foster confidence in stakeholders, particularly customers and shareholders, by ensuring the compliance of all products, services, and activities with Sharia principles. However, it is important to note that the regulators do not treat the standards issued by AAOIFI in the same way they treat the standards issued by the Basel Committee for conventional banking.

With the objective of highlighting an overview of the internal Sharia audit and its related standards issued by AAOIFI, this chapter is organised into five sections, including an introduction, auditing from a Sharia perspective, a review of the literature on the Sharia audit, analysis of AAOIFI's internal Sharia audit standard, and a conclusion.

4.2 AUDITING FROM A SHARIA PERSPECTIVE

The terminology "Sharia audit" is not explicitly mentioned in Sharia's primary or secondary sources. However, the concept of audit aligns with the principles of Hisbah, which encompasses "enjoining good and forbidding wrong" in Islam (Ibrahim, 2018). Historically, the person responsible for performing Hisbah was known as the Muhtasib. The Muhtasib was remunerated by the government and operated independently of the market. The scope of Hisbah extended beyond just the economic aspect, aiming to guide Muslims in their worship of God and safeguard the society (Khalid, Haron, and Msron, 2018).

During the early days of Islam, Hisbah served as a governmental institution that enlisted individuals known as Muhtasibs to encourage virtuous behaviour within the community and discourage wrongful actions. The Muhtasib's role was an official appointment by the government or ruler, entrusted with the responsibility of overseeing the proper implementation of Hisbah in Islamic society (Yaacob, 2012).

The Hisbah was supported in both Quran and Sunnah:

In the Quran, there are verses that ask Muslims to encourage the right actions and prevent the bad ones. E.g. from Quran:

> *"Let there arise out of you, a band of people, inviting to all that is good, enjoining what is right, and forbidding what is wrong: They are the ones, to attain felicity, "3:104*

Also,

> *"I.. .] So take what the Messenger assigns to you, and deny yourselves that which he withholds from you. And fear Allah; for Allah is strict in punishment." 59:7*

E.g. from Sunnah:

The prophet Muhammad (PBUH) said:

> *Whosoever among you sees an act of wrongdoing should change it with his hands. If he is not able to do so, then he should change it with his tongue. If he is not able to do so, then with his heart, and this is the weakest of faith.*

Also, prophet Muhammad (PBUH) acted as Muhtasib himself:

> *The Messenger of Allah (PBUH) appointed a man in charge of Sadaga (i, e. authorised someone to receive Sadaqa from the people on behalf of the State. When he returned (with the collection), hesaid: This is for you and (this is mine as) it was presented to me as a gift. The narrator said: The Messenger of Allah (PBUH) stood on the pulpit and praised God and extolled Him. Then he said: What about a State official whom I give an assignment and who (comes and) says: This is for you and this has been presented to me as a gift? Why didn't he remain in the house of his father or the house of his mother so that he could observe whether gifts were presented to him or not. By the Being in Whose Hand is the life of Muhammad, any one of you will not take anything from it but*

will bring it on the Day of Judgment, carrying on his neck a camel that will be growling or a cow that will be bellowing or an ewe that will be bleating. Then he raised his hands so that we could see the whiteness of his armpits. Then he said twice: O God, I have conveyed (Thy Commandments). (Sahih Muslim 1832a)

Also, the prophet used to go to the market to conduct an audit for the market:

God's Messenger (PBUH) once came upon a heap of grain, and when he put his hand into it his fingers felt some dampness, so he asked the owner of the grain how that came about. On being told that rain had fallen on it he said, "Why did you not put the damp part on the top of the grain so that people might see it? He who deceives has nothing to do with me." (Mishkat Al-Masabih 2860)

After the time of the Prophet Muhammad (PBUH), the role of the Muhtasib was upheld by all Caliphates. The first Caliph after the Prophet, Abu Bakr, followed a similar approach of overseeing actions, behaviours, and the market. When some individuals refused to pay Zakat (one of the pillars of Islam), he declared war against them to ensure its collection (Al-Madani, 1990). During the era of the second caliph, Umar Ibn Al-Khattab, the Islamic territory expanded, resulting in increased resources and expenditures. To ensure accountability in the marketplace, Umar appointed someone to review transactions, and he explicitly prohibited hoarding in the market (Al-Madani, 1990).

Moreover, Umar emphasised the necessity for all traders to possess knowledge of Islamic financial transactions before participating in any selling activities within the market. He firmly declared, "*no one should sit in our market without learning the Islamic jurisprudence*" (akhrajah al Tirmizi). Umar personally conducted audits of the market and implemented corrective measures as required, including admonishing a merchant who was selling raisins at an undervalued price, thereby safeguarding the interests of all traders (Malik Ibn Anas, p. 432).

During the 7th century, Imam Abu Hanifa stressed the significance of the Sharia audit by advocating that every merchant should be accompanied by a Sharia advisor to avoid any non-compliance issues related to Sharia principles in financial transactions (Al-Madani, 1990). This highlighted the need for auditors to support merchants, given the complexity of Islamic financial transactions that demanded specialised knowledge.

The concept of Sharia audit continued to evolve over the years, leading to the establishment of the first Islamic bank in Dubai in 1975. To ensure strict adherence to Sharia principles, Dubai Islamic Bank established a department to review its products and activities (Amaroh & Masturin, 2018).

Subsequently, in 1991, the AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions) was founded, and in June 1999, it introduced Governance Standard No. (3) Internal Sharia Review. The primary objective of this internal Sharia review was "*to ensure that the management of an Islamic financial institution discharges their responsibilities in relation to the implementation of the Sharia rules and principles as determined by the institution's Sharia committee*" (AAOIFI, 1999).

In 2019, AAOIFI issued a new standard, GS11 Internal Sharia Audit, superseding GS3 "Internal Sharia Review." This change in terminology was intended to maintain consistency among newer standards and align with industry practices, regulations, and governance standards (AAOIFI, 2019).

AAOIFI's GS11, titled "Internal Sharia Audit," stands as the latest and most pertinent Sharia audit standard. This standard represents a culmination of efforts to establish comprehensive guidelines for conducting internal Sharia audits within Islamic financial institutions, aiming to ensure effective adherence to Sharia principles and practices.

4.3 SHARIA AUDIT: A REVIEW OF LITERATURE

Upon conducting an extensive review of the academic literature on the subject, it became evident that there is a notable dearth of research specifically dedicated to the internal Sharia audit. Instead, the majority of existing studies primarily concentrate on the broader Sharia governance framework, with limited attention given to the intricacies of the internal Sharia audit itself. An intriguing observation is that none of the prior research has emphasised the significance of harmonising the internal Sharia audit, an area that warrants deeper exploration.

Moreover, the absence of analyses pertaining to the extent of compliance with AAOIFI's internal Sharia audit standards and the regulatory requirements governing the internal Sharia audit in the GCC countries is noteworthy. These crucial aspects have been overlooked in past research efforts, resulting in a significant research gap regarding the comprehension and examination of essential components of the internal Sharia audit within the context of the GCC, where Sharia-based banking assets represent a substantial portion of total banking assets (Akkaş, 2017). To gain a comprehensive understanding of how the internal Sharia audit operates in this particular region, it is imperative to address this research gap.

A survey undertaken by Mara et al. (2013) in both Malaysia and Indonesia aimed to investigate the scope of Sharia auditing practices in Islamic financial institutions. The findings of the survey revealed that Malaysia exhibits a more advanced level of development in Sharia audit compared to Indonesia. The study emphasises that Indonesia has considerable ground to cover to catch up with Malaysia's progress in Islamic finance, particularly in the realm of auditing practices.

The findings we have discussed highlight a crucial point: the compliance and development of the internal Sharia audit can vary significantly from one country to another. Each country may have its own unique approach to implementing the internal Sharia audit function within its Islamic banks. As a result, some countries may need to make significant improvements to strengthen their internal Sharia audit mechanisms.

In simple terms, different countries have different levels of progress when it comes to their internal Sharia audit practices. Some may already have robust systems in place, while others may need to work on enhancing their audit processes within Islamic banks. This emphasizes the importance of tailoring the internal Sharia audit to suit the specific context and regulatory environment of each country. By doing so, we can ensure better adherence to Sharia principles and bolster the overall governance framework in Islamic financial institutions.

On the other hand, Grais and Pellegrini (2006) argue that an independent and properly functioning internal Sharia audit is indispensable for any Islamic financial institution. The financial performance of the institution relies heavily on the trust and confidence of stakeholders, and any loss of such confidence may lead to customers withdrawing their funds and seeking alternative providers.

This research brings to light the vital significance of maintaining the independence of the internal Sharia audit function within Islamic banks. It underscores how crucial it is for the audit process to be free from any external influences, ensuring objectivity and reliability in its assessments. By upholding this independence, Islamic banks can instigate greater confidence in their stakeholders, assuring them that the audit process is carried out with integrity and without any bias.

Also, Sheila Ainon (2013) identified that the weakness in the Sharia compliant was attributed to the lack of established internal Sharia audit frameworks. Additionally, Yazkhiruni & Nurmazilah (2012) discovered that the internal Sharia audit has not been effectively implemented in Islamic banks due to misconceptions among Sharia auditors regarding the proper conduct of Sharia audits.

These findings are incredibly important as they bring to light significant weaknesses in Sharia compliance resulting from the absence of an internal Sharia audit function. The first study highlights the critical role of having this audit function in place within Islamic institutions to closely monitor and enforce adherence to Sharia principles. Without such a mechanism, there is a risk of non-compliance, which can compromise the institution's reputation and trustworthiness in upholding Sharia standards.

Moreover, the second study raises a noteworthy concern, emphasizing that merely having an internal Sharia audit function doesn't automatically guarantee full compliance with Sharia principles. The effectiveness of the audit process relies on how well it operates, and this can be influenced by misconceptions and misunderstandings among auditors about the actual purpose and goals of the Sharia audit. Such misconceptions can hinder the audit's effectiveness, leading to potential oversights or inadequate identification of non-compliant practices.

In another study conducted by Ahmed and Khatun (2013), it was pointed out that none of the Islamic banks in Bangladesh are fully compliant with the Sharia governance framework of AAOIFI. This deficiency is primarily attributed to the absence of an internal Sharia audit. The research suggests the need to enhance Sharia compliance levels across all banks in Bangladesh by implementing measures to ensure uniformity and transparency in the Sharia report.

The research findings reveal a concerning state of affairs in the Islamic banking sector of Bangladesh. According to the study, none of the Islamic banks in Bangladesh are in compliance with the AAOIFI governance standards. This means that each bank has its own unique structure for handling the internal Sharia audit function, leading to a lack of consistency among them.

What's even more troubling is the fact that none of the Islamic banks in Bangladesh have established an internal Sharia audit function. This is a significant oversight, as the internal Sharia audit plays a crucial role in ensuring compliance with Sharia principles and maintaining the banks' ethical integrity.

Another issue that the research highlights is the lack of uniformity and transparency in the Sharia reports of Islamic banks in Bangladesh. The inconsistent and unclear presentation of Sharia compliance information makes it difficult for stakeholders to assess the banks' adherence to Sharia principles accurately.

Another scholarly endeavour undertaken by Kantakji et al. (2018) has identified several significant challenges within the current Sharia governance framework in Malaysia. These challenges include the absence of standardisation and harmonisation, insufficient Sharia audit practices, and the concentration of Islamic banks on a limited number of Sharia Scholars who control numerous Sharia committees.

This research holds significant importance as it effectively highlights the lack of harmonisation and standardisation concerning the internal Sharia audit within the Islamic banking sector in Malaysia. The absence of standardised practices becomes comprehensible in the absence of reputable institutions issuing explicit guidelines and standards for the internal Sharia audit function.

However, the striking aspect emerges when we consider the existence of robust standards, such as AAOIFI, and yet none of the Islamic banks in Malaysia demonstrate compliance with these prescribed benchmarks. This raises a notable question mark, inviting further scrutiny into the factors contributing to this non-compliance and the implications it may hold for the overall governance framework within the Islamic banking industry.

Furthermore, as highlighted by Hassan and Haridan (2019), the existence of an imbalance in competency among Sharia Scholars and the absence of a proper Sharia audit framework within the governance structure often lead Sharia committees to delegate their Sharia audit responsibilities to the Sharia audit division. Consequently, the outcomes of the Sharia audit are submitted to them for approval. This passive approach observed among Sharia scholars raises valid concerns pertaining to the independence of Sharia members and, consequently, poses the risk of compromising the credibility and assurance provided by the Sharia audit to stakeholders. The mere Sharia certificate of products by Sharia scholars within Islamic financial institutions is inadequate to assert the bank's overall compliance with Sharia principles.

A more proactive approach is necessary, wherein an individual on the ground actively works as the eyes and ears of the Sharia scholars, which is the role of the internal Sharia auditors. These Sharia auditors ensure diligent oversight and verification, thereby guaranteeing the practical implementation of the stipulations outlined in the Sharia certificate. This collaborative effort between the scholars and Sharia auditors becomes imperative to fortify the credibility and effectiveness of the Sharia audit, instilling greater confidence among stakeholders regarding the institution's adherence to Sharia principles.

Recent research by Rahim et al. (2023) investigates the level of Sharia governance disclosure among Islamic banks in Malaysia and the GCC, as well as its impact on financial performance. Their findings suggest that Malaysian Islamic banks exhibit a higher degree of Sharia governance disclosure compared to their counterparts in the GCC. This study highlights the Sharia committee as the most significant determinant of financial performance, followed by transparency and disclosure. These results underscore the importance of implementing effective Sharia compliance practices to improve the financial outcomes of Islamic banks. Rahim et al. (2023) emphasise the practical necessity for Islamic banks to enhance their Sharia governance disclosure, particularly by incorporating certified Sharia auditors and increasing transparency. The authors argue that these improvements not only align with Sharia principles but also reinforce internal controls, enhance brand reputation, and improve accounting practices within these institutions.

Kamaruddin et al. (2024) examine the issues and challenges in implementing Sharia audit practices across various Sharia-based sectors in Malaysia, including the Islamic financial sector, Islamic Capital Market, Islamic cooperatives, and public Sharia-based entities. The study highlights the distinct challenges faced by each sector due to differing Sharia governance and assurance practices. Through a series of focus group discussions involving 124 participants from 76 Sharia-based institutions, the authors identify key issues hindering the effective implementation of Sharia audit practices. Based on their findings, they propose three main strategies to enhance Sharia audit practices: nurturing Sharia governance and assurance, developing sector-specific Sharia audit scopes, and enhancing the professionalisation of Sharia auditors. This pioneering study contributes to the literature by providing a comprehensive understanding of the challenges in Sharia audit practices across diverse sectors and offering actionable strategies for improvement (Kamaruddin et al., 2024).

In another significant contribution, Abdullahi et al. (2024) explore the independence of Sharia auditors in Islamic banks, focusing on its crucial role in ensuring the accurate application of Islamic law. The study identifies the inherent challenges faced by Islamic banks, notably the potential compromise of Sharia auditors' independence. Abdullahi et al. (2024) assert that the Sharia audit process cannot be fully effective unless auditors are free from the influence of senior management, particularly in regard to employment conditions and compensation structures. The study advocates for enhancing auditor independence by enabling their appointment and dismissal through state or Sharia supervisory bodies, such as Dar Al-Fatwa, and by adhering to standards set by AAOIFI. These measures are essential to maintaining the integrity and proper execution of Sharia compliance within Islamic banks, ensuring that audits are conducted impartially and in accordance with Sharia principles.

The review of existing literature reveals several notable gaps in the field of internal Sharia audit. First, there is an absence of comprehensive studies examining the current practices and effectiveness of internal Sharia audit departments in the context of GCC countries. Most research has focused on the Sharia Supervisory Committee, leaving a gap in understanding the operational role of internal Sharia auditors. Second, the literature lacks an in-depth analysis of the alignment between regulatory requirements in the GCC and international standards, such as those set by AAOIFI. Third, there is limited exploration of the challenges faced by internal Sharia auditors and recommendations for main stakeholders to improve internal Sharia audit practices.

This study aims to bridge these gaps by providing a detailed assessment of internal Sharia audit practices, evaluating the regulatory requirements of internal Sharia audits using the AAOIFI internal Sharia audit standard as a benchmark, and offering recommendations for enhancing the effectiveness of internal Sharia audits within GCC Islamic banks.

4.4 AAOIFI's GS 11 - THE INTERNAL SHARIA AUDIT (ISA)

In December 2019, the Governance and Ethics Board of AAOIFI issued the AAOIFI's Internal Sharia Auditor Standard for Islamic Financial Institutions, replacing the previously issued GS 3 "Internal Sharia Review" from 1999. This standard was presented in Malaysia, Bahrain, and Pakistan, and it provides guidance on the Sharia governance framework, handling conflicts of interest, defining the audit scope, objectives, documentation, competency of internal Sharia auditors, stages of the internal Sharia audit, and reporting requirements (AAOIFI, 2020).

Although AAOIFI's Internal Sharia Audit Standard is available, not all Islamic banks fully implement it (Ahmed and Khatun, 2013). Some countries use it only as guidance, and the standard is followed either fully, partially, or as guidance in several countries such as Bahrain, Jordan, UAE, Kyrgyz Republic, Mauritius, Nigeria, Qatar, Oman, Pakistan, Sudan, Syria, and Yemen. However, some countries do not consider this standard, and there is no harmonisation between Islamic banks (AAOIFI.com, 2020b).

According to AAOIFI's GS11 standard, the internal audit department plays a crucial role in the Sharia governance framework of Islamic financial institutions. It encourages compliance with Sharia principles and provides an independent review to strengthen internal control and manage Sharia non-compliance risk, thereby increasing stakeholders' trust.

AAOIFI's GS11 provides a framework for Islamic banks to effectively implement Sharia audit alongside other functions in the Sharia governance framework, including Sharia compliance, Sharia non-compliance risk management, and external Sharia audit.

AAOIFI defines the Internal Sharia Audit Department as "*a functional part of the governance organs of an Islamic financial institution, being independent of management, with a primary objective to provide assurance to those charged with governance and the Sharia Supervisory Committee in relation to the Islamic financial institution's adherence to Sharia principles and rules.*" The Internal Sharia auditors are defined as "*the individuals who perform the activities of the internal audit department*" (AAOIFI).

The distinction between the Internal Sharia Audit Department and the Sharia Compliance Department is evident in AAOIFI's definition. The Internal Sharia Audit Department assesses the adequacy and effectiveness of intended controls to ensure adherence to Sharia guidelines, while the Sharia Compliance Department is not independent function and it provides an ongoing process of monitoring the bank's overall activities and Sharia compliance environment.

It is important to note that the internal audit function is a different function to normal internal audit. In the study conducted by Shetu and Karim (2020), it was emphasised that internal Sharia auditors differ from regular auditors due to their heightened sense of accountability to all stakeholders, including Allah (SWT), as Muslims believe in the concept of Muraqabah, wherein their actions are constantly observed by God. Consequently, Sharia audit assumes a significant role in providing assurance to stakeholders regarding the Islamic institution's compliance with Sharia principles. Despite facing certain challenges during its implementation, the study suggests that these issues can be effectively addressed through the development of an appropriate Sharia governance framework (Shetu and Karim, 2020).

The objective of the Internal Sharia Audit standard is to establish a framework for the internal Sharia audit, facilitating proper and consistent Sharia audit practices in Islamic banks (Abdul Rahim, 2011).

The AAOIFI's GS11 standard encompasses various aspects of Sharia audit:

4.4.1 Compliance, quality control and ethical requirements

According to the Internal Sharia Audit Standard set forth by AAOIFI, financial institutions cannot claim compliance with the standard unless they fully implement all its requirements. The standard mandates that internal Sharia auditors must adhere to the "Code of Ethics for Accountants and Auditors of Islamic Financial Institution" issued by AAOIFI and the "Code of Ethics" issued by the Institute of Internal Auditors (IIA). Additionally, the standard emphasises the importance of quality control, requiring internal Sharia auditors to comply with the IIA’s Quality Assurance and Improvement Program (QAIP).

As per the standard, the internal Sharia audit department is required to undergo regular quality assurance and improvement assessments. These assessments must be carried out by an independent team to ensure that the function operates in accordance with its designated duties and responsibilities.

From the perspective of religious legitimacy, Sharia scholars strongly advocate the implementation of Sharia audits quality assurance as a means of providing assurance that Islamic financial institutions' operations indeed adhere to Sharia principles, as asserted by Syed Alwi in 2009. This quality assurance ensures the appropriate and correct conduct of Islamic financial institutions' Sharia-compliant activities, as emphasised by Nawal et al. in 2009. Furthermore, Sharia audits are instrumental in evaluating the procedures associated with each product to ensure compliance with Sharia principles, as indicated by Zurina et al. in 2010. Lastly, the quality assurance of Sharia audits plays a critical role in assessing the effectiveness of Islamic financial institutions' internal control systems, as emphasised by Zurina and Supiah in 2010.

AAOIFI's Sharia audit standard also emphasises the need for independence and objectivity in the internal Sharia audit function. The objective is to ensure the function remains independent from the executive team while remaining aligned with the institution. Consequently, the internal Sharia audit function should refrain from engaging in operational activities related to the first and second lines of defence and should have unrestricted access to all necessary documents.

Alam et al. (2022) emphasised that the internal Sharia audit department in their research in Bangladesh confronts significant challenges related to their independence and decision-making authority while conducting Sharia audits. In this research the Sharia auditors encounter limitations in addressing practical Sharia audit issues without interference and typically report to the institution's management. This reporting structure restricts them from expressing independent opinions without prior authorisation from the management.

Consequently, it is important to note that the mere presence of an internal Sharia audit department within a financial institution does not automatically guarantee the independence and effective functioning of the function. The findings from Alam et al. (2022) research underscore the critical importance of addressing these challenges to ensure the integrity and effectiveness of the internal Sharia audit.

Based on the above, The AAOIFI's Internal Sharia Audit Standard sets strict requirements for financial institutions to claim compliance, mandating adherence to specific codes of ethics and emphasising quality control through the internal audit's quality assurance program. Also, addressing the challenges related to independence is crucial for strengthening the internal Sharia audit effectiveness.

4.4.2 Independence and objectivity

According to AAOIFI's GS11, the internal Sharia audit function is expected to operate with a high degree of independence and objectivity. To achieve this, the function should have complete and unrestricted access to all relevant documents and information within the organization. In order to strengthen the independence of the internal Sharia audit, it is crucial for both the audit committee and the Sharia committee to provide their unwavering support to the function. Effective and open communication channels should be established between the Sharia auditors and the management to facilitate a seamless flow of information.

Furthermore, the internal Sharia audit function must refrain from engaging in operational activities. Its primary responsibility lies in conducting thorough and impartial audits, and the auditors should report their findings based on the work performed in an objective manner. This ensures that the conclusions drawn from the audits are based on rigorous assessment and adherence to Sharia principles, without any influence from operational or managerial affairs.

Mautz and Sharaf (1961) noted that independence, in its essence, encompasses two facets: independence of mind, which pertains to the auditor's mental disposition and capacity to exercise autonomy in audit planning and execution, and independence in appearance, which refers to stakeholders' perceptions regarding the auditors' autonomy. Therefore, it is imperative that internal Sharia auditors preserve their full independence without bias towards the audited entity and project an appearance of impartiality to improve trust among those reliant on the Sharia audit outcomes.

4.4.3 Internal Sharia audit: objectives and organisational structure

According to AAOIFI internal Sharia audit standard, the main goal of the internal Sharia audit is to provide assurance to all stakeholders of the Islamic financial institution regarding compliance with Sharia principles. Additionally, the internal Sharia audit aims to assure the suitability of the Sharia governance framework, the adequacy of internal Sharia controls for managing Sharia non-compliance risk, and the acceptability of Sharia non-compliance risk assessment criteria.

In the comparative analysis between internal audit and internal Sharia audit, Roszaini (2010) highlights distinct goal for each. The internal audit function serves to offer assurance that the overall operations of Islamic banks are functioning efficiently and effectively. On the other hand, the internal Sharia audit is specifically designed to provide assurance that the entirety of processes within the Islamic bank aligns with the principles of Sharia.

The standard also stipulates that the audit committee of the Islamic financial institution has the responsibility of overseeing the internal Sharia audit function and ensuring its effectiveness, with input from the Sharia Supervisory Committee on an as-needed basis. The internal Sharia audit function can operate as a separate department, or be integrated into the internal audit department, or be outsourced. However, the head of the internal Sharia audit should report directly to the audit committee with a dotted-line reporting relationship to the SC.

According to AAOIFI, the aforementioned reporting lines will empower internal Sharia auditors within the institution and ensure their independence. Isa et al. (2020) highlighted various significant concerns in the practice of internal Sharia audit in Malaysia, including the lack of an independent Sharia audit report, the absence of a standalone Sharia audit framework, and the shortage of competent Sharia auditors. However, the study also revealed a promising outlook for Sharia audit as a potential marketable career in the future in the Malaysian market. Based on the findings of this research, it is regrettable that not all internal Sharia auditors currently operate independently from the management within their respective institutions.

According to AAOIFI, the head of internal Sharia audit is also responsible for developing a Sharia audit plan, drafting policies and procedures for the Sharia audit team, and ensuring the efficient and effective functioning of the internal Sharia audit. In a study conducted by Rahman et al. (2018) in Malaysia, it was observed that Sharia audit is often limited to Sharia product compliance. Additionally, the absence of structured Sharia audit documentations and standardisation in the auditing process across various Islamic banks can create challenges for stakeholders in comparing Sharia compliance reports. As a result, this situation may hinder informed decision-making on the compliance with the Sharia principles.

4.4.4 Human resources for internal Sharia audit

As per AAOIFI GS11, the audit committee holds the responsibility of ensuring the presence of a competent and qualified head of the internal Sharia audit department. This entails selecting an individual with appropriate qualifications and experience in Sharia auditing. Subsequently, the appointed head of Sharia audit assumes the responsibility of assembling a capable team for the department and ensuring that its members receive regular and relevant training. The training provided should primarily focus on audit techniques and Islamic financial transactions. Moreover, the staff members should possess the necessary knowledge, skills, and competencies required to effectively conduct routine internal Sharia audits.

Previous studies have highlighted multiple factors contributing to the inadequate implementation of internal Sharia audit practices in Islamic banks. One significant reason is the insufficient understanding among internal Sharia auditors regarding the appropriate methodologies to conduct Sharia audits (Yazkhiruni & Nurmazilah, 2012). Moreover, it has been observed that certain Islamic banks experience weakened Sharia governance frameworks, resulting in insufficient training being provided to their internal Sharia audit teams, as documented by Sheila Ainon (2013). These factors collectively underscore the importance of addressing knowledge gaps and enhancing the overall effectiveness of internal Sharia audit practices in the Islamic banking sector.

4.4.5 Principal procedures

The AAOIFI's internal Sharia audit standard delineates the duties of the Head of internal Sharia audit in formulating an internal Sharia audit charter, an internal Sharia audit manual, and periodic Sharia audit plans. The Sharia audit charter encompasses four key elements: the statement of purpose and objectives, a concise summary of the internal Sharia audit's scope and responsibilities, the structure and reporting line, and the procedural framework for the internal Sharia audit, along with reporting expectations.

On the other hand, the internal Sharia audit manual should incorporate a minimum of five components, including the internal Sharia audit process, tools and methodologies employed during the internal Sharia audit, the mechanism for reporting and rating criteria, a risk matrix and summary of controls, and lastly, the ethical and professional requirements governing the internal Sharia audit activities.

The AAOIFI's GS11 standard emphasises the significance of having a Sharia audit charter and a Sharia audit manual, outlining the required titles for both documents. However, the standard falls short in providing concrete examples of these documents. This lack of practical illustrations may indicate that even the AAOIFI itself may not possess a fully crystallised vision of the specific content and structure of these documents. As a consequence, this dearth of detailed guidance could lead to inconsistencies and discrepancies in the practices of internal Sharia auditors across various institutions. Standardising these documents with specific examples could enhance harmonisation and promote a more unified approach to conducting internal Sharia audits within Islamic financial institutions.

In the context of Sharia audit practices within Islamic financial institutions are mainly in Malaysia, and the existing literature has predominantly focused on examining various aspects such as the scope, competency, working methodologies, and the prevailing framework employed to conduct Sharia audits (Nawal et al. 2009; Nik Shahrizal 2012; Yazkhiruni & Nurmazilah 2012). Nevertheless, it is noteworthy that there is a dearth of research studies pertaining to Sharia audit practices in the GCC countries. As of the current literature review, no relevant studies have been identified that specifically address this subject in the GCC region.

In accordance with AAOIFI's internal Sharia audit standard, the formulation of systematic annual and periodic plans is the responsibility of the Head of Internal Sharia Audit. These plans necessitate approval from both the Sharia Supervisory Committee and the audit committee. The standard mandates that the internal Sharia audit be conducted at least on an annual basis, aligning with the approved plans to ensure the regular assessment of Sharia compliance within the Islamic financial institution.

Shahar et al. (2018) emphasise the significance of maintaining documentation of Sharia audit department and implementing a comprehensive Sharia audit control system to achieve the objective of continuous and sustainable performance enhancement. Moreover, according to Shahar et al. (2018), the continuous improvement of Sharia audit practices and documentations is essential to foster greater accountability, transparency, and trustworthiness among Sharia auditors. This approach ensures a higher level of confidence in the integrity and reliability of Sharia auditing processes.

The findings of this study reveal a significant relationship between the presence of proper documentation and the level of confidence in the integrity and reliability of the internal Sharia audit. The availability of comprehensive and well-maintained documentation plays a crucial role in instilling trust among stakeholders in the accuracy and effectiveness of the internal Sharia audit process. This relationship underscores the importance of maintaining robust documentation practices as a means to enhance the credibility and assurance provided by the internal Sharia audit function within the Islamic financial institution.

4.4.6 Engagement audit - process flow

The AAOIFI's internal Sharia audit standard outlines a twelve-step Sharia audit cycle, which includes the following stages:

1. Planning: The Head of internal Sharia audit should identify the auditors and allocate time for each Sharia audit. They should determine the scope, required documents, and checklists, and review relevant materials like meeting minutes, Sharia standards, and Fatwas from previous audits.
2. Risk assessment: The Head of internal Sharia audit should conduct a risk assessment for each audited area.
3. Materiality assessment: This assessment should consider incidents that could significantly impact stakeholders' decisions.
4. Sampling: The internal Sharia audit team must select an appropriate sample that encompasses critical areas.
5. Internal Sharia controls assessment: The internal Sharia audit team evaluates the effectiveness and stability of existing controls, gathering sufficient evidence.
6. Internal Sharia controls testing: The internal Sharia audit team assesses employees' knowledge of Sharia principles, observes processes, asks relevant questions, and tests controls.
7. Evaluation of main observations: The internal Sharia audit team evaluates observations and may expand the sample size if necessary.

8. Assessing residual risk: The Islamic financial institution should maintain a zero-tolerance policy for major Sharia non-compliance risks. Therefore, the internal Sharia audit team evaluates any remaining Sharia non-compliance risk after their efforts to identify and mitigate significant risks.
9. Implementing detailed procedures: The internal Sharia audit team considers developing detailed procedures in audited areas to address Sharia non-compliance risks.
10. Closing meeting: Significant observations are discussed with relevant departments to agree on an action plan to resolve audit issues within a specific timeframe.
11. Reporting audit observations: The draft report is shared with the auditee to incorporate their official action plan to close audit issues.
12. Issuance of final reports and audit ratings: After receiving the auditee's action plan, the internal Sharia audit issues the final audit report with their recommendation for the rating. The final rating is reviewed and approved by the Sharia Supervisory Committee.

Through a review of the existing literature, it becomes evident that a comprehensive process to enhance stakeholders' confidence in the adherence of Islamic banks to Sharia principles is noticeably missing. This gap raises concerns regarding the potential risk of non-compliance with Sharia principles faced by Islamic banks. Such non-compliance could have a substantial impact on the credibility of these banks as institutions committed to upholding the rules and principles of Sharia (Nik Shahrizal, 2012). This highlights the pressing need for harmonisation approach to internal Sharia audit to strengthen Sharia audit and ensure compliance within Islamic banks.

4.4.7 Documentation and tools

As per the AAOIFI's internal Sharia audit standard, it is essential for all documentation, evidence, and policies to align with international best practices. Sufficient and appropriate documentation should be maintained in connection with the internal Sharia audit to enable auditors to draw sound conclusions. All relevant evidence, conclusions, comments from the Sharia Supervisory Committee, and management's action plan should be thoroughly documented in the audit report. Additionally, AAOIFI advocates the use of relevant software to enhance and support the internal Sharia audit function. Regarding the rating mechanism, AAOIFI recommends that the internal Sharia audit function collaborates with the Sharia Supervisory Committee to establish a rating system that evaluates the institution's compliance with Sharia principles.

Upon examination of the aforementioned points, it is evident that AAOIFI's GS11 lack specificity in defining the concept of "internal best practices," leaving room for interpretation among practitioners. Additionally, their recommendation to utilise relevant software to enhance the Sharia audit does not provide any specific software suggestions, leading to uncertainty in implementation. Furthermore, the absence of a recommended rating system for the internal Sharia audit adds to the unclear requirements, potentially hindering practitioners' understanding and execution of the process. These ambiguities in the guidelines may not adequately assist and support practitioners in the market, emphasising the need for clearer and more detailed guidelines in these areas to enhance the effectiveness and standardisation of the internal Sharia audit process.

In the research conducted by Shafii et al. (2010), it was emphasised that internal Sharia audit plays a significant role in addressing Sharia non-compliance risk in Islamic banks. The Sharia supervisory committee is responsible for issuing a Sharia certificate before the Islamic banks can offer any products. However, the committee heavily relies on the information provided by the internal Sharia auditor to assess the actual compliance of the Islamic banks. This evaluation encompasses various operational aspects, such as documentation, reporting, policies, procedures, and meeting minutes.

Based on the above study, in order to furnish stakeholders with more comprehensive information, it is essential that Sharia auditors possess a clear understanding of best practices, utilise appropriate software for conducting the internal Sharia audit, and have a well-defined recommended rating system. Addressing these factors will enhance the effectiveness and reliability of the internal Sharia audit process and further bolster stakeholders' confidence in the Sharia compliance of Islamic banks.

4.4.8 Reporting

As per AAOIFI's GS11 standard, the internal Sharia audit report should be submitted to both the audit committee and the Sharia Supervisory Committee, evaluating the institution's adherence to Sharia principles, at least annually. The contents of the “internal Sharia audit report” are specified by the standard, encompassing elements such as the title, addresses of the recipients, the overall scope of the internal audit department, the Sharia auditor's opinion on the institution's compliance with Sharia principles, and a concise summary of completed engagements since the last report, including key observations with ratings for each engagement. The report should also include an assessment of the Sharia governance framework and the Sharia non-compliance risk, a brief on the internal Sharia audit department's performance, and any updates to the Sharia audit plan.

In addition to the audit report, the internal audit report should provide an “engagement report” to the audited entity, containing elements such as the title, addresses of the recipients, the scope and period covered in the audit, the Sharia auditor's opinion on compliance with Sharia principles in the audited entity, the audit rating, a summary of key observations, and updates on previous Sharia audit issues, along with management's and the Sharia Supervisory Committee 's comments, if applicable.

Based on the above, the internal Sharia auditor is required to prepare two distinct reports, each serving a specific purpose. The first report is intended for the Sharia Supervisory Committee and the audit committee, providing them with detailed insights into the findings and outcomes of the Sharia audit process. The second report is designated for the audited entity, conveying relevant information pertaining to the audit outcomes specific to the department/function under review.

Although the AAOIFI offers guidelines on the content of these reports, it lacks concrete examples to illustrate their format and actual content. Consequently, this limited guidance may result in inconsistencies between the internal Sharia audit reports produced by different Islamic banks. The absence of comprehensive exemplars may lead to variations in reporting practices, potentially hindering comparability and standardisation across the industry. To address this concern, it would be beneficial for the AAOIFI to provide more detailed and illustrative examples of both types of reports, facilitating greater consistency and harmonisation in internal Sharia audit reporting practices among Islamic banks.

In study conducted by Puad and Rafdi (2015) to compare the Sharia audit report in Malaysia, Pakistan and Bahrain highlighted that the utilisation of different guidelines for Sharia audit reports leads to diverse presentations and disclosures. To enhance public confidence in Islamic banking and effectively achieve Sharia compliance goals, there is a crucial need for ensuring the disclosure of pertinent information. The research further indicates that the implementation of a comprehensive Sharia audit framework can play a significant role in accomplishing these objectives. Ultimately, prioritising transparency through enhanced disclosures holds the potential to benefit stakeholders and positively impact the Islamic banking industry.

According to AAOIFI's GS11 standard, the management and the Board of directors are accountable for guaranteeing adherence to Sharia principles within financial institutions and resolving all outstanding audit issues within agreed-upon timelines. Prior to commencing any new engagement, the internal Sharia auditor should engage with the entity to review and discuss prior audit observations.

By clearly delineating roles and responsibilities, the management and board of directors assume primary accountability for upholding Sharia compliance within the Islamic bank. The internal Sharia auditor, in turn, plays a pivotal role in ensuring that any historical Sharia none compliance concerns are rectified before conducting subsequent Sharia audit activities. This distinct allocation of responsibilities helps to reinforce the effectiveness of the Sharia audit process and promotes a robust adherence to Sharia principles within the institution.

4.4.9 Fit and proper criteria

According to AAOIFI's GS11 standard, the individual leading the Internal Sharia Audit Department preferably possess over a decade of experience along with a university degree or relevant professional qualifications, preferably in accountancy audit, internal audit or Sharia audit. The head of the department is expected to have an understanding of Islamic finance and understanding of Islamic financial transactions (Fiqh al-Muamalat). Approval from the institution's Sharia Supervisory Committee and, if applicable, from the regulator is necessary to ensure that the appointed individual possesses the necessary expertise and skills to fulfil their responsibilities effectively.

It is important to note that AAOIFI's GS11 standard presents certain ambiguities regarding the requirements for the head of the internal Sharia audit. The standard uses the term "preferably" when referring to the desired qualifications and years of experience, without providing a definitive mandate for these prerequisites. Moreover, concerning the understanding of Islamic financial transactions, the standard merely mentions a general level of understanding of Fiqh al-Muamalat, leaving room for interpretation and potential variations in the expected proficiency.

Shafii et al. (2014) highlights shortcomings in Sharia audit within Islamic financial institutions, leading to dissatisfaction among the public and Islamic bank customers. To address this, they propose providing formal Sharia audit training for auditors and enforcing the requirement for the Certified Sharia Advisor and Auditor credential from AAOIFI. These measures aim to improve Sharia audit quality and enhance stakeholders' confidence in Islamic financial products and services.

It is noteworthy that AAOIFI's GS11 standard does not make any specific reference to Certified Sharia Advisor and Auditor qualification, nor does it mandate that the head of the internal Sharia audit possess this credential. Despite the recognition of the importance of such a qualification by Shafii et al. (2014), the GS11 standard does not explicitly require it for the leadership position in the Internal Sharia Audit Department. As a result, this credential remains optional and not obligatory for individuals serving in the role of the internal Sharia auditors as per the AAOIFI guidelines.

In a study, conducted by Alam et al. (2017), focused on evaluating the competencies essential for Sharia auditors within Pakistan's Islamic finance industry. The research findings highlight the insufficient establishment of the necessary knowledge regarding Sharia audit. Additionally, the study uncovers a notable proportion of Sharia auditors who lack the appropriate experience and qualifications in the fields of Sharia audit and Islamic banking.

The situation of auditors lacking adequate experience and qualifications may be attributed to the lack of clarity regarding the requirements for internal Sharia auditors outlined in the AAOIFI standards. According to AAOIFI's GS 11, any individual engaged in regular auditing can assume responsibility for conducting Sharia audits, provided they possess a basic understanding of Sharia and are approved by the institution's Sharia committee. The ambiguity in the standard's requirements may have led to the inclusion of individuals without specialised expertise and experience in Sharia audit, which, in turn, could explain the identified issues in the competence and qualifications of Sharia auditors reported in the study by Alam et al. (2017).

Furthermore, the Islamic banking industry is facing a challenge in nurturing a new generation of internal Sharia auditors, as highlighted in a study conducted by Khalid et al. (2019). The research explored the awareness of internal Sharia audit among undergraduate students in Malaysia. The study findings revealed that accounting students exhibited a limited understanding of Sharia audit; however, they displayed a strong desire to enhance their knowledge in this area. The students stressed the significance of having qualified auditors with ample expertise in Sharia to effectively conduct internal Sharia audits.

The research findings presented by Khalid et al. (2019) demonstrate that possessing knowledge in accounting does not guarantee an individual's ability to comprehend and effectively conduct internal Sharia audits. The complexities and specificities involved in Sharia compliance necessitate specialised expertise and training beyond generic accounting knowledge.

In an alternative academic investigation undertaken by Islam and Abdullah (2015), the focus was on determining the knowledge and skills essential for conducting internal Sharia audits. The study emphasised that The Holy Qur'an and Hadith (the primary sources of Sharia as they explained in the second chapter) can be invaluable sources for guiding audit practices, especially when integrated with traditional auditing knowledge. Moreover, it highlighted the necessity for comprehensive efforts, involving devout individuals, to develop a specialized compilation based on selected Qur'anic verses, Sunnah, and divine messages. Initiatives aimed at cultivating a God-fearing mind-set among stakeholders and the implementation of divine message-based course curricula in diverse domains, including accounting and auditing, were also underscored.

Also, in the study conducted by Khalid et al. (2017), a significant and positive correlation was found between competency, work performance, and the effectiveness of internal Sharia audit. The research emphasised that possessing professional certification and skills emerged as the key competency factor influencing effectiveness. Additionally, the availability of sufficient information for Sharia auditors to form a sound opinion was identified as another important contributor to the effectiveness of Sharia audit. These findings underscore the importance of both competency and access to pertinent information in ensuring the successful execution of internal Sharia audit practices.

4.5 SUMMARY

This chapter undertakes a comprehensive analysis of AAOIFI's governance standard number eleven, which relates to the internal Sharia audit. The exploration commences with a historical inquiry into the Sharia audit from a Sharia perspective. While the primary and secondary sources of Sharia do not explicitly mention the Sharia audit, its origins can be traced back to the practices of Prophet Muhammad (PBUH) and the subsequent caliphates. Rooted in the concept of Hisbah, signifying "enjoining good and forbidding wrong," the Sharia audit evolved over time, finding culmination with the inception of the first Islamic bank in Dubai in 1975. Tasked with ensuring adherence to Sharia principles within the Dubai Islamic Bank, the role of the Sharia auditor emerged.

Subsequently, in 2019, AAOIFI introduced a revised internal Sharia audit standard, supplanting the earlier internal Sharia review standard. This new standard designates the internal audit department as a crucial component within the Sharia governance framework of any Islamic financial institution, entrusted with fostering Sharia compliance and furnishing an independent assessment.

Upon closely examining AAOIFI's GS 11 standard, it becomes evident that despite its emergence as a replacement for the outdated internal Sharia review standard, it retains areas necessitating improvement. For instance, the standard introduces concepts such as the internal Sharia audit manual, internal Sharia audit charter, internal Sharia audit report, and engagement Sharia audit report. However, it restricts itself to prescribing the titles of these documents without providing concrete exemplars or templates.

In light of the aforementioned analysis, while AAOIFI's standard represents a commendable starting point for Islamic banks to comprehend the foundational requisites of the internal Sharia audit function, it does reveal room for enhancement. The subsequent chapter will delve into an assessment of the regulatory framework governing the internal Sharia audit in the GCC, a region of paramount significance in the realm of Islamic banking.

CHAPTER 5: THE REGULATORY FRAMEWORK OF THE INTERNAL SHARIA AUDIT IN THE GCC

5.1 INTRODUCTION

The previous chapter cantered on an examination of prior scholarly investigations pertaining to internal Sharia audit, coupled with an analytical assessment of AAOIFI's internal Sharia audit standard. Nonetheless, the previous chapter primarily underscored theoretical aspects, neglecting exploration of practical applications. In accordance with the standards set forth by AAOIFI, it is obligatory for all Islamic banks to establish an internal Sharia audit function.

Given the variation in regulatory frameworks and stipulations on a global scale, a comprehensive evaluation of the regulatory structure governing Sharia audit becomes essential to check its compatibility with the internal Sharia audit standards published by AAOIFI. An optimal choice for this assessment lies within the GCC region, where the alignment between regulatory framework and internal Sharia audit standards can be effectively investigated. This regional focus is particularly suitable considering that the GCC countries collectively command a substantial share, exceeding 40%, of the global Islamic banking assets (REFINITIV, 2022). This unique positioning makes the GCC region a key and influential area for studying the interaction between regulatory norms and internal Sharia audit practices.

This chapter aims to highlight the regulatory landscape related to banking, the Sharia governance framework requirements, and the requirements related to the internal Sharia audit in the GCC region. The primary objective is to offer the researcher and readers a clear understanding of how the internal Sharia audit function for Islamic banks operates within the GCC.

5.2 GCC COUNTRIES

The GCC is a political and economic alliance of six countries in the Middle East: Saudi Arabia, United Arab Emirates, Kuwait, Qatar, Bahrain, and Oman. It was established on May 25, 1981, with the goal of fostering cooperation and coordination among its member states in various fields, including economics, defence, security, and culture. The GCC is headquartered in

Riyadh, Saudi Arabia, and operates through various institutions, including the Supreme Council, Ministerial Council, and Secretariat General (GCC, 2021).

Economically, the GCC member states are major oil and gas producers, and the GCC has been instrumental in promoting economic integration and coordination among its members. The GCC has implemented various economic initiatives, such as the Gulf Common Market, which aims to remove trade barriers and promote the movement of goods, services, and capital among member states. The GCC also launched a unified currency initiative, known as the Gulf Monetary Union, with the goal of establishing a single currency for the member states, but it has not yet been implemented (Kechichian, 2018).

Based on Refinitiv's analysis, the year 2021 witnessed a significant presence of Islamic banking within the domain of Islamic finance, constituting a substantial proportion of the overall assets. The estimated value of approximately US$2.8 trillion accounted for about 70% of the total Islamic finance assets. Notably, the GCC region emerged as a prominent force, representing 43% of the global Islamic banking assets. This noteworthy concentration of assets within the GCC region underscores the robustness of its Islamic banking infrastructure and underscores its pivotal role as a key contributor to the growth and development of the broader Islamic finance industry (REFINITIV, 2022).

While the GCC countries share a common goal of regional economic cooperation, they have distinct financial systems and regulatory frameworks. Each GCC country has its own regulatory requirements, monetary agencies and financial authorities. For example, Saudi Arabia has the Saudi Arabian Monetary Authority (SAMA) as its central bank, which is responsible for monetary policy, issuance of currency, and regulation of the banking sector. The United Arab Emirates (UAE) has the Central Bank of the UAE, which performs similar functions as SAMA. Other GCC countries like Kuwait, Qatar, Oman, Bahrain, and Qatar also have their respective central banks or monetary agencies.

In addition to central banks, each GCC country has its own financial regulatory authorities, such as the Capital Market Authority (CMA), Insurance Authority, and other regulatory bodies that oversee specific sectors of the financial industry within their jurisdictions. These regulatory authorities are responsible for ensuring compliance with Sharia requirements for Islamic financial institutions, financial regulations, supervising financial institutions, and safeguarding the stability and integrity of the financial systems in their respective countries.

When it comes to Sharia principles, the Sharia is applied primarily in the areas of family law, inheritance law and criminal law. For example, in Saudi Arabia, Islamic law is used to enforce strict punishments for certain crimes, such as amputations for theft and floggings for alcohol consumption (Alhaidan et al, 2022). However, the Sharia is not fully applied to the financial law as in Sharia, as highlighted in chapter 2, it is strictly prohibited to deal with interest and many banks in the GCC, including Saudi Arabia, are authorised and regulated by the government to charge and pay interest.

Also, in Qatar, conventional banks are generally not allowed to offer Islamic banking products, as according to the Qatar Central Bank (QCB) there is a clear distinction between conventional banking and Islamic banking due to Sharia principles. Conversely, the Central Bank of Oman (CBO) has established a regulatory framework for Islamic banking, and this framework allows conventional banks to offer Islamic banking products and services alongside their conventional banking activities, provided they obtain the necessary approvals from the Central Bank of Oman and comply with the applicable regulations.

Based on the above there may be similarities in the regulatory frameworks and financial systems among the GCC countries, but there are also differences in terms of specific regulations, laws, and practices in each country for Islamic banks. Therefore, it is essential to understand the specific regulatory environment for the internal Sharia audit in each GCC country before conducting any interviews with the practitioners.

5.3 BAHRAIN

5.3.1 Banking Regulation overview

Bahrain, a small island nation in the Middle East, is recognised as a prominent financial centre in the Gulf region, with a well-established and robust banking sector. The country has implemented a comprehensive regulatory framework to ensure the stability, transparency, and growth of its banking industry, which is overseen by the Central Bank of Bahrain (CBB).

Bahrain had a stronger influence from the English legal system compared to other countries in the GCC (Al-Suwaidi, 1993: 292-293). Nevertheless, after gaining independence in 1971, Bahrain underwent significant legal development, enacting substantive and procedural laws while also recognizing Sharia as a principal source of legislation, as explicitly stated in Article 2 of its Constitution (page 148). Article 76 of the 1987 Commercial Law in Bahrain expressly permits the levying of interest charges on commercial loans. Nevertheless, it stipulates that the interest rate must be established by the Bahrain Monetary Agency, as stipulated by the legislation (Al-Suwaidi, 1993: 292).

The banking regulation in Bahrain is governed by several key laws, including the Central Bank of Bahrain and Financial Institutions Law (CBB Law). The CBB plays an important role in regulating and supervising the banking sector in Bahrain. It operates as the primary regulatory authority responsible for granting licenses to banks and financial institutions, setting prudential regulations, conducting on-site and off-site inspections, and enforcing compliance with applicable laws and regulations. The CBB also issues guidelines and circulars on various aspects of banking operations, risk management, capital adequacy, and customer protection, among others (Laws & Regulations, 2023, Central Bank of Bahrain).

5.3.2 Islamic Banking Regulation overview

Islamic banks in Bahrain are subject to regulatory requirements that align with conventional banks, but also encompass specific obligations related to Sharia compliance. The Central Bank of Bahrain (CBB) has established the Centralised Sharia Supervisory Board (CSSB), an independent body responsible for ensuring Sharia compliance among Islamic banks (CBB, 2015). This board consists of renowned Sharia scholars who provide expert guidance and review the banks' operations, products, and services to ensure adherence to Sharia principles.

The Sharia governance requirements for Islamic banks in Bahrain, as outlined in the CBB Rulebook Volume 2: Islamic Banks, include:

1. Sharia Supervisory Committee (SSC): Islamic banks must establish an independent Sharia Supervisory Committee composed of Sharia scholars to ensure compliance with Sharia principles.

2. Internal Sharia Audit: Regular and independent Sharia compliance audits of the banks' operations, products, and services must be conducted by the Sharia Supervisory Committee or an approved external Sharia audit firm.
3. Sharia Governance Framework: Islamic banks must establish a robust Sharia governance framework that clearly defines the roles and responsibilities of the Sharia Supervisory Committee, internal controls, and reporting mechanisms.
4. External Sharia Audit: Islamic banks are required to undergo regular Sharia audits by an approved external Sharia audit firm to assess compliance and provide independent assurance.
5. Compliance with AAOIFI Standards: Islamic banks in Bahrain must adhere to the governance standards set by AAOIFI, as mandated by the CBB (CBB, 2014).

Taking the aforementioned into consideration, the Sharia governance requirements have been established to ensure that Islamic banks operate in accordance with Sharia principles and maintain the integrity of the Islamic financial system. These requirements have been put in place to ensure the credibility of the internal Sharia audit and to enhance public trust in the legitimacy of Islamic banks.

5.3.3 Internal Sharia audit

In 2017 the CBB issued the Sharia Governance Module (Module SG) containing rules related to Sharia governance for licensed Islamic banks in Kingdom of Bahrain (CBB, 2017). The internal Sharia audit requirements in the Sharia Governance Module include the following:

1. Every Islamic bank in Bahrain is mandated to establish an internal Sharia audit department that directly reports to the Sharia committee and holds administrative accountability to the CEO.
2. The management, in collaboration with the Sharia Committee, is responsible for devising the guidelines, procedures, and manual for the internal Sharia audit department. All of these components must secure approval from the board of directors. Per SG-4.1.2 of the CBB, these documents must incorporate various elements, including a declaration of purpose, authority, and responsibilities. It should be explicitly outlined that the internal Sharia audit staff do not wield executive powers over the processes they review.

3. The chief of the internal Sharia audit is tasked with ensuring that the respective Islamic bank complies with Sharia principles, abides by the Fatwas issued by the Sharia committee, adheres to the Sharia standards set forth by AAOIFI, and follows the Sharia policies and procedures established by the bank.
4. The appointment of the head of the internal Sharia audit is the responsibility of the management, with the consent of the Sharia committee and in consultation with the audit committee. Additionally, in cases where the head of the internal Sharia audit function departs from the role, whether due to resignation, suspension, or dismissal, Bahraini Islamic bank licensees are obligated to promptly notify the CBB.
5. Unrestricted access to documents, reports, and related materials is granted to the internal Sharia audit function.
6. The head of the internal Sharia audit is accountable for preparing the Sharia audit report, which is then submitted to the Sharia committee, the audit committee, and the CEO.
7. The Sharia committee must be consulted to resolve any disagreement related to Sharia matters between the management and the head of internal Sharia audit
8. The internal Sharia audit plan must be approved on annual bases by the Sharia committee.
9. The internal Sharia audit planning process entails developing an audit program, gathering background information, defining objectives and scope, acquiring relevant documents, allocating necessary resources, facilitating communication, conducting surveys, and creating a risk-based audit plan for a Bahraini Islamic bank licensee.

Building upon the aforementioned points, within Bahrain, adherence to the governance protocols set forth by AAOIFI is obligatory for Islamic banks, in accordance with directives from the CBB. Furthermore, in accordance with Bahraini legislation, every Islamic bank operating in the nation must institute an internal Sharia audit unit, directly answerable to the Sharia committee and holding administrative responsibility under the CEO. Nevertheless, this mandate deviates from AAOIFI's governance criterion, which specifies that the internal Sharia audit division should report directly to the audit committee, while maintaining a secondary reporting line to the Sharia committee.

The deviation from AAOIFI's governance standard, where the audit department reports solely to the Sharia Supervisory Committee without any reporting line to the audit committee, can result in a lack of enforcement in addressing audit-related issues. This misalignment may hinder the effective resolution of audit concerns and weaken the overall control and oversight mechanisms within the Islamic banks.

To ensure robust governance and compliance, it is essential for the internal Sharia audit department to report directly to the audit committee, in line with AAOIFI's standard. This reporting structure facilitates independent and objective oversight of the audit function, enabling a comprehensive evaluation of Sharia compliance and the identification of any potential non-compliance issues. By adhering to AAOIFI's governance standards, Islamic banks can enhance their internal control systems, strengthen the implementation of corrective measures, and bolster the effectiveness of the Sharia audit process

5.4 UNITED ARAB EMIRATES

5.4.1 Banking Regulation overview

The UAE is known for its modern cities, dynamic economy, and rich cultural heritage. The UAE is comprised of seven emirates, namely Abu Dhabi, Dubai, Sharjah, Ajman, Umm Al Quwain, Ras Al Khaimah, and Fujairah, each with its unique characteristics and attractions (The United Arab Emirates' Government portal, 2023). The UAE has experienced rapid economic growth, driven by its oil reserves, as well as its diversification efforts into sectors such as tourism, real estate, finance, and logistics. The UAE has a diverse population, with people from various nationalities living and working in the country. The UAE's cultural landscape is influenced by its Arab heritage, as well as the presence of expatriate communities from around the world, making it a vibrant and cosmopolitan society (Papadopoulou, 2022).

Banking regulation in the UAE is a critical component of the country's financial system, which plays a crucial role in supporting its economy and facilitating international trade and investment. The UAE has established a robust regulatory framework that governs its banking sector, ensuring stability, and compliance with international standards. The Central Bank of the UAE is the primary regulatory authority responsible for overseeing the country's banking sector. It has implemented various regulations and guidelines to promote the soundness and stability of banks operating in the UAE (Ahmed and Hussain Dar, 2022).

Article 7 of the UAE Constitution designates Sharia as a foundational element of legislation and affirms Islam as the state religion. Additionally, Article 75 of Federal Law No. 10/1973 requires the Supreme Court to apply Sharia, Federal Laws, and other relevant statutes across the Emirates, while also considering traditions, natural law principles, and comparative laws that are consistent with Sharia. In the context of banking and finance, the key regulatory framework is Union Law No. 10 of 1980, which governs the Central Bank, the Monetary System, and the Organisation of Banking. This law grants the UAE Central Bank the authority to oversee and regulate financial institutions.

5.4.2 Islamic Banking Regulation overview

Islamic banking constitutes a significant segment within the financial landscape of the UAE, a consequence of the nation's substantial Muslim population and its status as a global financial center. The regulatory structure underpinning Islamic banking in the UAE is firmly established, encompassing an array of laws and regulations designed to ensure the adherence of Islamic banks to Sharia tenets and to protect the interests of customers and stakeholders. It is important to note that Dubai Islamic Bank was the first bank in the world to officially incorporate Sharia in its overall activities (Iqbal and Mirakhor, 2007).

A key oversight authority responsible for Islamic banking in the UAE is the Central Bank of the UAE, which issues a series of regulations and guidelines governing the establishment, licensing, and functioning of Islamic banks. The Central Bank of the UAE has introduced a comprehensive suite of regulations, including the Sharia Governance Framework, delineating the prerequisites for the management and oversight of Sharia compliance within Islamic banks. This encompasses aspects such as the selection of a Sharia Supervisory Committee, their roles and duties, and the procedure for upholding conformity with Sharia principles across products, operations, and transactions (Central Bank of the UAE, 2020).

During 2018, the Central Bank of the UAE initiated the formation of the Higher Sharia Authority (HAS), an expert entity established with the purpose of offering direction and decisions concerning subjects associated with Islamic finance and adherence to Sharia principles. This body functions as a central entity for the interpretation and issuance of opinions regarding Sharia principles applicable to Islamic financial establishments within the UAE. The pronouncements and directives dispensed by the HAS hold substantial significance as a key point of reference for Islamic financial institutions engaged in activities within the UAE. As part of their operations, these institutions are obligated to seek counsel and endorsement from this Authority, ensuring alignment with Sharia principles (Central Bank of the UAE, 2018).

Some of the key elements of the Sharia Governance Framework for Islamic financial institutions include:

1. Appointment of Sharia Boards: The regulations require Islamic financial institutions to establish and maintain a dedicated Sharia board composed of qualified and independent Sharia scholars. The Sharia board is responsible for reviewing and approving products, operations, and transactions to ensure compliance with Sharia principles.
2. Roles and Responsibilities of Sharia Boards: The regulations outline the roles and responsibilities of Sharia boards, including their function as an independent body that provides guidance on Sharia compliance, reviews and approves financial products and services, and ensures ongoing supervision of the institution's activities.
3. Sharia Compliance Review: The regulations require Islamic financial institutions to conduct regular reviews of their operations and transactions to ensure compliance with Sharia principles. This include the appointment of internal Sharia auditors or external Sharia audit firms to assess the institution's adherence to Sharia requirements.
4. Starting from September 1st, 2018, all Islamic banks functioning as independent entities, as well as the Islamic divisions of conventional banks, and financial companies providing Sharia-compliant offerings in the UAE, are legally bound to adhere to the Sharia standards established by AAOIFI (AAOIFI, 2018a). Nevertheless, in the context of the UAE, Islamic banks are not mandated to adhere to the internal Sharia audit guideline issued by AAOIFI.

Based on the above, it is vital for Islamic banks to comply with the Sharia governance requirements, including establishing an internal Sharia audit function, as set by the UAE Central Bank.

5.4.3 Internal Sharia audit

According to the Sharia Governance standards for Islamic Financial Institutions set by the Central Bank of the UAE in 2020, the Internal Sharia audit requirements that Islamic banks in the UAE must comply with are as follows (Central Bank of the UAE, 2020):

1- The appointment of the head of the internal Sharia audit division is under the purview of the Board, necessitating the individual to be of the Islamic faith, hold a university degree in Sharia, be certified as a Sharia Advisor and Auditor by AAOIFI, possess a minimum of ten years of relevant experience, maintain a clean legal record devoid of court convictions, and possess a proficient command of English as well as a reasonable grasp of Arabic language skills.
2- The head of the internal Sharia department is accountable to the Board, with the Sharia report being submitted both to the Internal Sharia Supervisory Committee and the Board's audit committee.
3- Decisions pertaining to the compensation, promotions, bonuses, performance evaluations, and potential removal of the internal Sharia audit department's personnel are made by the Board, in collaboration with the audit committee, and in consultation with the Sharia Supervisory Committee.
4- The responsibility for assuring that the yearly Sharia report, authored by the Sharia auditors, undergoes assessment and endorsement by the Higher Sharia Authority at the Central Bank rests with the Board, prior to being presented to shareholders during the general assembly.
5- The members of the internal Sharia audit department must exhibit independence and abstain from participating in any activities that might fall under their audit purview.
6- The internal Sharia audit department's duties encompass drafting the audit manual, formulating the Sharia audit plan, conducting evaluations of the operations and undertakings of Islamic financial institutions to guarantee conformity with Sharia principles, evaluating the efficiency of internal Sharia controls, ensuring the compliance of all elements (products, services, forms, contracts, agreements, activities, and transactions) within the institution with Sharia, and ultimately producing a report detailing the outcomes of the internal Sharia audit.

7- The central banks of UAE made it clear that the internal Sharia audit department should not be fully outsourced to external companies.

In general, the internal Sharia audit requirements for Islamic banks in the UAE highlight the significance of adhering to Sharia principles, the autonomy of the internal audit function, proper documentation and reporting, and the avoidance of outsourcing the function entirely to external firms. Moreover, many of the regulatory requirements related to the Sharia audit function are relatively consistent with the requirements of AAOIFI's internal Sharia audit standard.

5.5 KUWAIT

5.5.1 Banking Regulation overview

Kuwait, a small country in the Middle East, is known for its rich oil reserves, diverse culture, and modern architecture. Its history dates back to ancient times, and it gained independence from British protectorate in 1961. However, Kuwait faced challenges when it was invaded by Iraq in 1990, leading to the Gulf War. Since then, Kuwait has rebuilt and developed into a prosperous country with a high-income economy and well-developed infrastructure, largely driven by its oil production and exportation (Central Intelligence Agency, 2023). The culture of Kuwait is influenced by its Islamic heritage, with the majority of the population being Muslim and Arabic being the official language.

Kuwait's legal framework shows significant influences from the French and Egyptian legal systems, particularly evident in its commercial legislation, such as the Commercial Companies Law of 1980 and the Commercial Code of 1981 (Gerald, 1991: 322). This influence is reflected in the constitution, where Article 2 acknowledges Sharia as a key legislative foundation and Islam as the state religion. This is further illustrated in the Civil Code Law of 1980, which includes provisions like Article 547, prohibiting interest on loans, and Article 305, which invalidates such transactions. Nonetheless, in the same year, Kuwait's authorities introduced regulations exempting commercial transactions from these restrictions (Ballantyne, 1985: 5). Consequently, the implementation of the Commercial Code of 1981 permits financial institutions in Kuwait to charge interest on loans (Ballantyne, 1987: 12-28).

Banking regulation in Kuwait is overseen by the Central Bank of Kuwait (CBK), which acts as the country's central monetary authority. The CBK has broader responsibilities, including setting and implementing monetary policies, regulating and supervising banking activities, issuing national currency, maintaining the stability of the Kuwaiti Dinar, directing credit policies to contribute to social and economic progress, serving as a banker and financial advisor to the government is responsible for issuing and implementing regulations to maintain stability, transparency, and efficiency in the banking sector, and to safeguard the interests of depositors and other stakeholders. Kuwait's banking sector caters to both conventional and Islamic banking services to serve the diverse needs of its population and customer have the option to choose the type of banking product based on their preferences (CBK, 2023).

5.5.2 Islamic Banking Regulation overview

Kuwait has played a notable role in fostering the expansion of Islamic banking, exemplified by the establishment of Kuwait Finance House (KFH) in 1977, which ranks among the earliest and most substantial Islamic banking institutions globally. Section 10 of the CBK Law (Articles 86-100) encompasses the legal regulations pertinent to Islamic finance, specifically addressing the regulations and oversight pertaining to Islamic Financial Institutions (IFIs). As stipulated by Article 86, the CBK holds the responsibility of supervising and managing the operations of Islamic financial institutions within Kuwait.

The characterisation of an Islamic bank is delineated within Article 86 of the CBK Law, defining it as a business entity engaged in banking activities that must align with Sharia principles. This comprehensive delineation permits a degree of adaptability in the operations of Islamic banks, without necessitating specification of every individual contract or transaction in accordance with Islamic law. This adaptability allows Islamic financial institutions in Kuwait the latitude to provide a diverse array of Islamic financial services and products, while upholding Sharia principles.

The CBK has issued comprehensive instructions and regulations to govern the operations of Islamic banks in Kuwait. These instructions cover areas such as risk management, liquidity, consumer finance, corporate governance, AML/CFT, the Sharia supervisory Committee, and more. They ensure compliance with Sharia principles, international best practices, and regulatory requirements. The instructions emphasise the importance of robust risk management practices, internal controls, customer protection, and Sharia non-compliance risk measures. These instructions play a crucial role in promoting transparency, stability, and integrity in the Islamic banking sector in Kuwait. The instruction related to the Sharia supervisory committee includes the requirements of the internal Sharia audit function and they serve as important references for Islamic banks when they want to establish internal Sharia audit function (CBK, no date).

5.5.3 Internal Sharia audit

In Kuwait, Islamic banks are obligated to establish an internal Sharia audit mechanism aimed at verifying their adherence to Sharia principles throughout their operations. Circular No. (2/IBS/369/2016) issued by the CBK outlines the Internal Sharia Audit as a routine assessment that evaluates the sufficiency and efficiency of the Sharia Supervisory System. This evaluation aims to ascertain whether the current system and its adherence offer reasonable assurance that the bank's management has effectively discharged its duties in ensuring the application of Islamic Sharia principles and goals, as prescribed by the bank's Sharia Supervisory Board.

The specific requirements for the internal Sharia audit function in Kuwait, pertaining to Islamic banks, are outlined in Circular No. (2/IBS/369/2016) of the CBK as follows (CBK, 2016):

- The Internal Sharia Audit Department Manager is expected to actively engage in the audit committee meetings to provide input and insights on Sharia audit matters. However, they will not be eligible to cast votes on committee resolutions.
- An independent internal department should be established for Sharia Audit, with the Department Manager being accountable for technical issues to the Sharia Supervisory Board and administrative issues to the Chairman via the Audit Committee. The appointment of the Department Manager and Sharia auditors requires approval from the Board of Directors and the Department operates with maximum independence and objectivity. Reports are submitted quarterly and annually to the Sharia Supervisory Board and Audit Committee.
- The Internal Sharia Audit Department and its manager report to the highest organisational level, separate from Executive Management. Sharia auditors do not assume executive functions or face restrictions in their audit scope or communication. Business procedures are applied to all audited departments.

- The Audit Committee appraises the department's performance in consultation with the Sharia Supervisory Board. The Executive Management cannot remove the department manager or staff, as that authority lies with the Board of Directors based on the opinion of the Sharia Supervisory Board and reasons given.
- The primary goals of the Internal Sharia Audit Department encompass confirming the Bank's administration enforces the Islamic Sharia regulations approved by the Sharia Supervisory Board, while also validating the sufficiency and efficiency of the internal Sharia audit system in guaranteeing adherence to Islamic Sharia across all transactions. Any disparities identified are reported for necessary corrective measures.
- The functions of the Internal Sharia Audit Department include reviewing the Bank's operations and ensuring compliance with Sharia Supervisory Board resolutions. This includes verifying the compliance of activities, products, services, and contracts, reviewing procedures and instructions, conducting onsite visits, preparing Sharia audit manuals, programs, and plans, and issuing periodic reports.
- The Sharia Audit Manual is prepared and periodically updated by the Internal Sharia Audit Department. It outlines objectives, plans, policies, selection standards for auditors, relations with external auditors, audit programs, charter, ethics, and responsibility for amendments. The manual requires approval from the Sharia Supervisory Board and the Board of Directors.
- The department also collaborates with bank departments, participates in meetings and seminars, reviews press releases and advertisements, and contributes to creating an appropriate environment for Sharia supervision, including disseminating awareness and answering Sharia questions from staff and customers.
- The Internal Sharia Audit Department Manager must meet certain qualifications, including holding a university degree in Islamic Sharia or a related field from a recognized institution, or obtaining an appropriate degree in economics, administration or law with a professional diploma in Sharia audit and Islamic banking from a standardized institution in the Islamic financial industry. The manager must also have at least five years of experience in Sharia audit, have no history of mistrust or dishonourable crime, and preferably be proficient in English for effective communication with bank stakeholders.

Drawing from the preceding points, the internal Sharia audit mechanism stands as a pivotal element within the governance structure of Islamic banks in Kuwait. Circular No. (2/IBS/369/2016), issued by the Central Bank of Kuwait, delineates specific prerequisites and directives for the setup and perpetuation of the internal Sharia audit function within these banks. According to this directive, the internal Sharia audit function necessitates leadership from a capable and seasoned Internal Sharia Audit Department Manager, vested with the responsibility of overseeing the auditing process while ensuring its alignment with Sharia principles.

Furthermore, the internal Sharia audit mechanism within Kuwaiti Islamic banks is mandated to operate under the oversight of the Sharia committee, the audit committee, and the Board. This arrangement guarantees an independent and impartial audit process, contributing substantively to the overall governance and risk management framework of the bank. In essence, the internal Sharia audit function assumes a pivotal role in upholding the operational integrity and ensuring conformity with Sharia principles in Islamic banks across Kuwait. The circular delivers clear guidance and prerequisites for the establishment and operation of this function, serving as an indispensable component of the comprehensive governance and risk management framework of these financial institutions.

5.6 SAUDI ARABIA

5.6.1 Banking Regulation overview

Saudi Arabia, situated in the Middle East, is renowned for its extensive historical legacy, cultural heritage, and substantial reservoirs of oil. The nation is host to the Islamic world's two holiest cities, Mecca and Medina, and possesses a distinctive governance framework grounded in Islamic principles (CIA World Factbook, "Saudi Arabia,"). As stipulated in article 1 of the Basic Law of Governance, the Kingdom of Saudi Arabia holds the status of an Arab Islamic nation with complete sovereignty. Its faith is Islam, with its foundational constitution being the Holy Quran and the Sunnah of the Prophet, peace be upon him. The Arabic language serves as its official tongue, and Riyadh stands as its capital city (Basic Law of Governance, 1992).

Based on this basic law, the main source of legislation in Saudi Arabia is the Sharia, which is a fundamental component of the legal system in Saudi Arabia. The highest body in the judicial system of Saudi Arabia is the Supreme Court, also known as the High Court. It is the highest appellate court in the country and has the authority to interpret and apply Sharia law in legal and commercial matters. The Supreme Court is responsible for ensuring consistency and uniformity in the application of Sharia across the country's courts, and its decisions are binding (Pepper, 1992).

The financial framework of Saudi Arabia operates under the supervision of the Banks Control System, which was introduced through Royal Decree No. 5 in 1966. However, this legislation does not explicitly tackle the matter of usury or interest. Consequently, a majority of financial institutions within the nation have adopted the conventional banking approach of applying interest to loans and other financial offerings (Sfeir, 1988: 729–759). The National Bank of Saudi Arabia, established in 1953, holds the distinction of being the inaugural commercial bank in the country. Since that time, the banking sector has experienced notable expansion, with the Saudi Arabian Monetary Authority (SAMA) functioning as the central bank and overseeing the financial system (Hamed, 1979: 167).

5.6.2 Islamic Banking Regulation overview

The progression of Islamic finance within Saudi Arabia follows a clear path, guided by the regulatory structure of the Banking Control law that governs the financial system. Notably, despite the influence of the Banking Control Law, Saudi Arabia's legal framework is fundamentally rooted in Islamic principles, with Sharia serving as the preeminent legal system. However, this legal framework does not overtly address the concepts of usury or interest, resulting in the majority of financial institutions operating within the realm of conventional banking practices (Saudi Arabian Monetary Authority, 1966).

In 2020, The Saudi Arabian Monetary Authority (SAMA) issued a framework to establish an effective Sharia Governance Framework (SGF) for banks conducting Sharia-compliant banking in Saudi Arabia. The SGF is designed to complement existing regulations and guidelines, ensuring that Islamic banking transactions in the country are Sharia compliant. The framework aims to improve compliance with Sharia principles in banks by defining the roles and responsibilities of various departments. The framework seeks to enhance the environment for Sharia compliance in banks by ensuring that key stakeholders are knowledgeable and equipped to apply Sharia requirements effectively. The SGF highlight some requirements related to internal Sharia audit (Saudi Arabian Monetary Authority, 2020).

5.6.3 Internal Sharia audit

The SGF outlines the internal Sharia audit as an unbiased evaluation undertaken to offer objective assurance, with the objective of augmenting the degree of conformity and value-enhancing facets of a bank's Islamic undertakings. This role is crafted to establish a resilient and efficient internal control mechanism for Sharia adherence, with the overarching aim of upholding the stability and efficacy of the bank's commitment to Sharia principles across its operations and endeavours.

It also highlighted that the Islamic banks should take into account the following:

- The bank is required to conduct an internal review of Sharia compliance across various levels of significance, at a minimum of once annually, while taking into consideration the bank's risk profile. Depending on the risk level and the potential impact of non-compliance with Sharia principles, Sharia audit can be integrated into specialized assessments of specific domains.
- The audit committee of the board, in collaboration with the Sharia committee, will define the projected outcomes or achievements anticipated from the internal Sharia audit function. These objectives will be harmonized with established auditing standards.
- The execution of the Sharia audit role should be entrusted to internal auditors who possess substantial comprehension and training in Sharia principles. During the audit process, internal auditors may also engage the assistance of the bank's Sharia officer, provided that the autonomy and impartiality of the audit are maintained.
- The findings and insights resulting from the internal Sharia audit are required to be communicated to both the board's audit committee and the Sharia committee.

The aforementioned regulatory mandates underscore the significance of comprehensive internal Sharia audits within Islamic banks in Saudi Arabia. This ensures alignment with Sharia principles and establishes effective reporting structures for pertinent committees. Conforming to these directives can substantially contribute to the efficacy of Sharia governance and risk management within Islamic banking activities.

It is noteworthy to emphasize that Saudi Arabia appears to lack specific regulatory obligations that necessitate adherence to AAOIFI's internal audit criteria. This observation is drawn from an examination of existing regulations pertaining to Islamic banks within the country, which do not expressly mandate compliance with AAOIFI's internal audit standards. Further investigation and scrutiny of pertinent regulatory frameworks and industry practices may be imperative to ascertain the current status of internal audit standards within Saudi Arabia's Islamic banking sector.

Based on the above, it can be observed that the internal Sharia audit requirements in Saudi Arabia, as stated, may be considered comparatively less comprehensive in comparison to those of Bahrain, UAE, and Kuwait. Also, it is worth noting that these requirements were introduced in 2020, several years after similar requirements were implemented in the aforementioned countries.

5.7 QATAR

5.7.1 Banking Regulation overview

Qatar, a small peninsula located on the north-eastern coast of the Arabian Peninsula, has a rich historical legacy that spans thousands of years. Originally a Bedouin society dependent on pearl diving and trade, Qatar's economy underwent a major change with the discovery of its large oil and gas reserves in the mid-20th century. As a result, the Qatari economy has experienced impressive growth and transformation, shifting from a traditional economy to a modern, diverse one (Planning and Statistics Authority, 2019). Today, Qatar is recognized as one of the wealthiest nations in the world, with its economy driven by its oil and gas exports, as well as key investments in finance, real estate, and tourism sectors (World Bank, 2022).

Qatar ratified its first Provisional Constitution on April 2, 1970, which was later replaced by the Revised Provisional Constitution on April 19, 1972 (Hamzeh, 1994: 83). Article 1 of the 1972 constitution clearly states that Islamic law is the main foundation of legislation and names Islam as the official state religion. However, there is a mismatch between the constitution and Qatar's Civil and Commercial Codes regarding the application of Sharia in banking transactions.

While the constitution recognizes Sharia as an important source of law, the Civil and Commercial Code treats it as a secondary source, especially in commercial transactions (Ballantyne, 1985: 9).

This inconsistency has led to the belief that interest-based transactions are allowed within Qatar's financial sector. It is important to note that the establishment of the Qatar Central Bank in 2006, governed by Decree Law No. 33 of Qatar's Banking Law, has further regulated and supervised the financial system in Qatar. Meanwhile, civil courts handle disputes related to commerce, banking, and finance (Ross, 2008: 134).

At the beginning of 2005, the Qatari government started setting up the Qatar Financial Centre (QFC) as a business and financial hub that provides a supportive environment for international financial institutions to operate in Qatar. The QFC functions as a separate legal and regulatory body, with its own laws, regulations, and court system (Qatar Financial Centre, no date). On the other hand, the government, under Law No. 33 of 2005, created the Qatar Financial Markets Authority (QFMA) as the regulatory body responsible for overseeing and regulating the financial markets in Qatar, including securities markets and investment funds (Qatar Financial Markets Authority, no date). While the QFC aims to attract financial and professional services companies, the QFMA sets rules, monitors compliance, and enforces laws related to securities and markets in Qatar.

5.7.2 Islamic Banking Regulation overview

Both the Qatar Central Bank (QCB) and the QFC have released guidelines and protocols applicable to Islamic banks. In March 2008, the QCB introduced prudential regulations for banking oversight referred to as Instructions to Banks (IB), with Part Seven presenting dedicated directives for Islamic banks. In parallel, the QFC introduced distinct regulations concerning the Sharia governance structure, delineated within the Islamic Finance Rule 2005. Furthermore, a specialized segment for Islamic banks was incorporated within the Governance and Controlled Functions Rules 2020 (CTRL).

According to chapter 3 of Islamic Finance Rules 2005 (ISFI), Islamic banks are required to disclose their status and adherence to Sharia principles to each customer. This includes informing customers that they are an Islamic financial institution and that their business is conducted in accordance with Sharia. Additionally, Islamic financial institutions must disclose information about their Sharia supervisory board, including the names of the board members, and provide details on the manner and frequency of Sharia reviews upon customer request (QFC legislation | rulebook, 2005).

Chapter 5 of the Islamic Finance Rules 2005 stipulates that Islamic banks are obligated to establish, execute, and uphold a comprehensive policy and procedures manual for their Islamic financial operations. This manual is required to encompass a range of elements, including delineating the approach to overseeing compliance in relation to Sharia principles, elucidating the responsibilities of the Sharia supervisory board in supervising and advising the institution, documenting and executing fatwas, verdicts, and directives issued by the Sharia supervisory board, the internal Sharia review process, addressing disputes arising from Sharia compliance matters between the Sharia board and the management, endorsing internal policies, procedures, systems, and controls to ensure Sharia compliance, ensuring effective dissemination of information to investors, and managing instances of conflicting interests.

Chapter 6 of the Islamic Finance Rules 2005 is divided into three distinct segments. The initial segment encompasses essential prerequisites associated with the appointment and functioning of a Sharia supervisory board. It covers aspects such as establishing policies for the Sharia supervisory board, adhering to record-keeping responsibilities, evaluating the competence of the Sharia supervisory board, underscoring the importance of maintaining the autonomy of the Sharia supervisory board, fulfilling the obligation of furnishing information about the Sharia supervisory board to the Regulatory Authority, and the requirement to extend complete collaboration and support to the Sharia supervisory board. Conversely, the second and third segments are dedicated to matters concerning Sharia review and internal Sharia review, respectively.

The above rules are praiseworthy as they serve to uphold transparency and promote adherence to Sharia principles in the operational framework of Islamic banks in Qatar.

5.7.3 Internal Sharia audit

Part 3 of Chapter 6 of the Islamic Finance Rules 2005 pertains to the internal Sharia review, which aligns with the Sharia governance standard 3 of AAOIFI that was issued in 1999. AAOIFI had historically utilised the term "review" in lieu of "audit" in this context. However, as stated in the previous chapter that in 2019, AAOIFI issued the internal Sharia audit standard, explicitly stating that the "internal Sharia audit" standard supersedes the "internal Sharia review" standard.

The part 6.3 in the Islamic finance rules of 2005 encompass only three paragraphs, which address:

- The obligation to conduct internal Sharia reviews is incumbent upon Islamic financial institutions, necessitating a comprehensive assessment of the institution's adherence to the fatwas (Islamic legal opinions), rulings, and guidelines promulgated by its Sharia supervisory board. Such reviews serve as a critical mechanism to ensure compliance and align the institution's operations with the principles of Sharia law within its governance framework.
- The conduct of internal Sharia reviews by Islamic financial institutions must adhere to the established guidelines outlined in the AAOIFI Standards on Governance (GSIFI No. 3 – which refers to the Internal Sharia Review).
- The responsibility for conducting internal Sharia reviews within an Islamic financial institution lies with ensuring that (a) the internal audit function or compliance oversight function performs the review, and (b) the individuals or departments entrusted with this task possess the necessary competence and independence to effectively evaluate compliance with Sharia principles.

On the hand, the Division 9.3.C of the Governance and Controlled Functions Rules 2020 (CTRL) refers to the internal Sharia review. The CTRL highlighted the following:

- The fundamental aim of performing an internal Sharia review is to verify that the leadership and senior administration of the Islamic financial entity meet their responsibilities and commitments in alignment with Sharia principles, as prescribed by the institution's Sharia supervisory board.
- The outcomes of each internal Sharia review, including any identified instances of noncompliance, must be thoroughly documented. Subsequently, the Islamic financial

institution is obligated to take appropriate measures to rectify such instances of non-compliance to the fullest extent possible.

- The entity or function responsible for conducting the internal Sharia reviews within a given timeframe is required to report its findings in a timely manner for consideration during the next meeting of the Sharia supervisory board. In the event that no reviews were conducted by the entity or function during the preceding period, it is incumbent upon them to notify the board of such omission.
- In accordance with regulatory mandates, an Islamic financial establishment must provide the Regulatory Authority with a duplicate of the report or reports produced by the institution's Sharia supervisory board. These report(s) need to be submitted within a period of three months subsequent to the culmination of the pertinent financial year of the institution.

In conclusion, the Islamic Finance Rules 2005 and Division 9.3.C of the Governance and Controlled Functions Rules 2020, provide comprehensive regulations for Sharia governance and internal Sharia reviews in Islamic financial institutions. These regulations highlight the commitment of regulatory authorities to ensuring that Islamic financial institutions comply with industry standards and best practices as set forth by AAOIFI. It is recommended that the regulatory authority in Qatar consider revising the existing regulations to align with the updated standard of AAOIFI Internal Sharia Audit, instead of referring to the superseded standard 3 of Internal Sharia Review. This update would ensure that the regulatory framework aligns with the latest industry standards and best practices as set forth by AAOIFI.

5.8 OMAN

Oman, situated within the Middle East and counted among the GCC nations, boasts a history replete with cultural diversity. With Arabic as its official language and Islam holding sway as the predominant faith, the country presents a rich tapestry. In Oman, the keystone legal document dictating the nation's governance structure and outlining the roles and authority of its distinct governmental branches is the Basic Law of the State. This legal instrument was promulgated on November 6, 1996, via Royal Decree No. 101/96. A pivotal tenet of the Basic Law is the affirmation of Islam as the nation's official religion, with Islamic Sharia forming the bedrock of its legal framework (Ministry of Justice and Legal Affairs, no date).

According to RD No. 90/1999, Oman's court system designates the Primary Court (Commercial Circuit) as the principal authority for handling commercial disputes, regardless of whether they relate to matters of Islamic finance or not. Appeals against decisions made by the Primary Commercial Court can be taken to the Appellate Court (Commercial Circuit) and the Supreme Court of Oman. Before the establishment of the Primary Commercial Court, commercial matters were exclusively adjudicated by the Commercial Court and the Authority for Settlement of Commercial Disputes.

Although there is no specific court in Oman explicitly designated for resolving Islamic finance disputes, the Sharia Circuit within the Primary Court addresses personal affairs like marriage, divorce, and inheritance. Rulings issued by the Sharia Circuit can be appealed to the Appellate Court (Sharia Circuit) and the Supreme Court, mirroring the process for judgments from the Primary Commercial Court.

Regarding agreements related to Islamic finance, the parties involved have the option to refer their disputes to an arbitration tribunal and stipulate the applicable laws and arbitration rules for the proceedings. If a defendant invokes the presence of an arbitration agreement in disputes arising from their transaction, an Omani court is required to dismiss a lawsuit brought before it.

5.8.1 Banking Regulation overview

Effective oversight and regulation of Oman's banking and financial sector holds paramount importance in bolstering the country's economic advancement and stability. The pivotal role in attaining these objectives is assumed by the Central Bank of Oman (CBO), a cornerstone institution. Its establishment in 1974 under the Banking Law has vested the CBO with the pivotal responsibility of ensuring the robustness and security of Oman's financial framework. This mandate encompasses the vigilant supervision of banks and other financial entities operating within the nation, ensuring their adherence to pertinent regulations and directives.

The CBO further wields the authority to grant licenses to banks and financial establishments, concurrently monitoring their operations to verify alignment with the legal and regulatory framework of Oman. As of 2016, the banking landscape comprised 16 conventional banks, including 7 domestically registered and 9 foreign banks. The same year marked the inception of two fully-fledged Islamic banks. Furthermore, a network of 70 branches under Islamic windows of commercial banks, equipped with 72 ATMs and 17 cash deposit machines, underscored the expanding Islamic finance sector (Mohammed, 2020).

Furthermore, the CBO's purview extended to the registration and licensing of 6 finance and leasing enterprises. Notably, the country featured 3 specialized development banks focused on housing, agriculture, and fisheries, namely The Oman Development Bank, The Oman Housing Bank, and the Oman Bank for Agriculture and Fisheries, as highlighted in the CBO's Annual Report of 2016 (Mohammed, 2020).

5.8.2 Islamic Banking Regulation overview

The oversight of Islamic banking regulations in Oman, much like the regulations for conventional banking, falls under the purview of the CBO. However, the introduction of Sharia-compliant banking in Oman during 2012 generated considerable anticipation as it marked the final inclusion of an Islamic bank among the Gulf Cooperation Council states. The implementation of the Islamic Banking Regulatory Framework (IBRF) aimed to establish an elevated benchmark for Sharia compliance and governance. The CBO is committed to ensuring transparency, accountability, and alignment with principles of Islamic commercial jurisprudence, broader Islamic jurisprudence, and ethical and moral Islamic values.

Drawing from both contemporary corporate governance theory and practice, the IBRF seeks to set a pioneering standard for the global industry. It does so while incorporating careful and judicious innovation (Morrison, 2015).

The IBRF does not mandate compliance with the AAOIFI’s internal Sharia audit standards. However, the IBRF does include stringent requirements related to Sharia audit (Central Bank of Oman, no date).

5.8.3 Internal Sharia audit

According to the Islamic BANKING Regulatory Framework (IBRF):

- Islamic financial institutions that adhere to regulations are required to establish a Sharia audit unit operating within the framework of the bank's Sharia Governance. This unit reports to the Internal Sharia Reviewer.

- The primary role of this unit is to aid in forming an assessment of the degree of the bank's Sharia compliance. It also involves evaluating the bank's Sharia compliance system and the effectiveness of its performance.
- Sharia audit officers are mandated to maintain objectivity, uphold independence, and exercise due professional diligence in carrying out their responsibilities.
- The Internal Sharia Reviewer assumes the responsibility of overseeing the internal Sharia audit process, commencing from the planning phase.
- The charter for the Sharia audit unit is developed by the management, endorsed by the Sharia Supervisory Committee, and ratified by the Board of Directors. This document is subject to periodic reviews and updates.
- Sharia audit officers enjoy unrestricted access to documentation, reports, and all tiers of management, including the Internal Sharia Reviewer, Sharia Supervisory Committee, and external auditors.
- Prior to commencing an effective internal Sharia audit, comprehensive background information about the activities earmarked for audit should be collected. This encompasses details pertaining to products, services, branches, and divisions.
- The audit team must also establish explicit objectives and scope for the audit. Furthermore, it is vital to procure pertinent guidance and information, such as Sharia Supervisory Committee Fatwas, directives, and instructions, alongside reports from previous year's internal and external audits.
- According to the IBRF, to carry out a successful internal Sharia audit, several steps must be followed. Firstly, the necessary resources for the audit must be determined. Secondly, all individuals relevant to the audit should be informed. Thirdly, a survey should be conducted to identify areas of emphasis and gather feedback. Fourthly, internal audit programs should be written. Fifthly, decisions should be made regarding how and when to communicate audit results. Sixthly, approval from the Sharia Supervisory Committee for the audit plan should be obtained. Seventhly, the audit program should be implemented. Eighthly, the draft report should be shared with the Internal Sharia Reviewer for clarification and rectification. Finally, the audit report should be finalized for presentation to the Sharia Supervisory Committee. Furthermore,

the audit results should include any relevant correspondence, including communication with supervisory and regulatory agencies.

- Sharia audit personnel bear the responsibility of collating and recording data that substantiates their outcomes from internal audits. This encompasses scrutinizing documents and conducting analytical assessments. The amassed information needs to be comprehensive, dependable, pertinent, and valuable to ensure the credibility of audit findings and proposed measures. Thoroughly prepared, reviewed, and maintained working documents are crucial to substantiating audit conclusions and suggestions.
- The internal Sharia audit team is mandated to deliberate their findings, suggestions, and determinations with the Internal Sharia Reviewer and relevant tiers of management prior to issuing the definitive written report. Additionally, they are obligated to compile a quarterly report, endorsed by the Internal Sharia Reviewer, which evaluates the Licensee's mechanisms and controls for upholding Sharia compliance.
- In case of any disagreement between management and Sharia audit officers regarding Sharia interpretation, the matter should be referred to the Internal Sharia Reviewer and Sharia Supervisory Committee (if necessary). The Sharia Supervisory Committee is the ultimate authority on Sharia interpretation.
- The report from the internal Sharia audit division must be submitted for examination and suitable action to the Licensee's Sharia Supervisory Committee, while a duplicate of the report should be furnished to the Board's Audit Committee. This report ought to be impartial, lucid, productive, and punctual. It should elucidate the objective, extent, and outcomes of the internal Sharia audit, along with the internal Sharia auditor's viewpoint. The report should also offer suggestions for prospective enhancements and remedial measures, and acknowledge commendable performance when pertinent.
- Sharia audit officers must ensure that the management takes appropriate action on their findings and recommendations, as well as follow up on other Sharia-related suggestions made by external auditors and regulatory agencies. The Internal Sharia Reviewer is responsible for managing internal Sharia audit and developing plans for its fulfilment.

- Sharia audit officers must assist in training the employees of the Licensee and the Central Bank will include Sharia audit in its annual examination of the Licensee. The Licensee must also conduct an annual independent Sharia audit by a third-party to enhance the credibility of the internal Sharia audit and public confidence in the Sharia legitimacy of the Licensee.
- The Sharia audit encompasses an identical range as the internal audit and is not intended to provide a verdict on the Sharia validity of Sharia Supervisory Committee's determinations. The report is conveyed to the Board of Directors, the Central Bank, Sharia Supervisory Committee, and Licensee management.
- To ensure competence, the internal Sharia audit personnel must possess pertinent education and training, encompassing a grasp of Sharia principles and Figh al Mu' amalat. Suitable criteria for this should be defined by the Internal Sharia Reviewer. Recruitment should focus on individuals who are qualified, experienced, and dedicated, with management extending support for continuous learning and growth. The Sharia audit officers ought to sustain technical proficiency, and their performance must be periodically evaluated based on recommendations from the Internal Sharia Reviewer and the Sharia Supervisory Committee.

Based on the above, Oman emerged as the final GCC country to regulate Islamic banks, and adherence to AAOIFI standards is not compulsory for Islamic banks. However, the IBRF instituted by the Central Bank of Oman seems to be the most robust regulatory framework for Islamic banking in the GCC region. The IBRF mandates that Islamic banks institute a Sharia audit unit operating under the bank's Sharia Governance framework, with reporting lines to the Internal Sharia Reviewer.

Notably, the Internal Sharia Reviewer holds substantial influence within Oman's Islamic banks. Appointed by the bank's management in consultation with the Sharia Supervisory Committee and the Board of Directors, the termination of the internal Sharia reviewer necessitates approval from both the Sharia Supervisory Committee and the Board of Directors. It is imperative to underscore that Omani Islamic banks are bound to notify the Central Bank of Oman about any termination or resignation of the internal Sharia reviewer.

Additionally, if deemed necessary, an exit interview with the Central Bank of Oman must be arranged. The IBRF places significant emphasis on the roles of the internal Sharia reviewer and the internal Sharia auditor, as they bear the responsibility of ensuring the bank's adherence to Sharia compliance. The cessation of their roles could have profound implications for the bank's overall alignment with Sharia principles. Therefore, the stringent regulations pertaining to the appointment and termination of the internal Sharia reviewer play a pivotal role in upholding the integrity and credibility of Islamic banks in Oman.

5.9 SUMMARY

In conclusion, the analysis presented in this chapter underscores the prevailing regulatory landscape within the GCC, revealing that a majority of the regulations do not explicitly mandate compliance with the AAOIFI's internal Sharia audit standard. Instead, internal Sharia audit practices in these countries are primarily guided by legal and supervisory requirements, offering Islamic banks the flexibility to align with AAOIFI's standards while ensuring harmony with the existing regulatory framework.

The implications drawn from the findings point towards a notable need for enhanced congruence between prevailing regulations and the AAOIFI standard. It is imperative to emphasise that the absence of robust and effective internal Sharia audit practices, whether due to regulatory gaps or organisational choices, could potentially hinder the future advancement of the Islamic banking industry.

Such enhancements are pivotal for reinforcing the trajectory of growth and development in the realm of Islamic banking.

CHAPTER 6: RESEARCH METHODOLOGY AND METHODS

6.1 INTRODUCTION

The preceding chapters have provided in-depth explorations of fundamental subjects such as corporate governance, the Sharia governance framework, internal Sharia audit, the analysis of AAOIFI's internal Sharia audit standard, and the regulatory framework of internal Sharia audit in the GCC. It has come to light that the domain of internal Sharia audit remains relatively unexplored properly in prior research, indicating a need for further development in this area, which is crucial for instilling confidence among stakeholders regarding adherence of Islamic banks to Sharia principles.

Building upon these observations, the researcher asserts the originality of this study, considering its empirical investigation conducted within the expansive realm of the largest Islamic banking market. This research proffers fresh interpretations of both primary and secondary data, thereby yielding noteworthy evidence and insights that carry substantial implications for stakeholders within the Islamic finance industry. The findings of this study hold the potential to offer valuable insights for stakeholders, aiding in the enhancement of internal Sharia audit practices in the Islamic banking industry.

This chapter marks an important point in the research effort, as it outlines the complete research process and the methods used. Through a thorough explanation, this chapter describes the research design and strategy chosen, clarifying the reasons behind the selected methods, which all help achieve the research objectives.

6.2 RESEARCH METHODOLOGY

Choosing the suitable research methodology is of utmost importance in achieving the stipulated research objectives. As articulated by McGregor and Murname (2010), research methodology can be delineated in the subsequent manner:

"The word methodology comprises two nouns: method and ology, which means a branch of knowledge; hence, the methodology is a branch of knowledge that deals with the general principles or axioms of the generation of new knowledge. It refers to the rationale and the

philosophical assumptions underlie any natural, social or human science study, whether articulated or not".

Also, Bogdan and Taylor (1975: 1) define methodology as:

"The process, principles, and procedures by which we approach problems and seek answers".

Drawing upon the aforementioned definitions, it can be contended that research methodology encompasses the array of tools and techniques adopted by a researcher to comprehensively investigate a specific issue or problem. Optimal methodology is characterised by its efficacy in aiding the researcher to attain the defined research objectives.

Within the realm of social sciences, a paramount challenge confronting researchers, particularly those engaged in the study of Sharia governance and Sharia audit, lies in the judicious selection of a research methodology that engenders credibility in achieving the research objectives. Research methodology conventionally encompasses two principal paradigms: quantitative and qualitative methodologies.

Collis and Hussey (2003) assert that the quantitative approach is most pertinent when soliciting information from expansive samples, subsequently subjected to statistical scrutiny to discern prevalent trends. Furthermore, Creswell (1994) posits that the quantitative methodology is tailored to furnish substantiated insights predicated on numerical data. It entails the meticulous collection of data for statistical analysis, culminating in the presentation of empirical evidence pertaining to a specific subject matter.

Conversely, the qualitative research methodology is employed when a profound comprehension of a phenomenon is sought after. This approach places greater emphasis on linguistic expressions rather than statistical data, as articulated by Boddy (2016). Qualitative research primarily hinges upon linguistic discourse rather than numerical quantification in the acquisition of data and the subsequent analysis, adhering to a more naturalistic paradigm, as espoused by Bryman (2016).

According to Creswell (2005), qualitative research is "*a type of educational research in which the researcher relies on the view of participants, asks broad, general questions, collects data* *consisting largely of words (or texts) from participants, describes and analyses these words for themes, and conducts the inquiry in a subjective, biased manner (p. 39*)".

The main goal of this research, as explained in the introductory chapter, is to evaluate the internal Sharia audit practices within the GCC. The investigation then aims to assess the regulatory requirements related to internal Sharia audits, with the overall purpose of identifying any obstacles or issues faced by Islamic banks. Based on these findings, the study seeks to provide recommendations to main stakeholders that not only improves current practices but also has the potential for widespread adoption among different Islamic banks.

6.3 RESEARCH STRATEGY

In order to effectively achieve the research objectives and provide accurate answers to the research questions, the researcher will employ a research strategy that establishes a linkage between the theoretical framework elucidated in the preceding chapters and the data collected during the study.

Stebbins (2001, p. 6) posits that researchers should embrace a flexible approach when engaging with information and maintain an open-minded stance in their pursuit of knowledge. Bryman (2008: 11) outlines that the utilisation of both inductive and deductive methods serves to establish a cohesive linkage between theoretical constructs and empirical data. The inductive approach is harnessed in situations where theory exhibits informational gaps, thereby facilitating the generation of novel conceptual insights. This approach involves progressing from empirical observations to the development of theories (Blaikie, 2007). In contrast, as elucidated by Bryman and Bell (2003), the deductive approach seeks to test pre-existing theories by subjecting them to empirical scrutiny and comparing them with collected data.

In light of the above, the researcher will adopt an inductive approach to derive insights from specific observations related to Sharia governance and Sharia audit practices within Islamic banks operating in the GCC. The research will begin with a thorough examination of the prevailing practices in the GCC's Islamic banking sector, allowing for the identification of key patterns and issues. These findings aim to offer valuable insights that can aid stakeholders in enhancing internal Sharia audit practices across the Islamic banking industry in the region.

6.4 RESEARCH DESIGN

The research design serves as a strategic framework that guides the researcher in collecting evidence and addressing research inquiries in an efficient manner. As delineated by Bryman (2008), the research design functions as a navigational tool, charting the trajectory of the study towards its destination and objectives. Within the realm of research designs, three prevalent categories are recognised: exploratory, descriptive, and explanatory.

The exploratory research design finds utility in scenarios marked by ambiguity and a dearth of prior investigations on the subject matter, as underscored by Saunders et al. (2009: 139). Conversely, the descriptive approach is engaged when the intention is to elucidate the attributes of a phenomenon or concept. This mode of inquiry delves into the "what" of the research domain, relying on historical occurrences while omitting emphasis on causal factors, as expounded by Sekaran and Bougie (2009: 105). Lastly, the explanatory approach delves into the causal intricacies underlying a given phenomenon's functioning. Employed in scenarios wherein relationships between multiple variables exist, this approach seeks to uncover the "why" behind observed phenomena, as outlined by Saunders et al. (2009: 140).

Evident from the initial chapter of this study, the realm encompassing internal Sharia audit within the purview of the GCC's Islamic banking sector has, notably, remained a domain with limited exploration. Moreover, the availability of primary data pertinent to this subject has proven to be constrained. To address this constraint, a recourse was taken to employ semi-structured interviews, which facilitated the collection of data and insights directly from practitioners actively engaged in internal Sharia audit functions in Islamic banking.

Additionally, two interviews were conducted, involving a senior member of AAOIFI and a regulatory advisor well-versed in the policies of various central banks across the GCC nations. Recognising the inherent constraints of the semi-structured interview method, we bolstered our investigative tools. We combined documentary analysis of Islamic banking regulations across the GCC with the above method, enhancing the robustness of our research outcomes and reinforcing the rationale behind our findings.

To better understand the development of the regulatory framework for internal Sharia audit, the researcher created an index framework based on the benchmarks outlined in the AAOIFI internal Sharia audit standard. This approach facilitated a thorough grasp of how internal Sharia audit regulations are different within the GCC.

In summary, a combination of exploratory and descriptive research designs has been used to clarify and explain the operational environment of internal Sharia audit within the GCC's Islamic banking sector.

6.5 RESEARCH METHODS

To derive meaningful findings from the research, it is crucial for the researcher to utilise suitable research methods. It is noteworthy that, analogous to research methodology, research methods are not inherently binary, being classified as either true or false (Silverman, 2001, 12). The term "research methods" encompasses a variety of techniques and procedures employed within a study for the purpose of data collection, analysis, and interpretation (Cohen, Manion and Morrison, 2007: 47).

Research methods are commonly categorised into two main types: quantitative and qualitative. The choice of the most suitable methods is contingent upon the research design, inquiries, and aims. As posited by Yin (1994), a pivotal criterion for selecting research methods pertains to the nature of the research questions.

Quantitative research finds application within the realm of social sciences, particularly when extensive datasets are attainable, and the researcher aims to glean numerical insights into intricate phenomena. This method employs an array of quantitative techniques, encompassing tools like surveys and statistical correlation analysis (Blaikie, 2003).

Conversely, qualitative research is characterised by its foundation in language and discourse. In this approach, the researcher assumes an interactive role, serving as a conduit for data collection by engaging with interviewees to gather their observations and perspectives (Bryman, 2016, p. 374). Employing open-ended and comprehensive inquiries, the researcher taps into the interviewees' viewpoints, thus facilitating a nuanced exploration. This methodology affords a deeper comprehension of the subject matter, as the interviews encompass emotions, thoughts, personal encounters, and viewpoints (Creswell, 2005).

Numerous scholars contend that the incorporation of both qualitative and quantitative methods can yield enhanced insights and more robust outcomes (Bryman, 2016). Reiter (2011) emphasises the value of employing diverse data collection methods and sources to unravel the intricacies of complex research subjects. Furthermore, Jack (1979) underscores the potential of mixed research methodology to furnish researchers with enriched data, engendering heightened confidence in their findings and conclusions. However, it is essential to acknowledge that employing a mixed methods approach entails challenges, as it demands substantial time and effort due to its multifaceted nature, and selecting appropriate samples for both qualitative and quantitative components can be complex (Denscombe, 2010).

Many researchers, including Denscombe (1998) and Robson (2002: 269), have highlighted various drawbacks associated with the utilisation of the survey questionnaire as a research instrument. Despite its widespread recognition, this method is not without limitations. Notably, participants' ability to express their perspectives or emotions beyond the response options is restricted. Additionally, challenges arise when participants encounter difficulty comprehending the posed questions, thereby potentially compromising the integrity of the data and subsequent outcomes. Lastly, the confidential nature of certain topics may engender reluctance among participants to provide precise information. These limitations underscore the need for researchers to use the survey questionnaire as a data collection tool.

The research philosophy underpinning this study is interpretivist, focusing on understanding the subjective experiences and perspectives of individuals involved in internal Sharia audits within GCC Islamic banks. Interpretivism posits that reality is socially constructed and shaped by personal experiences and interactions. This philosophy directly influenced the choice of qualitative methods, particularly semi-structured interviews, to obtain in-depth insights into the practices, challenges, and regulatory frameworks of internal Sharia audits. By prioritising rich, contextual data over numerical generalisations, the interpretivist approach facilitated a comprehensive exploration of the internal Sharia audit process and its complexities within the specific cultural and regulatory context of the GCC region.

A quantitative research approach, such as a survey questionnaire, was not employed in this study due to the limited number of Islamic banks in the GCC (less than fifty) and the small size of many internal Sharia audit departments, with some banks having only one internal auditor or none at all. Given this, the potential sample size would have been too small to yield meaningful and generalisable data. Moreover, surveys have limitations in capturing the depth of sensitive and complex issues such as Sharia compliance and audit practices, as they restrict participants' ability to express their views fully and may lead to incomplete or inaccurate responses due to confidentiality concerns. Therefore, qualitative methods, including semi-structured interviews and documentary analysis, were chosen to provide richer, more detailed insights into the roles, practices, and challenges of internal Sharia auditors, better aligning with the research objectives and the context of the study.

6.5.1 Data Collection Instruments

Optimal selection of data collection instruments is pivotal for researchers to efficiently and effectively execute their study. These well-suited tools aid in comprehending the subject of investigation (Buenechea-Elberdin, 2017). Furthermore, Biggam (2015, P. 110) underscores the role of the literature review in guiding the choice of data collection instruments and in addressing research inquiries. Similarly, Creswell and Clark (2007) emphasise the central tenet of data collection as acquiring information that offers insight into research questions.

In light of these considerations, the researcher will employ semi-structured interviews as the chosen data collection method to encompass a broad spectrum of information. The research design is characterised by elements of both exploratory and descriptive approaches. Given the limited availability of data pertaining to Sharia governance and Sharia audit within the GCC market, a combination of semi-structured interviews and documentary analysis will be used in the data collection process.

6.5.1.1 Semi-structured interviews

Interviews constitute widely employed research tools, serving as vehicles for achieving research objectives and goals. These dialogues facilitate a nuanced comprehension of subject matters by engaging participants in conversations that elicit their perspectives, sentiments, viewpoints, and behaviours.

Various interview formats exist, with structured, semi-structured, and unstructured interviews being the most prominent. Structured interviews entail closed-ended questions, necessitating consistent questioning across participants. This format, however, restricts participants' freedom to expound on their viewpoints. In contrast, semi-structured interviews offer a more flexible interaction, affording both interviewer and participant greater latitude. Interviewers can pose additional queries to extract richer insights, while participants can express opinions freely. Unstructured interviews provide a broad topic guideline, permitting participants to share insights within its framework (Robson, 2002: 282; Bryman, 2012).

Despite the interview being a famous research tool, it has many advantages and disadvantages. If possible, the researcher had to avoid managing the weakness when using this research tool.

Robson (2002: 261) and Jankowicz (2000) enumerate several advantages of interviews:

- Interviews yield comprehensive participant insights;
- Researchers can verify information accuracy and validity during the process;
- Interviews necessitate minimal equipment and administrative efforts.

Conversely, challenges include:

- Complicating data extraction from interview transcripts;
- Time-intensive nature for extensive questioning or numerous participants;
- Risk of researcher influence compromising data integrity.

The selected interview method, especially the semi-structured type, offers clear benefits for this research. It allows for a wide range of information, including participants' opinions, backgrounds, knowledge, and skills, encouraging detailed responses that suit each person's unique perspective.

6.5.1.1.1 Semi-structured interviews design

The semi-structured interview questions were carefully designed to address the research questions presented in Chapter 1. These interviews were conducted with professionals specializing in internal Sharia audit across the GCC. In order to provide a diverse and comprehensive perspective that reinforces the research findings, a distinct set of questions was developed for semi-structured interviews with a senior representative from AAOIFI and an Islamic finance regulatory advisor provide advices to multiple Islamic banks across the GCC.

In line with the research questions of this study, the researcher formulated a series of eighteen questions to guide the interview dialogue with the internal Sharia audit practitioners. These questions were categorised into six distinct sections. Furthermore, an additional set of six questions was crafted to steer the discourse during the interview sessions with the senior representative from AAOIFI and the regulatory advisor. Notably, the majority of these questions leaned towards an open-ended format, affording participants the option to articulate their responses according to their individual preferences and perspectives.

The development of the interview questions was influenced by the existing body of literature, which predominantly focuses on general Sharia governance and the roles of Sharia Supervisory Committees in Islamic banks. While these studies provided valuable insights into the broader Sharia governance framework, they offered limited exploration of the specific practices and challenges of internal Sharia audits. To address this gap, the interview questions were carefully structured to build upon themes commonly addressed in prior researches about the Sharia committees and Sharia governance but tailored specifically to investigate internal Sharia audit practices. This approach ensured that the questions aligned with familiar research themes while focusing on an area not extensively explored in previous studies, enabling a more targeted and meaningful examination of internal Sharia audit functions within the GCC region.

The semi-structured interviews with internal Sharia audit practitioners were directed towards exploring various facets of interest, including:

1. Current practices of internal Sharia audit
2. The existing regulatory framework in the GCC
3. Roles played by the internal Sharia audit department
4. Mechanisms ensuring competency, independence, and confidentiality of internal Sharia auditors
5. A comprehensive evaluation of the internal Sharia audit department
6. Approaches and operational procedures related to internal Sharia audit

Conversely, the semi-structured interviews conducted with the senior representative from AAOIFI and the Islamic finance regulatory advisor, who provide their advance to numerous Islamic banks across the GCC, were focused around the subsequent areas:

1. Advantages and significance of the AAOIFI's Internal Sharia Audit Standard
2. Navigating the regulatory landscape within the GCC
3. Strategies and endeavours fostering the adoption and adherence of AAOIFI standards
4. Addressing concerns and challenges pertaining to AAOIFI standards
5. Prospects for future developments and advancements related to harmonisation and standardisation
6. Proposals for a harmonised and standardised integrated approach to internal Sharia audit

The table below shows each research questions with their relevant question from the semi-structured interview.

Table 7: Research questions and the semi-structured interview

Questions linked to objectives	The interview with the internal Sharia audit practitioners	The questions of the interview with AAOIFI and the regulatory advisors
How do the regulatory frameworks and internal practices of internal Sharia audit differ among Islamic banks in the GCC countries?	Q4, Q5	Q2, Q3, Q5
What are the current practices, roles and responsibilities of the internal Sharia audit department within the Islamic banks in the GCC?	Q1, Q2, Q3, Q6	Q1, Q4
What measures are in place to ensure the independence, competence, confidentiality, ethical compliance, and quality assurance of the internal Sharia audit department within the Islamic banks of the GCC?	Q7, Q8, Q9, Q10, Q11, Q12, Q13, Q14	N/A

What would be the most suitable and effective integrated approach to internal Sharia audit for Islamic banks in the GCC?	Q15, Q16, Q17, Q18	Q6

The complete set of questions is listed in the appendix, while the data collected from the semi-structured interviews is analysed and summarised in the subsequent chapters.

6.5.1.1.2 Conducting the interviews

The exploration of potential respondents encompassed key roles within the internal Sharia audit domain, comprising heads of internal Sharia audit departments, internal Sharia audit managers, and internal Sharia auditors, all actively engaged in Islamic banking in the GCC countries. Correspondingly, senior representatives from AAOIFI and regulatory advisors associated with central banks within the GCC were also identified as prospective participants for the second interview. The outreach to these individuals was facilitated through a variety of communication channels, including emails, mobile and telephone calls, and LinkedIn messages.

The limited number of Islamic banks in the GCC region, coupled with the small size of many internal Sharia audit departments, made it impractical to conduct a pilot study. In the GCC, there are fewer than fifty Islamic banks, and many of these banks have only a small team or even a single internal Sharia auditor. In some cases, there are no dedicated internal Sharia auditors at all, which severely restricts the pool of potential participants for the pilot study. Given these constraints, the feasibility of conducting a meaningful pilot study was compromised, as the sample size would have been too small to generate reliable preliminary data. This limitation was one of the key factors in the decision to bypass the pilot phase and proceed directly with interviews.

Despite challenges inherent to the limited availability of internal Sharia practitioners, the researcher successfully conducted a total of fourteen interviews with internal Sharia audit practitioners. Additionally, one interview was conducted with a senior member of AAOIFI, and another with a regulatory advisor for central banks in the GCC.

The research employed a snowball sampling technique to identify suitable participants. This method entails initiating the process by identifying and selecting one or more individuals possessing pertinent knowledge in the field of internal Sharia audit (Naibaho and Manik, 2022). Subsequently, recommendations were solicited from these initial participants to identify further relevant individuals within their professional network. The utilisation of this method was necessitated by the inherent challenges associated with directly accessing all internal Sharia auditors across the GCC.

The adoption of snowball sampling was driven by practical considerations, primarily stemming from the limited availability of information concerning these specific individuals. Unlike Sharia scholars, whose names are publicly acknowledged within the committees of Islamic banks, the names of internal Sharia auditors remain less conspicuous. This discrepancy in public visibility necessitated an alternative approach to participant selection, thus warranting the employment of the snowball sampling method.

All participants were male, reflecting the gender composition typically observed in senior roles within the GCC's banking sector. All participants were employed at Islamic banks, aligning with the research focus on internal Sharia audit practices in these institutions. Their professional experience exceeded 10 years, providing valuable insights from both strategic and operational perspectives. The interviews varied in duration, lasting between 30 minutes and 1 hour, allowing participants to elaborate on their experiences and perspectives comprehensively.

Table 8: Semi-structured interview (profile of interviewees)

Informant code	Job title	Country	Date of interview	Duration (minutes)
Interviewee 1	Chief Sharia Officer	Bahrain	12th May 2023	41
Interviewee 2	Head of internal Sharia audit	Bahrain	11th August 2023 The participant provided written answers to the questions.	N/A
Interviewee 3	Assistant general manager Sharia audit	Kuwait	8th June 2023	48

Interviewee 4	Senior Shari auditor	Kuwait	9th June 2023	36
Interviewee 5	Internal Sharia audit manager	Oman	2nd JUNE 203	32
Interviewee 6	Head of internal Sharia audit	Oman	16th May 2023	58
Interviewee 7	Assistant general manager – Shari audit	Qatar	8th May 2023	41
Interviewee 8	Sharia audit manager	Qatar	11th May 2023	59
Interviewee 9	VP – Sharia audit manager	Saudi Arabia	9th June 2023	60
Interviewee 10	Head of Sharia audit	Saudi Arabia	5th June 2023	50
Interviewee 11	Chief Sharia Auditor	UAE	2nd June 2023	33
Interviewee 12	Head of internal Sharia audit	UAE	28th May 2023	35
Interviewee 13	Internal Sharia audit manager	UAE	2nd June 2023	39
Interviewee 14	Head of internal Sharia audit division	UAE	3rd June 2023	45

Given the geographical dispersion of participants, the researcher used diverse platforms such as Microsoft Teams, Zoom, and phone calls to administer the semi-structured interviews. In preparation for each interview, participants were provided with the interview questions, a consent form, and an informative participant information sheet. During the interview, the researcher introduced themselves and provided an overview of the research's scope, objectives, and rationale. Consent for recording the interviews was diligently sought and secured from all participants. Also, detailed notes were taken during the interviews.

To address the linguistic and cultural context of the participants, some interviews in this research were conducted in Arabic, based on the request of the interviewees. Given that the majority of the respondents were based in the GCC countries, where Arabic is the primary language, conducting interviews in Arabic ensured a more comfortable and effective communication environment, allowing participants to express themselves more freely and in greater detail. This approach also helped eliminate potential language barriers that might have hindered the quality of responses, ensuring that the nuances of their insights were accurately captured. The English and Arabic versions of the interview questions, which were utilised in the interviews conducted in the GCC region, can be found in the appendix. However, the interviews conducted with both the AAOIFI senior member and the regulatory advisor in the GCC were conducted in English; therefore, only the English version is provided in the appendix.

Upon completion of the interview phase, the recorded interview were securely stored on the University of Salford's OneDrive platform and subsequently subjected to analysis. This analysis was underpinned by an interview coding and thematic approach, enabling systematic extraction of meaningful insights.

To ensure the accuracy and validity of the translations, all interviews conducted in Arabic were translated into English. The translation process was carried out carefully to preserve the meaning and context of the participants' responses. Once the translations were completed, they were carefully reviewed by me and the records were shared with my supervisor, both of whom are bilingual, to ensure that the nuances and specific terminologies related to Sharia audit were correctly conveyed. This collaborative process helped maintain the integrity of the data and ensured that the translated interviews reflected the participants' original perspectives accurately.

The rich qualitative data garnered from these interviews proved immensely valuable, offering profound insights of the research topic within the Islamic banking industry. The participants' perspectives enriched the understanding of internal Sharia audit practices at both the individual and institutional levels, including the viewpoint of AAOIFI on general internal Sharia audit practices.

6.5.1.1.3 Analysis of the semi-structured interviews

The process of analysing the interviews encompasses several intricate research steps. Initially, the discussions held with the interviewees are transcribed, ensuring an accurate record of the dialogue. Subsequently, a systematic examination is undertaken to identify the responses relevant to the research inquiries. This involves a search for specific patterns, distinctive trends, and noteworthy insights embedded within the transcriptions. Furthermore, a comprehensive effort is exerted to highlight the themes that exhibit consensus and alignment across multiple interviewees. This analysis approach contributes to the comprehensive extraction of valuable insights from the interview data, thus enriching the research outcomes (Blee and Taylor, 2002: 111).

The responses provided by the interviewees summarised in coding process, whereby each response was systematically categorised and associated with the pertinent research questions. These questions were thoughtfully structured into six distinct components: Current Internal Sharia Audit Practices, Regulatory Framework, The Role of the Internal Sharia Audit Department, Mechanism of the Internal Sharia Audit (encompassing Competence, Independence, and Confidentiality), General Assessment of the Internal Sharia Audit Department, and Sharia Audit Approach and Operational Procedure. Drawing upon the semi-structured interview framework, the researcher proceeded to present the insights about the internal Sharia audit by the interviewees. Each response was then correlated with a thematic category that corresponded to the relevant interview question, thus facilitating a coherent and insightful analysis.

On the contrary, documentary analysis was employed to analysis the interviews conducted with the senior member of AAOIFI and the regulatory advisor to the regulatory bodies within the GCC. Following the framework outlined by Sekaran and Bougie (2009), the documentary analysis process involves three key stages: data reduction, data display, and drawing conclusions. The interview questions were organised into six distinct components: Benefits and Importance of the Internal Sharia Audit Standard, Understanding the Regulatory Landscape, Encouraging Adoption and Compliance, Addressing Concerns and Obstacles, Future Outlook and Potential Developments, and Integrated Audit Approach.

6.5.1.2 Documentary Analysis

In response to the limitations inherent in semi-structured interviews, the utilisation of documentary analysis serves as a helpful approach aimed at reinforcing the research outcomes drawn from the interviews (Beattie, McInners, & Fearnley, 2004, pp. 208–213), which raised pertinent queries regarding the regulatory requirements for internal Sharia audit within the GCC.

Documentary analysis, a qualitative research form, involves the review and interpretation of accessible documents to yield analytical insights conducive to the study's subject matter (Bowen, 2009). This research instrument offers an effective means of procuring reliable data, particularly when certain documents are publicly available, thereby enabling multiple reviews without susceptibility to researcher influence (Bowen, 2009).

Conversely, this methodology necessitates investigative approach, given that documents are not tailor-made to suit the research objectives, potentially yielding incomplete data for the study's purposes. Additionally, the confidentiality of certain documents and potential inaccuracies therein (Bowen, 2009) underscore the requirement for carful application. Consequently, this method is deemed less valid when employed in isolation, thereby prompting its inclusion as an additional tool to the semi-structured interviews.

Documentary analysis facilitates the compilation of essential legislations concerning internal Sharia audit across GCC nations, subsequently subjecting them to a comparison with the AAOIFI's internal Sharia audit standard. This approach was vital in offering the researcher comparative insights and highlighting deficiencies within internal Sharia audit regulations across the GCC.

The application of documentary analysis was instrumental in evaluating the alignment of regulatory stipulations with the AAOIFI's internal Sharia audit standard. The analysis of regulatory requisites for internal Sharia audit within the GCC entailed a systematic process. Beginning with an assessment of AAOIFI's internal Sharia audit standard, the researcher created a composite index, segmented into 5 sections. These sections encompass: the establishment of a comprehensive framework for Sharia governance, the approach and documentation of Sharia audit, independence and objectivity, quality control and ethical standards, and the human resources of internal Sharia audit. This index comprises 25 indicators that serve as benchmarks.

Subsequently, a comparison was undertaken between the index's requirements and the regulatory provisions in each GCC country. Assigning scores to each country based on their adherence to AAOIFI standards follow, culminating in a ranking of their compliance levels. The resultant analysis provided meaningful insights into the regulatory landscape. The set of 25 indicators proved instrumental in offering both quantitative and qualitative insights into the realm of internal Sharia audit practices across the GCC.

The degree of regulatory compliance with AAOIFI’s internal Sharia audit standards has been categorized into five levels: 'underdeveloped' regulations with scores from 1 to 5, 'emerging' regulations from 6 to 10, 'improved' regulations between 11 and 15, 'good' regulations between 16 and 20, and 'best' regulations between 21 and 25.

The validity of the created index is strong as it has been established based on the AAOIFI's internal Sharia audit standard. AAOIFI, which similar to the Basel Committee in conventional banking, adds credibility to the index's development, as explained in the earlier parts of this study.

6.6 SUMMARY

As emphasised in Chapter 1, the purpose of this research is to investigate how internal Sharia audits are conducted by Islamic banks in the GCC. It also examines whether these banks and countries adhere to the internal Sharia audit standard established by AAOIFI. The study involves analysing the insights of experts and the regulations within these countries. Based on the findings, the thesis attempts to highlight any needed improvement and to propose from the practices valuable guidelines and policy recommendations for an effective internal Sharia audit framework. To achieve the aforementioned objectives, a robust research methodology is essential. Thus, this chapter provides an overview of the research methods and tools utilised in this research.

CHAPTER 7: PERCEPTIONS OF THE SHARIA AUDITORS: INTERVIEWS ANALYSIS

7.1 INTRODUCTION

This chapter aims to thoroughly examine viewpoints of the industry Sharia audit practitioners in six distinct areas: namely current internal Sharia audit practices and the associated challenges, the regulatory framework, the role of the internal Sharia audit department, attributes of the internal Sharia audit in terms of mechanisms of competence, independence and confidentiality, general assessment of the internal Sharia audit department, the Sharia audit approach and operational procedure.

As outlined in the previous chapter, a series of interviews was conducted during 2023. The interviews encompassed a total of fourteen participants, distributed across various countries. Specifically, two interviews were conducted in Bahrain, Kuwait, Saudi Arabia, Qatar and Oman respectively. The majority of interviews, totalling four, were carried out in the UAE.

The selection of interviewees was carefully tailored to target individuals holding key positions within their respective banks' internal Sharia audit departments. This included the heads of internal Sharia audit departments, senior internal Sharia audit managers, and internal Sharia audit managers who possessed a comprehensive understanding of their banks' internal Sharia audit approach. By engaging with these knowledgeable professionals, this study aimed to gather valuable insights and perspectives on the internal Sharia audit practices employed within their countries.

By conducting these interviews across diverse countries and involving a range of experienced individuals, this research endeavour sought to capture a comprehensive and representative understanding of the current state of internal Sharia audits in the selected Islamic banks. The outcomes of these interviews will serve as a foundation for analysing and evaluating the internal Sharia audit practices, as well as providing valuable recommendations for improvement within the context of each respective countries.

The chapter is divided into four sections. The first section serves as an introduction. The second section focuses on the analysis of the interviews conducted in Bahrain, Kuwait, Saudi Arabia, Oman, Qatar, and the UAE.

The third section entails a comparative analysis, utilising the findings from the aforementioned six countries. Its purpose is to identify similarities, differences, and notable trends in their approaches to internal Sharia audits. By comparing these perspectives, a comprehensive comprehension of the wider scope of internal Sharia audits in the region can be attained. Lastly, the fourth section provides essential conclusions derived from the interview findings. It summarises the key points discussed throughout the chapter, emphasising significant insights, emerging themes, and potential avenues for future research.

7.2 AN ANALYSIS OF THE INTERVIEWS CONDUCTED IN THE GCC

In this section, it is crucial to emphasise the interconnected nature of the findings with the viewpoints and concerns expressed during the interview section. The richness and depth of understanding can be fully appreciated when these findings are examined collectively rather than in isolation. Therefore, it is recommended to approach the analysis by considering the findings as a cohesive whole.

To enhance clarity and facilitate comprehension, a systematic approach has been employed, whereby findings are highlighted in a coded and thematic manner. This coding and thematic structure enable a concise and structured summary of the results, ensuring that the key themes and patterns are effectively captured.

Furthermore, after presenting the main findings in the tables, a detailed discussion takes place. The coded analysis is thoroughly examined, exploring the details and challenges shown by the data. This thorough examination complements the initial findings, providing a deeper understanding of the underlying factors involved. This methodological framework amplifies the significance and practical implications of the findings, enabling a comprehensive exploration of the research objectives. Valuable insights are uncovered, and potential avenues for future investigation are identified. Ultimately, this approach ensures that the findings are not isolated fragments but rather integrated contributions that contribute coherently to the overall research endeavour.

7.2.1 Current internal Sharia audit practices and the associated challenges

There are three questions within this section. The first helps build a connection between participants and the interviewer while gaining a general understanding of the internal Sharia audit within the Islamic bank. The second question aims to determine the primary challenges encountered by internal Sharia auditors. The third question assesses the adherence of Islamic banks to AAOIFI's internal Sharia audit standard, seeking insights from practitioners on their perspectives of this standard. This section is designed to analyse and evaluate the existing implementation of AAOIFI's internal Sharia audit standard.

Question 1: What Internal Sharia Audit means at your Islamic bank?

Focused coding:

- Coding 1: Ensuring adherence to Sharia principles
- Coding 2: Providing independent assurance to stakeholders
- Coding 3: Everything related to Sharia

Theme: The Internal Sharia Audit across all Islamic banks is an independent function with the objective of ensuring compliance with Sharia principles and providing confidence to stakeholders regarding compliance.

Table 9: Interviewees' answers for Question 1

Interviewee	Country	Answer
Interviewee 1	Bahrain	It is an independent function that assesses the compliance of all activities of the bank to provide assurance to stakeholders that the bank is compliant with Sharia principles.
Interviewee 2	Bahrain	The internal Sharia audit is the third line of defence at the bank from Sharia perspective. The Sharia audit must cover all aspects of the bank's business operations and activities in order to assess the extent of Sharia compliance requirements.
Interviewee 3	Kuwait	The internal Sharia audit comprises comprehensive processes and time management to provide assurance about the compliance with Sharia principles. It is divided into three processes: planning, execution, and reporting. While some experts include follow-up in

		this process, I consider it a separate step. When the Sharia auditor submits the report, it signifies the completion of the Sharia audit. Failure to conduct follow-up does not imply incomplete audit work.
Interviewee 4	Kuwait	In our bank, there is a Sharia compliance function responsible for overseeing the day-to-day activities of the bank, and an internal Sharia audit as an independent function provides assurance to stakeholders regarding the bank's compliance with Sharia principles.
Interviewee 5	Oman	It is equivalent to an internal audit department in its work and independency, but the difference here is that we have zero tolerance for Sharia non-compliance issues.
Interviewee 6	Oman	This function ensures the bank's alignment with Sharia principles set by the Sharia committee and adheres to the central bank's framework for Islamic banks. The primary objective to provide assurance about the compliance with Sharia so enable the Sharia committee to issue the annual certificate upon year-end.
Interviewee 7	Qatar	The Sharia audit is accountable to the Sharia committee, which is responsible for issuing Fatwas and overseeing their execution within the bank. When dealing with Sharia audit, it's essential to assess the scope, implementation authority, and clarity of the mission.
Interviewee 8	Qatar	It signifies the entirety of Sharia principles within the bank. It serves as the primary contract function between management and the Sharia Supervisory Committee.
Interviewee 9	Saudi Arabia	Everything related to Sharia in the bank includes aspects such as product development, Sharia compliance, and research, along with Sharia audit procedures.
Interviewee 10	Saudi Arabia	The function ensures that everything is in line with Sharia after the activities have been done. It is to give enough assurance to the Sharia committee that the bank was working in line with Sharia principles.
Interviewee 11	UAE	It is an internal control function within the bank that helps ensure the bank's activities are in line with Sharia principles. This function ensures that everything related to products is reviewed before being

		offered to customers, while it is offered to customers, and after it is offered, to ensure the entire process is in line with Sharia principles.
Interviewee 12	UAE	It is a regular process aimed at assessing and evaluating the bank's compliance with Sharia principles and the effectiveness of the Sharia governance framework.
Interviewee 13	UAE	A function that must plan its activities annually, collecting the necessary documents to complete the audit. Once the documents are gathered, they execute the actual audit to ensure no breaches have occurred during the year. Any issues found are reported to implement proper controls to prevent similar issues in the future.
Interviewee 14	UAE	The function responsible for conducting the internal Sharia audit plan ensures that Sharia non-compliance risk is managed by the Islamic bank. The internal Sharia audit function derives authority from both the board and the Sharia supervisory committee.

Analysis of what internal Sharia audit means from the interviewees' perspective.

1- Primary Objective:

Across all responses, the primary objective of internal Sharia audit is consistently emphasised as ensuring compliance with Sharia principles. This includes assessing the alignment of bank activities with Sharia requirements and providing assurance to stakeholders, such as the Sharia committee or board, regulators regarding adherence to Sharia principles.

2- Independence and Accountability:

Many interviewees stress the independence of internal Sharia audit as a critical aspect of its function. It is portrayed as an independent function accountable to the Sharia committee or board, similar to internal audit departments in conventional banks.

3- Scope and Processes:

The scope of internal Sharia audit's activities varies across interviewees depend on the country and in some cases it encompasses all aspects of the bank's operations related to Sharia compliance. This includes product development, research, compliance assessment, and oversight of Sharia-related activities.

It is worth noting that Sharia audit in Qatar and Saudi Arabia is responsible for everything related to Sharia within the bank, raising questions about the independence of this function and how this function operates within the second and third lines of defence. Thus, they handle Sharia compliance and Sharia audit simultaneously, and in some cases, they are involved in product development.

4- Relationship with Sharia Governance:

Internal Sharia audit is closely linked with the Sharia governance framework of the bank. It serves as a critical component in assessing the effectiveness of Sharia governance practices and ensuring that Sharia principles are integrated into all aspects of the bank's operations.

5- Risk Management and Assurance:

Internal Sharia audit is viewed as a risk management function, responsible for identifying and mitigating Sharia non-compliance risks within the bank. Its role in providing assurance to stakeholders, including the Sharia committee, board and the regulators, is highlighted as essential for maintaining trust and confidence in the bank's adherence to Sharia principles.

Overall, the responses highlight the critical role of internal Sharia audit in ensuring Sharia compliance within Islamic banks. However, there are clear indicators that there are differences in what Sharia audit means in each bank and in each country.

Question 2: What are the challenges you might be facing in relation to Internal Sharia Audit?

Focused coding:

- Coding 1: Scarcity of qualified Sharia audit professionals
- Coding 2: Limited resources and technological infrastructure
- Coding 3: Lack of standardised approaches and terminology
- Coding 4: Issues related to management perception and support for Sharia audits

Theme: The main challenge faced by Sharia auditors regarding Internal Sharia Audit is the scarcity of qualified personnel and limited resources, blocking the effectiveness of Sharia audits and necessitating investment in staffing and technology to meet Sharia audit demands.

Table 10: Interviewees' answers for Question 2

Interviewee	Country	Answer
Interviewee 1	Bahrain	The main challenge lies with individuals and their limited understanding of Islamic banking. Additionally, there is a scarcity of experts in Sharia audit. Currently, if a bank seeks to hire someone for the Sharia audit function, it is difficult to find a suitable candidate who possesses knowledge in Sharia, audit practices, banking, and finance.
Interviewee 2	Bahrain	Mainly lack of resources, qualifications and shifting from traditional way to digitalisation.
Interviewee 3	Kuwait	The resources required to conduct the internal Sharia audit are crucial; lacking a proper team can render the Sharia audit ineffective, failing to provide assurance to stakeholders. A strong team is essential. Another challenge is maintaining a large team in the Sharia audit department without ensuring their competence to conduct the audit. There is a lack of qualified individuals in the field of Islamic banking and internal Sharia audit. Currently, many staff members are being sourced from conventional banking backgrounds, and they tend to apply their previous knowledge. I have been actively searching for a qualified Sharia audit professional to join my team for six months, yet have been unsuccessful in finding one so far.
Interviewee 4	Kuwait	Based on my experience, the internal Sharia audit varies across different Islamic banks, as there is no standardized approach in the market. Differences are observed in processes, reporting, stages, results, and terminologies. This difference stems from the fact that Islamic banking is still evolving as a concept, particularly in the context of Sharia audit, which lags behind conventional internal audit practices. Even the reporting lines for internal Sharia audit differ among Islamic banks, tailored to suit each management's preferences rather than stakeholders as a whole.

		Furthermore, there is a lack of clear segregation of responsibilities within the internal Sharia audit function. Currently, in some countries, a single individual handles Sharia audit, compliance, training, and product development. While internal auditors adhere to the International Professional Practices Framework (IPPF) standards issued by the IIA, Sharia auditors lack equivalent standards for conducting Sharia audits. Holding regular conferences among internal Sharia auditors could foster knowledge sharing and harmonisation of their practices. Also, There is a lack of consistency in the terminologies associated with internal Sharia audit.
Interviewee 5	Oman	We do not have many Sharia auditors proficient in the English language, and the contracts of products, especially in treasury, are in English.
Interviewee 6	Oman	During the Sharia audit process, interactions with the audited department and the presentation of the audit report to management are key stages. However, challenges often arise in these interactions. There is sometimes a perception that we are seeking errors, when our true aim is to enhance processes. Additionally, system-related challenges are encountered along the way.
Interviewee 7	Qatar	Sharia compliance is not given a serious level of attention by the management, primarily due to the fact that many members of the management team come from conventional banking backgrounds and have limited understanding of Sharia principles.
Interviewee 8	Qatar	The main challenge is that the management perceives internal Sharia audit as an expense centre.
Interviewee 9	Saudi Arabia	The management did not take the Sharia audit seriously; however, this stance was challenged after the central bank issued guidelines on Sharia governance for Islamic banks. Nevertheless, these measures are still insufficient, and further enforcement is needed from the central bank.

Interviewee 10	Saudi Arabia	The management of the bank, in some cases, does not take compliance with Sharia as a serious matter as no strong enforcement to Sharia audit from the regulators.
Interviewee 11	UAE	Not having enough resources and finding the appropriate candidate to do the job.
Interviewee 12	UAE	The main challenge is that we lack a unified approach to conducting internal Sharia audits, and this is a widespread issue across the entire market, not just in the UAE.
Interviewee 13	UAE	Collecting information and documents from various departments, including any miscommunications related to resolutions issued by the Sharia committee.
Interviewee 14	UAE	The internal audit function is more welcomed by the board compared to Sharia audit, as they perceive it can improve their processes. However, the board may view our function as potentially reducing profits due to non-Sharia compliance or as a police officer who supported by the regulators to ensure compliance with Sharia.

Analysis of the challenges the internal Sharia auditors facing

1- Human Resources and Expertise:

A common challenge highlighted across multiple responses is the scarcity of qualified individuals with expertise in both Islamic banking and internal Sharia audit. This scarcity extends to finding candidates proficient in the English language, which is often necessary for auditing contracts and documents.

Islamic banks struggle to find suitable candidates who possess the necessary knowledge in Sharia principles, audit practices, banking, finance, and proficiency in English. This shortage of qualified personnel weakens the effectiveness of Sharia audits and may lead to reliance on staff with backgrounds in conventional banking, who may not fully understand Sharia principles.

2- Resource Constraints:

Limited resources, both in terms of staffing and technological infrastructure, pose significant challenges to conducting effective Sharia audits. Islamic banks face difficulties in maintaining adequately sized and competent teams within the Sharia audit department. Transitioning from traditional methods to digitalization also presents challenges, indicating a need for investment in technology and training to adapt to evolving audit practices.

3- Standardization and Consistency:

There is a lack of standardized approaches and terminology in internal Sharia audits across Islamic banks and markets. This variation in processes, reporting, and terminology complicates efforts to benchmark practices and ensure consistency. The absence of equivalent standards for Sharia audits, similar to those for internal audits in conventional banking, contributes to the divergence in practices and reporting observed among Islamic banks.

4- Management Perception and Support:

Challenges related to management perception and support for Sharia audits are prevalent. Some management teams may not prioritize Sharia compliance or may view the Sharia audit function primarily as a cost centre rather than a value-added activity.

It was highlighted in some countries that without regulatory enforcement mandating a Sharia audit function, its strength may not reach its full potential. Even when regulatory enforcement exists, internal Sharia auditors are perceived by management as akin to police officers and are not accorded the same respect as internal auditors, who assist the board and shareholders in improving processes. The Sharia auditor may be viewed as a function that costs money and reduces profit for the shareholders.

5- Regulatory Environment:

While regulatory guidelines on Sharia governance have been issued by central banks in some cases, such as Saudi Arabia, interviewees express concerns about the adequacy of enforcement measures. Further regulatory enforcement and guidance are deemed necessary to ensure compliance and strengthen the standing of Sharia audits within Islamic banks.

Overall, the identified challenges underscore the complex and multi-dimensional nature of conducting internal Sharia audits within Islamic banks. Addressing these challenges requires efforts to enhance human resources, standardise practices, improve management support and perception, and strengthen regulatory frameworks to ensure effective Sharia compliance and audit practices.

Question 3: Does your bank comply with the internal audit standard issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI)? If yes/no, to what extent does implementing this standard improve your work?

Focused coding:

- Coding 1: Diverse levels of compliance with AAOIFI standards
- Coding 2: Recognition of potential benefits and challenges associated with implementing AAOIFI standards
- Coding 3: Influence of regulatory mandates and differences in regional compliance methods

Theme: The responses highlight a range of perspectives regarding compliance with AAOIFI standards for internal audit among Sharia auditors. While some Sharia auditors recognise the potential benefits and strive for compliance, others face challenges or prioritise adherence to local regulations.

Table 11: Interviewees' answers for Question 3

Interviewee	Country	Answer
Interviewee 1	Bahrain	The bank is not fully compliant with the AAOIFI standard, but our main objective is to align with regulations. The regulations from the central bank recommend compliance with AAOIFI standards but do not enforce it.
Interviewee 2	Bahrain	Not fully but following the international and professional standards create great value for the internal Sharia audit and keep a good reference for standardisation of work and spread the best practices in the industry.

Interviewee 3	Kuwait	We are not fully compliant and I reviewed the standards issued by AAOIFI, but they fall below expectations when compared to the standards issued by the IIA for conventional internal audit. The AAOIFI standards can be useful as a benchmark, but not as a comprehensive guide for conducting Sharia audits. In Kuwait we use the AAOIFI standards as a guidelines not mandatory. It is important to note that AAOIFI does a great job with Sharia standards, but the governance standards are still relatively weak.
Interviewee 4	Kuwait	AAOIFI is optional and not mandatory for implementation; currently, we are not fully compliant. In my opinion, the AAOIFI internal Sharia audit standard still requires significant improvements.
Interviewee 5	Oman	No, we do not comply with the AAOIFI internal Sharia audit standards. I am not fully aware of the standards to provide a view on the improvement of our work.
Interviewee 6	Oman	We do not adhere to the AAOIFI internal Sharia audit standard, primarily because regulatory authorities do not make it a mandatory requirement. In Oman, while AAOIFI accounting standards are obligatory, governance standards are not. While implementing the AAOIFI internal Sharia audit standard could potentially enhance our operations, it might also lead to conflicts with regulations or our established approach to internal Sharia audit.
Interviewee 7	Qatar	We do not fully adhere to AAOIFI standards; rather, we treat them as guiding principles. While it would be beneficial to fully implement AAOIFI standards, it's unfortunate that these standards, developed by esteemed experts in the Islamic finance sector, often face challenges in practical implementation within their own Islamic banks.
Interviewee 8	Qatar	We strive for compliance, but unfortunately, we haven't achieved it yet. AAOIFI offers excellent standards, but implementing them

		would incur extra costs for the business. Without a regulatory mandate for this compliance, the management may be hesitant to allocate additional funds.
Interviewee 9	Saudi Arabia	No, we are currently not compliant with AAOIFI standards. Our priority is to adhere to the regulations or guidelines issued by the central bank. However, I'm not familiar enough with AAOIFI standards to determine their utility or relevance for our operations.
Interviewee 10	Saudi Arabia	It is not a regulatory requirement to be compliant with AAOIFI so we are not fully compliant.
Interviewee 11	UAE	No we are not compliant with AAOIFI's internal Sharia audit standard. It will greatly improve the work of the internal Sharia auditor and create harmonization in the industry if all players are compliant with the AAOIFI Sharia audit standard.
Interviewee 12	UAE	No, we strictly adhere to the regulatory requirements issued by the central bank of the UAE. Each country has its own regulations, so it is difficult to enforce AAOIFI standards on all banks worldwide.
Interviewee 13	UAE	We are required to comply with the Sharia standards issued by AAOIFI, but this is not mandatory when it comes to the internal Sharia audit standard. However, we fully comply with the standards issued by the central bank.
Interviewee 14	UAE	No, we are simply complying with the regulatory framework issued by the Central Bank of the UAE.

Analysing compliance with internal Sharia audit standards issued by AAOIFI:

1- Compliance Levels:

Majority of the interviewees (10 out of 14) do not fully comply with the AAOIFI internal Sharia audit standard. This lack of full compliance is often attributed to several factors including:

- Absence of regulatory enforcement: Many interviewees noted that while they aim to align with AAOIFI standards, there is no regulatory mandate compelling their Islamic banks to do so. This lack of regulatory pressure reduces the urgency for full compliance.

- Cost considerations: Some interviewees mentioned that implementing AAOIFI standards would incur additional costs for the Islamic bank. Without a regulatory mandate or clear benefits outweighing the costs, management may be hesitant to allocate resources towards compliance.
- Perception of standards: Some interviewees expressed concerns about the comprehensiveness and effectiveness of AAOIFI standards, particularly in comparison to other international standards like those issued by the IIA (Institute of Internal Auditors).

2- Perceived Utility and Improvements:

Despite the varying levels of compliance, there is recognition among some interviewees that implementing AAOIFI standards could improve internal audit practices and enhance operations. Benefits mentioned include:

- Alignment with international and professional standards: Compliance with AAOIFI standards is seen as a means to adhere to best practices in the industry and maintain a good reference for standardisation of work.
- Harmonisation and industry improvement: Interviewees from the UAE highlighted the potential for AAOIFI standards to create harmonisation within the industry and improve the work of internal Sharia auditors.
- Increase reliability and trust in the Islamic bank: Compliance with AAOIFI standards gives assurance to stakeholders that the Islamic bank is truly compliant with Sharia principles.

3- Challenges and Criticisms:

Several interviewees raised criticisms and challenges associated with AAOIFI standards:

- Perceived weaknesses: Some interviewees mentioned concerns about the adequacy and effectiveness of AAOIFI standards, particularly in governance-related areas.
- Practical implementation challenges: Interviewees noted challenges in practically implementing AAOIFI standards within their Islamic banks, citing difficulties in reconciling these standards with existing regulatory frameworks and internal audit approaches.

4- Regional Variations:

There are differences in attitudes and regulatory environments across countries:

- Countries like Bahrain and the UAE have varying degrees of adherence to AAOIFI standards, with some Islamic banks recognising the importance of compliance while others prioritise adherence to local regulatory frameworks.
- In Qatar, Saudi Aribia, Kuwait and Oman, AAOIFI standards are viewed more as guidelines rather than mandatory requirements

Overall, while there is recognition of the potential benefits of complying with AAOIFI standards for internal Sharia audit, practical challenges, varying regulatory environments, and perceptions of standard effectiveness contribute to the mixed levels of compliance observed among the interviewed Islamic banks.

7.2.2 The regulatory framework

Acknowledging the regulatory challenges associated with the internal Sharia audit function, this section addresses relevant queries posed to practitioners. The primary question seeks to clarify existing regulatory prerequisites concerning the internal Sharia audit function within the participants' respective countries. This inquiry also seeks insights into potential consequences stemming from non-compliance by an Islamic bank with these stipulations, if applicable. The subsequent query investigates practitioners' strategies for remaining well-informed about evolving regulatory mandates, shedding light on their measures to ensure solid adherence.

As the GCC countries share many commonalities, there is an expectation of a harmonised regulatory approach towards this unique function. The main objective of this section is to comprehensively comprehend the regulatory landscape governing the internal Sharia audit within the dynamic realm of the GCC's Islamic banking industry.

Question 4: Is the Internal Sharia Audit subject to any regulatory requirements? If yes, what will happen when an Islamic bank breaches these requirements?

Focused coding:

- Coding 1: Acknowledgment of regulatory requirements or guidelines for Internal Sharia Audit
- Coding 2: Lack of clarity regarding penalties for breaching regulatory requirements

Theme: The responses indicate that Internal Sharia Audit is subject to regulatory requirements or guidelines in all interviewed experts, typically issued by central banks or regulatory authorities. However, there is a notable lack of clarity regarding the penalties for breaching these requirements.

Table 12: Interviewees' answers for Question 4

Interviewee	Country	Answer
Interviewee 1	Bahrain	Yes, there are regulations related to the internal Sharia audit function, and while these regulations are robust, there are no clear penalties, such as fines or imprisonment, if Islamic banks do not comply with the regulatory requirements.
Interviewee 2	Bahrain	Yes, the Sharia governance module of central bank of Bahrain (CBB), its available on their official website. In case of any breach to these requirements, the bank is subject to financial penalties but the penalty is not clear in the regulation.
Interviewee 3	Kuwait	Yes, but there is still a lot to be done when it comes to internal regulatory requirements of the internal Sharia audit and I am not aware about the exact penalty.
Interviewee 4	Kuwait	Yes, the Central Bank of Kuwait has issued regulations related to internal Sharia audit. I believe there are penalties for breaches, although I am not fully aware if any banks have been subjected to such penalties.
Interviewee 5	Oman	Yes, there are specific requirements published by the Central Bank of Oman, but there is no clear penalty for breaching these requirements.
Interviewee 6	Oman	The internal Sharia audit operates under regulatory guidelines, and we ensure compliance with these guidelines. For instance, according to the regulatory requirements, Sharia audits should be conducted quarterly, and we meet this stipulation.

		Additionally, the audit report is submitted to the audit committee, as mandated by the regulatory guidelines. However, no clear penalty for breaching the Sharia requirements.
Interviewee 7	Qatar	The existing requirements for Islamic banks, unfortunately, lack robustness. While they mandate the presence of a Sharia committee and internal Sharia auditor, they lack comprehensive details. Presently, any new products necessitate approval from the central bank before implementation. However, the authority of Sharia auditors is ultimately derived from the strength of the Sharia committee rather than from regulations. It is our hope that regulators will extend a similar level of recognition and importance to the internal Sharia audit function as they do to the internal audit function.
Interviewee 8	Qatar	Yes, there are regulatory requirements for internal Sharia audit. However, penalties for breaching these requirements are usually absent. In case of a breach, the bank is typically granted a period to address and resolve the issue.
Interviewee 9	Saudi Arabia	The Central Bank of Saudi Arabia has issued guidelines; however, there are no penalties specified for breaching these guidelines.
Interviewee 10	Saudi Arabia	In all countries around the world, there are Islamic banks and conventional banks. However, in Saudi Arabia, that is not the case. The government does not admit that conventional banks are not in line with Sharia, as if they do so, this would be a breach of the country's constitution. The central bank of Saudi Arabia claims in its regulations that they are working in line with Sharia, but in reality, they are not compliant in their practices and activities. For example, when Alrajhi Bank wanted to call themselves Alrajhi Alislami, the request was rejected by the regulators, as if this implies that other banks are not Islamic. Similarly, Alinma Bank wanted to state in their articles of association that the bank works only in line with Sharia

		principles; however, this too was rejected by the regulators. Currently, there are guidelines for Sharia governance issued by the central bank, but these guidelines are applicable to all banks in Saudi Arabia and do not specify which banks should comply with them.
Interviewee 11	UAE	Yes, the internal Sharia audit is subject to the standard Sharia governance for Islamic banks issued by the central bank of the UAE. There are penalties for breaching these requirements, but the penalty is not mentioned in the standard. However, I am not aware of any case where the central bank imposed penalties on any bank for not being in line with Sharia.
Interviewee 12	UAE	Yes, the internal Sharia audit is subject to regulatory requirements in the UAE and is also subject to regulatory Sharia audits by the central bank. Any breaches would potentially incur fines, although the specific details of these fines are not disclosed by the central bank.
Interviewee 13	UAE	Yes, there are regulatory requirements related to internal Sharia audit issued by the UAE central bank. Non-compliance with these standards will result in fines imposed by the regulators.
Interviewee 14	UAE	Yes, the standards are issued by the Central Bank of the UAE, but the law does not specify the fine for breaches.

Analysis of the regulatory requirements of the internal Sharia Audit

1- Existence of Regulatory Requirements:

The majority of interviewees affirm the existence of regulatory requirements governing internal Sharia audit, with reference to guidelines issued by central banks or regulatory authorities in their respective countries. These requirements typically mandate the presence of a Sharia committee and an internal Sharia auditor within Islamic banks at institutional level.

2- Level of Robustness and Clarity:

While regulatory requirements are acknowledged, there are varying perceptions regarding their robustness and clarity. Some interviewees express concerns about the comprehensiveness and specificity of existing regulations, noting gaps in detailing the roles, responsibilities, and processes associated with internal Sharia audit.

It is worth noting that in Saudi Arabia, it is not allowed for any Islamic banks to call themselves Islamic banks, as that would imply that other banks are not Islamic, breaching the country's rules that everything should comply with Sharia. This may raise additional challenges for Islamic banks in Saudi Arabia, despite it being the largest Islamic finance industry in the GCC.

3- Penalties for Breaches:

Interviewees provide mixed responses regarding the imposition of penalties for breaching regulatory requirements related to internal Sharia audit. Several interviewees mention the absence of clear penalties, such as fines or imprisonment, for non-compliance with internal Sharia audit regulations. This lack of clarity regarding penalties raises questions about the effectiveness of regulatory enforcement in ensuring compliance.

In contrast, some interviewees in the UAE mention the potential for financial penalties imposed by regulators in the event of breaches. However, the specific details of these penalties, including the amount and nature of fines, remain undisclosed or unspecified by regulatory authorities.

4- Regulatory Oversight and Audits:

Interviewees highlighted the role of regulatory authorities, such as central banks, in overseeing internal Sharia audit and conducting audits to assess compliance with regulatory requirements. It was noted that apart from the UAE, all other GCC regulators do not conduct a regulatory Sharia audit to ensure that the Islamic banks in their areas are compliant with the regulations or guidelines issued by the regulators.

5- Challenges and Expectations:

Some interviewees express expectations for regulators to extend greater recognition and importance to internal Sharia audit, similar to the internal audit function such as the case in Qatar. This includes calls for enhanced regulatory guidance, clarity on penalties for breaches, and standardized approaches to internal Sharia audit practices across Islamic banks.

6- Country-specific Contexts:

Responses highlight country-specific nuances in regulatory frameworks and enforcement mechanisms. For example, interviewees from the UAE, Bahrain, Kuwait and Oman reference standards issued by their respective central banks, while others mention guidelines from regulatory authorities in Qatar, and Saudi Arabia.

Overall, the responses underscore the importance of regulatory oversight in governing internal Sharia audit and ensuring compliance with Sharia principles within Islamic banks. However, challenges remain regarding the clarity, robustness, and enforcement of regulatory requirements, as well as the need for greater alignment with international best practices and standards.

Question 5: How do you stay updated with changes in regulatory requirements pertaining to Internal Sharia Audit? What mechanisms or processes do you have in place to ensure compliance with evolving regulations?

Focused coding:

- Coding 1: the importance of the Sharia compliance department or regulatory compliance department in monitoring regulatory requirements and ensuring compliance.
- Coding 2: Reliance on channels such as central bank circulars, notifications, websites, specialized WhatsApp groups, AAOIFI mail lists, media channels, and direct communication with regulators to stay informed about regulatory changes.

Theme: The Sharia compliance department or regulatory compliance department assumes primary responsibility for monitoring regulatory changes and ensuring compliance within the Islamic bank. Through regular communication with regulators, reliance on central bank circulars and notifications, and participation in specialised information networks, Islamic banks ensure timely access to regulatory updates and strive to align their internal processes with evolving regulatory standards.

Table 13: Interviewees' answers for Question 5

Interviewee	Country	Answer

Interviewee 1	Bahrain	The Sharia compliance department is responsible for maintaining regular contact with regulators to ensure the bank's continuous alignment with regulations
Interviewee 2	Bahrain	Through the central banks circulars, AAOIFI mail list and specialized WhatsApp groups.
Interviewee 3	Kuwait	This is the responsibility of the Sharia compliance department, and they monitor the compliance with the regulatory Sharia requirements
Interviewee 4	Kuwait	The Central Bank of Kuwait usually sends out regular notifications regarding any new regulations.
Interviewee 5	Oman	We stay up to date with the regulations by obtaining the circulars from the central bank
Interviewee 6	Oman	Based on the circulars issued by the central bank.
Interviewee 7	Qatar	Via the central bank's circulated communications.
Interviewee 8	Qatar	We stay informed by regularly visiting the central bank's website and by receiving regulatory updates through circulated notifications.
Interviewee 9	Saudi Arabia	Through the central banks directly.
Interviewee 10	Saudi Arabia	We go through the central bank and regulator's website.
Interviewee 11	UAE	Throughout, the Chief Compliance Officer has a direct connection with the Central Bank in the UAE.
Interviewee 12	UAE	Through the second line of defence, we are working closely with regulators to ensure the bank is in line with regulatory requirements.
Interviewee 13	UAE	Through the regulatory compliance department.
Interviewee 14	UAE	Through the media, the regulatory compliance department and directly from the central bank of UAE.

Analysis of how they stay up-to-date with regulatory requirements

1- Responsibility and Departmental Roles:

The Sharia compliance department emerges as the primary entity responsible for staying updated with regulatory requirements related to internal Sharia audit. This department plays a pivotal role in monitoring compliance with regulatory Sharia requirements and ensuring the Islamic bank's alignment with evolving regulations. In some cases, the regulatory compliance department is also mentioned as having responsibility for staying updated with regulatory changes, particularly in the UAE. Meanwhile, the Sharia audit department is responsible for everything related to Sharia in Qatar and Saudi Arabia.

2- Communication with Regulators:

Islamic banks maintain regular communication with regulators, primarily through channels such as central bank circulars, notifications, and updates. These channels serve as essential sources of information regarding new regulations, guidelines, and requirements issued by regulatory authorities. Some Islamic banks highlight direct communication with regulators or visits to their websites as key mechanisms for staying informed about regulatory changes.

3- External Sources and Information Networks:

Islamic banks utilise external sources of information, such as AAOIFI mail lists, specialised WhatsApp groups, and media channels, to stay updated with regulatory developments. Collaborative efforts, such as participating in specialised WhatsApp groups or quality assurance programs, are mentioned as mechanisms for ensuring compliance with evolving regulations and standards.

4- Central Bank Notifications and Circulars:

Circulars issued by central banks serve as crucial sources of regulatory updates for Islamic banks. Islamic banks rely on these circulars to obtain information on new regulations, amendments, and guidelines relevant to internal Sharia audit.

5- Direct Contacts and Liaisons:

Some Islamic banks emphasise direct connections and relationships with regulatory authorities, such as the Chief Compliance Officer's direct connection with the Central Bank in the UAE. These direct contacts facilitate timely access to regulatory information and updates.

Overall, the responses demonstrate a proactive approach by Islamic banks in staying updated with changes in regulatory requirements pertaining to internal Sharia audit. These mechanisms and processes not only facilitate compliance with regulatory standards but also contribute to maintaining alignment with Sharia principles and best practices in Islamic finance.

7.2.3 The role of the internal Sharia audit department

The rationale behind this section is to examine the perception of the internal Sharia auditors about their roles and responsibilities in the banks they work for. Given all participants are responsible for the Sharia audit, the expectation is to find similarities in their roles and responsibilities.

Question 6: What are the main roles and responsibilities of the Internal Sharia Audit department in your bank?

Focused coding:

- Coding 1: To independently ensure adherence to Sharia principles and alignment with fatwas issued by the Sharia committee.
- Coding 2: To be responsible about anything related to the Sharia aspect of the bank.

Theme: The internal Sharia audit **department plays a pivotal role in ensuring adherence to Sharia principles and guidelines within Islamic banks. This includes overseeing compliance with fatwas issued by the Sharia committee, promptly reporting any deviations from Sharia principles, evaluating the bank's adherence to Sharia guidelines, and providing assurance to the stakeholders regarding compliance.**

Table 14: Interviewees' answers for Question 6

Interviewee	Country	Answer
Interviewee 1	Bahrain	To ensure that all activities within the Bank are compliant with Sharia principles and aligned with the fatwas issued by the Sharia committee.

Interviewee 2	Bahrain	Ensuring that there is a sound control system related to Sharia Ensuring that the Bank's management is discharging its responsibilities of implementing the Sharia principles Ensuring that all the Bank's transactions are complying with Sharia
Interviewee 3	Kuwait	The main role is to verify the Islamic bank's adherence to the principles of Islamic Sharia in its transactions and activities
Interviewee 4	Kuwait	The Sharia auditor is responsible for assessing and verifying that all activities of the Islamic bank adhere to Sharia principles and guidelines.
Interviewee 5	Oman	The main role and responsibility of the Sharia audit is to serve as the vigilant oversight for the Sharia committee within the bank. Any activities or occurrences that deviate from Sharia principles are promptly reported to the Sharia Supervisory Committee.
Interviewee 6	Oman	The internal Sharia audit is tasked with evaluating the internal Sharia reviewer and the Sharia committee to form an opinion about the bank's compliance with Sharia principles. It ensures that all executed financial transactions are in alignment with Sharia principles. The Sharia auditors primarily concentrate on products rather than policies or procedures.
Interviewee 7	Qatar	We operate within the second and third lines of defence. Our role involves reporting to the Sharia committee, essentially serving as the secretariat. We conduct audits on transactions and documentation, and we assess products both before and after their launch.
Interviewee 8	Qatar	We are responsible for ensuring Sharia compliance, conducting internal Sharia audits, overseeing product development, providing Sharia training to staff, and managing Sharia non-compliance risk.
Interviewee 9	Saudi Arabia	We do product development, Sharia compliance, providing Sharia training to colleagues and Sharia audit.

Interviewee 10	Saudi Arabia	To be a representative of the Sharia supervisory committee at the bank and to provide assurance to the Sharia committee about the bank's commitment to compliance with Sharia.
Interviewee 11	UAE	To independently conduct Sharia audits and ensure the bank is compliant with Sharia principles.
Interviewee 12	UAE	Arrange the internal Sharia audit plan and independently conduct the audit. Additionally, we are required to organize any internally required documentation such as the internal Sharia audit manual and Sharia audit charter.
Interviewee 13	UAE	To provide assurance to the Sharia committee and the management that the bank is compliant with Sharia principles, and if there were any breaches, to ensure that controls are in place to avoid similar issues in the future.
Interviewee 14	UAE	To achieve the internal Sharia audit plan, as approved by the Sharia committee and board audit committee, we collaborate with relevant departments to ensure that audit issues are properly addressed and closed in a timely manner.

Analysis of the main roles and responsibilities of the Internal Sharia Audit department

1- Sharia Compliance Oversight:

Internal Sharia audit serves as a vital component in ensuring that all activities and transactions within the bank are compliant with Sharia principles. This includes verifying adherence to fatwas issued by the Sharia committee and ensuring alignment with Sharia guidelines.

2- Vigilant Oversight and Reporting:

Internal Sharia audit acts as a vigilant oversight function, promptly reporting any activities or occurrences that deviate from Sharia principles to the Sharia Supervisory Committee or within the bank. This role emphasises the importance of timely detection and reporting of non-compliance issues.

3- Evaluation and Assurance:

Internal Sharia audit is tasked with evaluating the bank's adherence to Sharia principles, both in terms of internal Sharia review processes and the activities of the Sharia committee. The department provides assurance to the Sharia committee and management regarding the bank's commitment to Sharia compliance.

4- Everything related to Sharia :

In Qatar and Saudi Arabia the internal Sharia audit is responsible for everything related to Sharia such as Sharia compliance, Sharia audit, product development and Sharia training. This may create conflict of interest in doing all of these activities and may weaken the Sharia audit function.

5- Risk Management and Control Implementation:

Internal Sharia audit plays a role in managing Sharia non-compliance risk within the bank. In cases of breaches, internal Sharia audit ensures that controls are in place to address issues and prevent similar occurrences in the future. This highlights the department's contribution to risk mitigation and control implementation.

Overall, the responses highlight the complex nature of internal Sharia audit's roles and responsibilities, encompassing and indicate that no consistency in the roles and responsibilities' of the internal Sharia audit department.

7.2.4 The qualities of the internal Sharia audit with regard to aspects such as competency, autonomy, and confidentiality mechanisms.

This title is designed to explore the various aspects of the internal Sharia audit, specifically focusing on three important aspects: competence, independence, and confidentiality. Each aspect is addressed by two questions to gather valuable insights from internal Sharia auditors. The objective of this section is to assess the extent of independence, competency, and confidentiality upheld by the internal Sharia audit department.

7.2.4.1 Competence

Question 7: Is the bank's Internal Sharia Audit staff trained on a regular basis? And is there any assessment or evaluation of the head of internal Sharia audit?

Focused coding:

- Coding 1: Regular training sessions for internal Sharia audit staff.
- Coding 2: The absence or limited access to regular training opportunities for internal Sharia audit staff.
- Coding 3: Periodic assessments and evaluations of internal Sharia audit staff by various entities.

Theme: The interviewees recognise the importance of investing in the professional development of internal Sharia audit **staff to maintain competence and effectiveness in Sharia auditing. This includes providing regular training sessions to enhance knowledge and skills, both internally and externally, and conducting periodic assessments and evaluations to ensure accountability and continuous improvement.**

Table 15: Interviewees' answers for Question 7

Interviewee	Country	Answer
Interviewee 1	Bahrain	Yes, the internal Sharia audit staff need to enhance their knowledge regularly, and we send them to attend both internal and external training sessions to ensure they stay up to date with all developments in this field. There is an assessment conducted by Sharia committee and the CEO on regular bases.
Interviewee 2	Bahrain	Yes, indeed. We have set a career development plan for each staff member to ensure the progress in the capabilities. And yes there is annual assessment for the head of internal Sharia audit by the Sharia committee and the CEO.
Interviewee 3	Kuwait	Yes, the internal Sharia auditor attends regular training. Currently, in Kuwait, we have a qualification known as the "Certified Sharia Auditor Certificate" which is directly related to the procedures involved in conducting internal Sharia audits. A noteworthy aspect is that the Central Bank of Kuwait has mandated a regulatory requirement that all staff members in the internal Sharia audit department must

		possess this qualification. This qualification's strength lies in its alignment with actual practices.
Interviewee 4	Kuwait	After obtaining the certified internal Sharia auditor qualification from AAOIFI, the bank did not provide further training specifically related to internal Sharia audit. The assessment and evaluation of the head of Sharia is conducted with the CEO at the end of each year.
Interviewee 5	Oman	No, we do not attend regular trainings. However, there is a routine assessment conducted by the internal Sharia reviewer.
Interviewee 6	Oman	Indeed, all personnel within the Sharia department are mandated to hold certification as Sharia advisors and auditors from AAOIFI. Additionally, they are required to obtain the Islamic Finance Qualification from the Chartered Institute for Securities and Investment. The Sharia auditors also undergo an evaluation conducted by the internal Sharia reviewer.
Interviewee 7	Qatar	We have not received any training opportunities so far. Attending the Certified Internal Auditor (CIA) program would greatly benefit our internal Sharia auditors. Additionally, spending a brief period within each department would enhance their understanding of departmental activities. The CEO decided the rating of the head of Sharia audit at the end of the year in consultation with the Sharia Supervisory Committee.
Interviewee 8	Qatar	I am already certified by AAOIFI and possess various other qualifications. However, I have not undergone regular Sharia-related training. The assessment of the head of Sharia is typically conducted by the CEO.
Interviewee 9	Saudi Arabia	No regular training is arranged for the Sharia audit team.

Interviewee 10	Saudi Arabia	We do not have regular training for Sharia auditors, and the executives, jointly with the Sharia committee, assesses the work of the Sharia auditors.
Interviewee 11	UAE	Yes, we are subject to regular training. The assessment and evaluation of the Head of Internal Sharia Audit are conducted by the Sharia Committee and the board audit committee.
Interviewee 12	UAE	Yes, it is required for all internal Sharia auditors to attend the Certificate in Sharia Advising and Auditing qualification issued by AAOIFI. The assessment is conducted by the Sharia Supervisory Committee.
Interviewee 13	UAE	It is required for us to complete the Certified Sharia Advisor and Auditor certification issued by AAOIFI. The head of the Sharia audit department is assessed by both the internal audit committee and the Sharia committee.
Interviewee 14	UAE	Yes, we attend regular training, and assessments are typically arranged by the audit committee and the Sharia supervisory committee.

Analysis of the competency of the Internal Sharia auditors

1- Regular Training for Internal Sharia Audit Staff:

Responses indicate a varied approach to training for internal Sharia audit staff. While some Islamic banks in some countries prioritise regular training sessions to enhance staff knowledge and keep them updated with developments in the field of Sharia audit, others note a lack of regular training opportunities. Training programs mentioned include internal and external sessions, certifications such as the Certified Sharia Auditor Certificate and the Certificate in Sharia Advising and Auditing issued by AAOIFI, and qualifications such as the Certified Internal Auditor (CIA) program.

The requirement for staff members to hold certifications from AAOIFI and other relevant qualifications underscores the importance placed on professional development within internal Sharia audit departments.

2- Assessment and Evaluation of Internal Sharia Audit Staff:

Interviews reveal that assessments and evaluations of internal Sharia audit staff are conducted periodically, typically by the Sharia committee, CEO, and internal board audit committee. These evaluations help in assessing the performance, competence, and effectiveness of internal Sharia audit staff members in fulfilling their roles and responsibilities. Some Islamic banks conduct routine assessments of the head of internal Sharia audit to ensure accountability and effectiveness in leadership roles within internal Sharia audit departments.

When the executives or the CEO assesses the work of the internal Sharia audit function, such as the response from Qatar, Saudi Arabia, and Bahrain, this raises a question mark about the independence and the efficiency of the internal Sharia audit in these countries.

3- Challenges in Training and Development:

Some interviewees express challenges or limitations in accessing training opportunities for internal Sharia audit staff, highlighting the need for ongoing support and investment in professional development initiatives. Suggestions for enhancing training effectiveness include participation in programs like the CIA program and gaining exposure to departmental activities through cross-functional rotations.

Question 8: What are the most important fit and proper criteria for the Head of the Internal Sharia Audit department?

Focused coding:

- Coding 1: Dual expertise in Sharia and audit
- Coding 2: Educational background, experience, and regulatory approval
- Coding 3: Language proficiency, business understanding, and continuous professional development

Theme: The role of the head of Sharia audit demands mastery in Sharia law, internal auditing, and other essential skills. Proficiency in these areas is crucial for ensuring comprehensive compliance and effective oversight within the Islamic bank.

Table 16: Interviewees' answers for Question 8

Interviewee	Country	Answer

Interviewee 1	Bahrain	They need qualifications in both Sharia and audit. Without knowledge in Sharia, the Sharia auditor might rely solely on checklists, missing potential clear Sharia non-compliance issues. A strong understanding of Sharia is essential for accurate Sharia auditing.
Interviewee 2	Bahrain	Sharia qualification, professional qualification, business/activity understanding and English language.
Interviewee 3	Kuwait	In my opinion, the internal Sharia audit should require qualifications in both auditing and a foundational understanding of Sharia. Possessing these skills would significantly enhance the efficiency and quality of the Sharia audit process. According to the central bank of Kuwait any one with qualification of Sharia, law, business or relevant qualification can work in the internal Sharia audit department. In conditions, to have experience in this filed.
Interviewee 4	Kuwait	In my view, the head of Sharia should possess knowledge in business, banking, human resources, audit, and Sharia.
Interviewee 5	Oman	In my perspective, individuals in this role should possess qualifications in both Sharia and audit. However, the current practice allows for some flexibility to be the Islamic bank to choose.
Interviewee 6	Oman	In our bank, the selection criteria for Sharia auditors primarily revolve around their educational background and prior experience working within Islamic banking institutions.
Interviewee 7	Qatar	The paramount "fit and proper" criterion is obtaining approval from the Sharia committee.
Interviewee 8	Qatar	To be well-equipped, it's essential to comprehend banking products, operations, and attain certification as a Sharia advisor and auditor from AAOIFI.

Interviewee 9	Saudi Arabia	The most crucial aspect is to have an AAOIFI-certified internal Sharia auditor. However, many current practitioners build their experience while on the job. In my view, experience holds more significance than qualifications
Interviewee 10	Saudi Arabia	To be qualified in Sharia principles and to find Sharia-compliant solutions for banking products.
Interviewee 11	UAE	In my view, the most important fit and proper criteria are to have experience and knowledge in auditing. Once they master auditing, the Certified Sharia Advisor and Auditor qualification offered by AAOIFI is more than enough to know how to conduct Sharia audits.
Interviewee 12	UAE	The Head of Internal Sharia Audit must be approved by the central bank to ensure that he or she meets the proper fit and proper criteria to perform the job correctly.
Interviewee 13	UAE	The Sharia auditor must understand the banking sector, have a general understanding of audit procedures, and, above all, possess Sharia knowledge.
Interviewee 14	UAE	The most important criteria include having a business background and qualifications issued by AAOIFI, such as certification as a Sharia advisor and auditor. Additionally, possessing qualifications in Sharia would be beneficial, as it would help save time for both Sharia scholars and the Islamic bank.

Analysis of the fit and proper criteria for the head of Sharia audit:

1- Sharia and Audit Qualifications:

The majority of interviewees emphasise the importance of possessing qualifications in both Sharia and audit. This dual expertise ensures a comprehensive understanding of both Sharia principles and internal audit methodologies, which is crucial for accurate and effective Sharia auditing.

2- Educational Background and Experience:

Many interviewees highlight the importance of educational background and prior experience in the field. Candidates are expected to have a strong foundation in Sharia, business, banking, and audit, as well as relevant professional certifications from Islamic banks such as AAOIFI.

3- Approval from Sharia Committee or Regulatory Authorities:

Some interviewees mention the necessity of obtaining approval from the Sharia committee or regulatory authorities as a crucial fit and proper criterion. This endorsement ensures that candidates meet the required standards and are deemed capable of fulfilling the responsibilities of the role.

4- Language Proficiency and Business Understanding:

Language proficiency, particularly in English, is mentioned as an important criterion, given the international nature of Islamic finance. Additionally, candidates are expected to have a solid understanding of banking products, operations, and business activities.

5- Experience vs. Qualifications:

There is a varying emphasis on the relative importance of experience and qualifications. While some interviewees prioritise qualifications such as AAOIFI certification, others highlight the significance of practical experience gained on the job.

Overall, the responses reflect a consensus on the importance of a multidimensional skill set combining Sharia knowledge, audit expertise, educational qualifications, language proficiency, and regulatory compliance for individuals assuming leadership roles in Internal Sharia Audit departments within Islamic banks.

7.2.4.2 Independence

Question 9: Who is responsible for setting up and dismissing the Internal Sharia Audit department?

Focused coding:

- Coding 1: Sharia committee / Sharia Reviewer
- Coding 2: CEO
- Coding 3: Board of Directors / Audit Committee
- Coding 4: Central Bank / Regulatory Authorities

Theme: There is no single party responsible for establishing and dismissing the Internal Sharia Audit department in the GCC. In some cases, this responsibility falls on the Sharia committee, Sharia reviewer, CEO, board of directors, audit committee, central bank, regulatory authorities, or depending on the country.

Table 17: Interviewees' answers for Question 9

Interviewee	Country	Answer
Interviewee 1	Bahrain	The Sharia committee is responsible for appointing and dismissing the internal Sharia auditor, in consultation with the executives of the Islamic bank. Any report will send to the Sharia committee will also be sent the board so the auditor will have more power in the bank.
Interviewee 2	Bahrain	The CEO in consultation with Sharia Supervisory Committee.
Interviewee 3	Kuwait	The appointment of the Head of Internal Sharia Audit is initiated by the Board of Directors and finalised by the CEO in coordination with the Sharia Committee. As such, the CEO retains the authority to remove the Head of Internal Sharia Audit; however, this decision necessitates justification presented to both the Board and the Sharia Committee.
Interviewee 4	Kuwait	The Board Audit Committee and the CEO
Interviewee 5	Oman	The internal Sharia auditor reporting to the Sharia reviewer, who also manage the Sharia compliance function. Consequently, auditing the Sharia compliance function becomes complex in Oman, as the audit report could be subject to modifications by the internal Sharia reviewer prior to its submission to the Sharia committee or board audit committee.
Interviewee 6	Oman	The internal Sharia reviewer reports directly to the Sharia board. The Sharia reviewer manage various functions, including Sharia

		compliance, internal Sharia audit, and managing Sharia non-compliance risks. As part of their responsibilities, the Sharia reviewer is in charge of appointing and dismissing internal Sharia auditors.
Interviewee 7	Qatar	The Sharia audit function reports functionally to the Sharia committee and administratively to the CEO. They are both responsible for appointing and dismissing the head of internal Sharia audit.
Interviewee 8	Qatar	The CEO, in collaboration with the board and Sharia committee.
Interviewee 9	Saudi Arabia	The internal Sharia audit function reports administratively to the CEO and functionally to the Sharia committee.
Interviewee 10	Saudi Arabia	Unfortunately, in Saudi Arabia, we do not have independence when it comes to Sharia auditors. On paper, the Sharia committee is responsible for selecting and dismissing the Sharia auditor. However, in reality, one requirement for the Sharia auditor at my bank is to be a member of the teaching staff at a Saudi university. So, if the Sharia auditor is fired due to disagreement with the management regarding Sharia, the auditor has another job at the university.
Interviewee 11	UAE	The board audit committee and the centralized Sharia supervisory committee in the central bank.
Interviewee 12	UAE	The board of directors oversees the audit committee of the bank. However, even if the board wishes to appoint or dismiss the internal Sharia auditor, the central bank will arrange a meeting with the internal Sharia audit to ensure there are no concerns from a Sharia perspective.
Interviewee 13	UAE	The audit committee, the Sharia supervisory committee, and the Central Bank of the UAE. The head of the Sharia auditor could be approved by the Bank, but the central bank might reject the appointment if they feel that the head of Sharia audit does not have enough experience or knowledge.

Interviewee 14	UAE	The involvement of the board, the board audit committee, and the Sharia supervisory committee strengthens the internal Sharia audit in the UAE. However, reporting directly to the Central Bank of the UAE would enhance its strength further. Currently, we operate with relative independence, but reporting to the board and the board audit committee means we are under the Islamic bank, and our salaries come from this Islamic bank. This situation could potentially create conflicts of interest.

Analysis of the independence

1- Authority of Sharia Committee and CEO:

The Sharia committee plays an important role in appointing and dismissing the internal Sharia auditor in many Islamic banks. This highlights the committee's authority in ensuring Sharia compliance and governance within the organisation. Additionally, the CEO often collaborates with the Sharia committee in making such decisions, indicating a dual oversight structure involving both management and Sharia governance bodies. However, this may lead to weak practices, as the internal Sharia auditor would have to audit the CEO's practices. If the CEO has the authority to appoint and dismiss the auditor, it may create a lack of independence, as seen in the case of Qatar and Bahrain.

2- Involvement of Board of Directors and Audit Committee:

In some cases, the Board of Directors, particularly through its audit committee, holds significant authority in the appointment and dismissal processes. This reflects the importance of corporate governance and oversight functions in ensuring the effectiveness and independence of the internal Sharia audit department. This practice would align such Islamic banks with AAOIFI governance standards.

3- Central Bank Oversight and Regulatory Compliance:

In the UAE, the involvement of the central bank or regulatory authorities is emphasised. This highlight the regulatory oversight and compliance requirements imposed on Islamic banks, highlighting the importance of aligning internal Sharia audit practices with regulatory standards. When regulators are involved in the appointment and dismissal of the Sharia audit, this would give strong power to the Sharia auditor, but at the same time, they may be treated more as police officers rather than as part of the team.

4- Complexities in Appointment and Dismissal:

Some interviewees mentioned complexities and challenges associated with the appointment and dismissal processes. For instance, in Saudi Arabia, the independence of Sharia auditors may be compromised due to certain requirements, such as being a member of the teaching staff at a university, potentially impacting their independence and objectivity. If the Sharia auditor disagrees with the management of the bank, he or she should expect that the management would dismiss him or her, raising questions about the power Sharia auditors have in Saudi Arabian Islamic banks.

5- Role of Sharia Reviewer:

In Oman, the internal Sharia auditor reports to the Sharia reviewer, indicating a hierarchical structure within the Sharia governance framework. This arrangement may have implications for the independence and objectivity of the internal Sharia audit function, as the Sharia auditor's reports could be subject to modifications by the Sharia reviewer before it goes to the Sharia committee of to the board.

Overall, the responses highlight the complex relationship between organizational dynamics, regulatory requirements, and governance mechanisms in shaping the establishment and operation of internal Sharia audit departments within Islamic banks.

Question 10: Who is responsible for the ongoing/day-to-day monitoring of the Islamic bank’s overall activities and Sharia compliance environment?

Focused coding:

- Coding 1: Sharia Compliance Department
- Coding 2: The internal Sharia audit Department
- Coding 3: Reliance on External Consultancy Firms

Theme: majority of the interviewees highlighted the critical functions performed by Sharia Compliance Departments in overseeing daily operations and upholding adherence to Sharia principles.

Table 18: Interviewees' answers for Question10

Interviewee	Country	Answer
Interviewee 1	Bahrain	The Sharia compliance department, is responsible for the ongoing day-to-day activities, which is separate from the internal Sharia audit function.
Interviewee 2	Bahrain	The Head of internal Sharia compliance department, as in Bahrain the CBB separated the two functions.
Interviewee 3	Kuwait	The Sharia compliance department is responsible for ensuring the compliance with Sharia in the day-to-day activities.
Interviewee 4	Kuwait	The Central Bank of Kuwait allows Islamic banks to rely on financial consultancy firms to handle Sharia compliance and conduct Sharia audits. However, I believe this approach could potentially weaken the effectiveness of Sharia audits. While these external companies may produce the same Sharia audit report, the overall quality and scope of the work might not meet expectations. In the long run, many Islamic banks might opt for such external firms due to cost-effectiveness and reduced management involvement.
Interviewee 5	Oman	This is under the role of Sharia compliance which reports to the Sharia reviewer
Interviewee 6	Oman	Sharia compliance and the Sharia reviewer function
Interviewee 7	Qatar	The Sharia audit department operates within the second and third lines of defence.
Interviewee 8	Qatar	The head of Sharia, who is responsible for all matters related to Sharia.
Interviewee 9	Saudi Arabia	The Sharia department is responsible for everything related to Sharia including Sharia audit and Sharia compliance
Interviewee 10	Saudi Arabia	The Sharia department, which is also responsible for conducting the Sharia audit.

Interviewee 11	UAE	The Sharia compliance department
Interviewee 12	UAE	The Sharia compliance department
Interviewee 13	UAE	The Sharia compliance department
Interviewee 14	UAE	At some point in the UAE, the Sharia department used to be responsible for everything related to Sharia. However, after the issuance of standards by the Central Bank related to Sharia governance, Islamic banks were mandated to separate Sharia compliance from the internal Sharia audit function.

Analysis of the responsibility for ongoing sharia compliance monitoring

1- Role of Sharia Compliance Department:

Across multiple responses, the Sharia compliance department emerges as the primary entity responsible for overseeing day-to-day activities and ensuring compliance with Sharia principles such as the case in UAE. This department plays a crucial role in monitoring various aspects of the Islamic bank's operations to align them with Sharia requirements.

2- Sharia Reviewer's Role:

In Oman, the Sharia reviewer is mentioned as being responsible for ongoing monitoring. This highlights the importance of having dedicated personnel tasked with assessing and ensuring Sharia compliance on a continuous basis.

3- Separation of Sharia Compliance and Audit Functions:

In jurisdictions like Bahrain and the UAE, there is a distinct separation between the Sharia compliance and internal Sharia audit functions. This separation is mandated by regulatory standards to enhance governance and ensure independence in Sharia compliance assessments.

4- Concerns about External Consultancy Firms:

One interviewee from Kuwait expressed concerns about the reliance on external financial consultancy firms for Sharia compliance. While these firms may handle compliance with Sharia, there are concerns about the quality and scope of their work, which could potentially weaken the effectiveness of Sharia audits. As these external companies would only have access to the data and documents sent to them by the management.

5- Responsibility of the Head of Sharia:

In Qatar, the head of the Sharia department is mentioned as being responsible for overseeing all matters related to Sharia. This underscores the leadership role in ensuring adherence to Sharia principles throughout the Islamic bank's activities. However, the Sharia audit department's position within the second and third lines of defence may create a conflict of interest and make the Sharia audit less effective.

6- Regulatory Mandates:

The mention of regulatory mandates, such as those issued by the Central Bank in the UAE regarding Sharia governance standards, highlights the influence of regulatory authorities in shaping the organisational structure and responsibilities within Islamic banks.

Overall, the responses reflect the diverse approaches adopted by Islamic banks in allocating responsibilities for ongoing monitoring of activities and ensuring Sharia compliance. These approaches are influenced by regulatory requirements, organisational structures, and the perceived effectiveness of internal control mechanisms.

7.2.4.3 Confidentiality

Question 11: Does the Internal Sharia Audit department have full and unrestricted access to all documents and records?

Focused coding:

- Coding 1: Unrestricted Access to Documents
- Coding 2: Access Contingent on Sharia Audit Plan

Theme: While there is a general agreement on unrestricted access, there are also considerations for scope, strategic alignment, and Sharia audit plan.

Table 19: Interviewees' answers for Question 11

Interviewee	Country	Answer
Interviewee 1	Bahrain	The internal Sharia auditors have full and unrestricted access to all documents required to conduct the Sharia audit, as long as it is within the scope of their Sharia audit plan
Interviewee 2	Bahrain	Yes, we have full and unrestricted access
Interviewee 3	Kuwait	Yes, the internal Sharia auditors have the same authority as internal auditors, and any information available to the internal auditors is also available to the internal Sharia auditor.
Interviewee 4	Kuwait	Yes, the internal Sharia audit department has full access to the required documents as long as they are necessary to execute the Sharia audit plan.
Interviewee 5	Oman	Yes, we do have complete access.
Interviewee 6	Oman	In 99% of cases, we receive the information we require. However, certain details concerning staff salaries are not accessible to us. Nonetheless, it is important to note that this specific information is not essential for our purposes
Interviewee 7	Qatar	In general, yes, we have full access.
Interviewee 8	Qatar	Yes, to a certain extent, as long as the audit is requested by the Sharia committee.
Interviewee 9	Saudi Arabia	Within the agreed audit plan, we will have access to the required documents for the audit.
Interviewee 10	Saudi Arabia	Yes, we do have full and unrestricted access as long as the access is needed to complete the Sharia audit plan.
Interviewee 11	UAE	Yes, as long as the documents are required to accomplish the internal Sharia audit plan.
Interviewee 12	UAE	Yes, we have full access to all required documents.
Interviewee 13	UAE	Yes, we do have full access to all required documents.
Interviewee 14	UAE	Yes, as long as the documents are necessary to complete the Sharia audit plan.

Analysis of the confidentiality of the Sharia auditors

1- Consistency in Access:

The majority of respondents affirm that the Internal Sharia Audit department has full and unrestricted access to the necessary documents and records. This consistency indicates a standard practice across various Islamic banks where Sharia auditors are granted adequate access to perform their duties effectively.

2- Scope Limitations:

Some respondents mention that access is dependent upon the documents being necessary to execute the Sharia audit plan. This indicates that while there is generally open access, there may be limitations based on the predefined scope of the audit.

In Qatar, one respondent mentions that access is granted as long as the audit is requested by the Sharia committee. This suggests that oversight by the Sharia committee may influence the extent of access granted to Sharia auditors, ensuring alignment with strategic objectives and priorities.

3- Exceptional Cases:

One respondent from Oman highlights that certain sensitive information, such as staff salaries, may not be accessible to Sharia auditors. However, they note that this information is not essential for their audit purposes, indicating a pragmatic approach to access restrictions.

4- Comparison with Internal Auditors:

In Kuwait, one respondent mentions that Sharia auditors have the same authority as internal auditors, indicating parity in access rights. This aligns with the principle of equity and fairness in granting access to auditors regardless of their specialisation.

In conclusion, the responses indicate a generally positive attitude towards granting Sharia auditors full access to documents and records necessary for their audits.

Question 12: What steps are taken to ensure the confidentiality of audit findings and sensitive information? How do you handle and safeguard the confidentiality of audit reports and related documents?

- Coding 1: Confidentiality Agreements
- Coding 2: Physical and Digital Security Measures
- Coding 3: Ethical Standards

Theme: Islamic banks adopt a comprehensive approach to safeguarding the confidentiality of Sharia audit findings and sensitive information. By combining confidentiality agreements, security measures, and ethical standards.

Table 20: Interviewees' answers for Question 12

Interviewee	Country	Answer
Interviewee 1	Bahrain	The internal Sharia auditor signs a confidentiality agreement upon joining the department, and all documents are stored in locked cabinets. Soft copies are protected by passwords. Breaching this confidentiality agreement can lead to legal action by the bank against the internal Sharia auditors
Interviewee 2	Bahrain	The report and the findings shared with the stakeholder only which are the head of department for their feedback then the Sharia Supervisory Committee, CEO and the Audit Committee for their information/action/guidance.
Interviewee 3	Kuwait	It is outlined in the Internal Sharia Audit manual that all Internal Sharia auditors are required to adhere to the code of ethics detailed within the manual. This code includes a dedicated section on the confidentiality of Sharia audits, which is regularly communicated to Internal Sharia auditors to ensure their familiarity with its provisions
Interviewee 4	Kuwait	We do not have any specific requirements related to confidentiality apart from relying on the ethical standards of the individuals themselves.
Interviewee 5	Oman	Information is only accessible to specific team members
Interviewee 6	Oman	We maintain robust security controls, such as the requirement for justification before sending any documents externally. It is crucial to emphasise that these measures apply not only to Sharia-related matters but also across all departments.

Interviewee 7	Qatar	Everything is stored securely, and any soft copy we want to send via email must be protected with a password.
Interviewee 8	Qatar	Sending documents outside the bank requires justification and even sending documents to the Sharia committee triggers an email block, released upon IT security manager's approval. Data is encrypted and password-protected, shared via secure communication. Sharia committee members sign confidentiality agreements, breaching which leads to legal consequences.
Interviewee 9	Saudi Arabia	Before commencing the internal Sharia audit, the team must sign a confidentiality agreement with the bank.
Interviewee 10	Saudi Arabia	Confidentiality is part of the agreement between the bank and the Sharia auditor.
Interviewee 11	UAE	The contracts of the internal Sharia employees ensure confidentiality, as do the terms of reference of the Sharia audit department.
Interviewee 12	UAE	We sign a confidentiality agreement before conducting the internal Sharia audit.
Interviewee 13	UAE	We sign a confidentiality agreement before we start the work at the internal Sharia audit department.
Interviewee 14	UAE	We deal directly with the head of the department, and we sign a confidentiality statement before starting the Sharia audit.

Analysis of how Islamic banks ensure confidentiality of audit findings and sensitive information

1- Confidentiality Agreements:

Many interviewees mention the requirement for internal Sharia auditors to sign confidentiality agreements upon joining the department or before commencing audits. This formal agreement serves as a legal measure to ensure the protection of sensitive information and audit findings.

2- Storage and Access Controls:

Several Islamic banks employ physical security measures such as storing documents in locked cabinets and implementing digital security measures like password protection for soft copies. These controls restrict access to authorised personnel, thereby safeguarding the confidentiality of audit reports and related documents.

3- Ethical Standards and Codes of Conduct:

In Kuwait the interviewees emphasize adherence to ethical standards and codes of conduct outlined in internal manuals or agreements. This includes provisions specifically addressing confidentiality of audit findings and sensitive information, ensuring that internal Sharia auditors are aware of their responsibilities in maintaining confidentiality.

4- Restricted Access to Information:

There is a consensus among respondents that access to information is restricted to specific team members or stakeholders directly involved in the audit process. This limitation ensures that only authorised individuals have access to sensitive information, minimizing the risk of unauthorized disclosure.

5- Stakeholder Involvement and Oversight:

Some Islamic banks involve stakeholders such as department heads, CEOs, audit committees, and Sharia committees in the review and dissemination of audit findings. This ensures accountability and oversight while maintaining confidentiality within the organization.

In conclusion, the responses highlight the multifaceted approach taken by Islamic banks to ensure the confidentiality of audit findings and sensitive information. By combining legal agreements, security measures, and ethical standards, these Islamic banks aim to uphold the integrity and confidentiality of their internal Sharia audit processes.

7.2.5 General assessment of the internal Sharia audit department

Compliance with audit ethical standards and the presence of quality assurance enhance the reliability and trust of stakeholders in the Sharia audit report. Furthermore, having both elements in place would contribute to the Islamic bank's better alignment with AAOIFI's internal Sharia audit standard.

To explore these aspects, the researcher has formulated two questions intended for the participants. The first question aims to gather information about the extent of compliance with audit ethical standards and how these standards contribute to the enhancement of audit quality. The second question is designed to investigate whether any quality assurance or assessments are carried out on the internal Sharia audit process and, if so, to explore the methods employed for conducting such assessments.

Question 13: Do you comply with any other audit or ethical standards? If so, what are the standards, and how do these standards improve your work?

- Coding 1: Not following any ethical standards
- Coding 2: Reliance on Internal Ethical Standards

Theme: The majority of the interviewees do not comply with any audit ethical standards. These approaches highlight the complexity of ethical considerations within the context of Sharia audit and Islamic banking practices.

Table 21: Interviewees' answers for Question 13

Interviewee	Country	Answer
Interviewee 1	Bahrain	No, we do not comply with any specific external ethical standards, but we adhere to our internal ethical standards that have been issued and approved by our Sharia board
Interviewee 2	Bahrain	No, as it is not required.
Interviewee 3	Kuwait	No, we do not fully conform to any particular set of ethical standards; nevertheless, we follow specific standards established by the IIA. In the past, we sought to engage with the IIA regarding the possibility of indicating our alignment with their standards and the adoption of industry best practices in our reports. However, our request was declined due to our partial adherence to their standards. Given our focus on Sharia audit, full compliance with IIA standards is unlikely. Therefore, it might be more suitable to establish an equivalent Islamic bank within Islamic banking, similar to the IIA.

Interviewee 4	Kuwait	No, we do not have any specific requirements to ensure compliance with ethical standards.
Interviewee 5	Oman	No, we do not comply with any ethical standards.
Interviewee 6	Oman	No, we do not comply with any ethical standards as it is not mandated by the regulators.
Interviewee 7	Qatar	No, we do not comply with any specific ethical standards. Ethics mainly stem from the values of the individuals involved.
Interviewee 8	Qatar	No we do not.
Interviewee 9	Saudi Arabia	No, we do not
Interviewee 10	Saudi Arabia	No, we do not comply with any ethical standards.
Interviewee 11	UAE	We comply with the ethical standards issued by the Chartered Institute of Internal Auditors, and these standards greatly improve our work and align us with the best industry practices.
Interviewee 12	UAE	We are in line with the standards issued by the Chartered Institute of Internal Audit.
Interviewee 13	UAE	Yes, we follow the standards issued by the Chartered Institute of Internal Audit Ethical Standards.
Interviewee 14	UAE	We do not comply with any ethical standards.

Analysis of the compliance with ethical standards

1- Non-Compliance and Lack of Requirements:

Majority of interviewees state that their Islamic banks do not comply with any specific external ethical standards. Reasons cited include the absence of regulatory mandates or requirements or internal requirements to do so.

2- Internal Ethical Standards:

Several interviewees mention adherence to internal ethical standards established and approved by their respective internal committees. This indicates a reliance on internally developed frameworks rather than external well-known standards.

3- Partial Compliance:

Some interviewees express partial compliance with external standards, such as those set by the Institute of Internal Auditors (IIA). However, challenges in fully aligning with these standards are cited, leading to discussions about the need for equivalent standards tailored to Islamic banking practices.

In conclusion, the responses highlight a diversity of approaches to ethical standards compliance within Islamic banks, ranging from non-compliance with any standards to reliance on internal frameworks or alignment with industry-recognized standards. It was clear that compliance with ethical standards is not sufficient in all countries and requires more development from relevant stakeholders, including AAOIFI, the regulators, and the management of Islamic banks.

Question 14: Is there any internal quality assurance or assessment conducted on your Internal Sharia Audit? If so, how do you conduct/assess such in-house quality checks?

- Coding 1: Absence of Formal Quality Assurance
- Coding 2: Recognition of Importance and Potential Benefits
- Coding 3: Informal Feedback Mechanisms

Theme: There is a pressing need for Islamic banks to address the absence of formal quality assurance processes for Internal Sharia Audit. While there is recognition of the potential benefits of such mechanisms, challenges and barriers to implementation exist, underscoring the complexity of ensuring the quality, consistency, and credibility of Sharia audit activities.

Table 22: Interviewees' answers for Question 14

Interviewee	Country	Answer
Interviewee 1	Bahrain	There is currently no quality assurance process in place for the internal Sharia audit. However, there is recognition of its importance for the future as quality assurance would ensure the currency of fatwas and documentation. A 'maker and checker'

		approach is suggested, where the Sharia audit serves as the maker and the quality assurance as the checker.
Interviewee 2	Bahrain	No proper quality assurance but we ran annual quality assessment by head of internal Sharia audit.
Interviewee 3	Kuwait	We do not have a formal quality assurance process, but we gather feedback from the auditee departments through surveys regarding the conducted Sharia audits. We use this feedback to enhance our department's performance. The surveys typically focus on the internal Sharia auditor rather than the audit itself. We administer these surveys quarterly or annually.
Interviewee 4	Kuwait	Currently, there is no quality assurance process in place for the internal Sharia audit within our bank.
Interviewee 5	Oman	Currently, only the Sharia reviewer audits the work of the internal Sharia auditors. However, we lack any quality assurance measures related to the internal Sharia audit function.
Interviewee 6	Oman	We do not conduct assessments of internal Sharia audit as we lack the expertise to carry out Sharia quality assurance.
Interviewee 7	Qatar	There is no formal quality assurance process in place. Additionally, there is an understanding between the internal audit and internal Sharia audit functions that they do not conduct audits on each other.
Interviewee 8	Qatar	No quality assurance on our work.
Interviewee 9	Saudi Arabia	No quality assurance
Interviewee 10	Saudi Arabia	We do not have quality assurance for the work of the internal Sharia auditors.
Interviewee 11	UAE	We do not do quality assurance for the internal Sharia audit.
Interviewee 12	UAE	No, there is no quality assurance on the work of internal Sharia auditors.

Interviewee 13	UAE	We do not have quality assurance on our work, and even it is not allowed for an internal auditor to check our work.
Interviewee 14	UAE	No one conducts quality assurance on our work, but sometimes the Sharia supervisory committee conducts reviews of our work. We proposed to the management to apply for ISO certification for the Sharia audit department, but our request was rejected due to the costs involved.

The analysis of the compliance with the quality assurance

1- Absence of Formal Quality Assurance:

The majority of interviewees indicate the absence of a formal quality assurance process for the Internal Sharia Audit within their Islamic banks. This suggests a gap in ensuring the effectiveness, accuracy, and consistency of Sharia audit activities.

2- Recognition of Importance:

Despite the absence of formal quality assurance mechanisms, some interviewees acknowledge the importance of such processes for ensuring the currency of fatwas, documentation, and overall performance improvement. There is recognition that quality assurance measures could enhance the credibility and reliability of Sharia audit functions.

3- Informal Feedback Gathering:

Some interviewees gather feedback from audited departments through surveys to assess the performance of internal Sharia auditors. However, these feedback mechanisms are informal and focused more on the auditors themselves rather than the audit processes or outcomes.

4- Limited Expertise:

Several interviewees mention a lack of expertise to carry out Sharia quality assurance, indicating potential challenges in implementing effective internal assessment processes tailored to Sharia audit requirements.

5- Restricted Oversight:

There are instances where internal audit functions are not allowed to check the work of internal Sharia auditors, nor can the Sharia auditor audit the work of the internal auditors. This makes it less likely for improvements to occur in the work of both functions.

In conclusion, the absence of formal quality assurance processes for Internal Sharia Audit across the interviewed Islamic banks underscores a potential area for improvement in ensuring the quality, consistency, and credibility of Sharia audit activities.

7.2.6 The Sharia audit approach and operational procedure

The Sharia audit approach and operational procedures are crucial elements when conducting a Sharia audit. The audit approach pertains to the overarching strategy employed by internal Sharia auditors for conducting the audit, while operational procedures encompass the specific steps undertaken by these auditors during the audit process.

Four questions have been asked in this section to explore the commonly used Sharia audit approach, examine the documents utilised in the Sharia audit function, assess the current utilisation of technologies, and gather practitioners' opinions on the viability of implementing a unified approach for Sharia audits. The objective of this section is to assess the existing audit approach and operational procedures.

Question 15: Could you explain the current Internal Sharia Audit approach?

- Coding 1: Departmental vs. Product-Based Approach
- Coding 2: Risk-Based Sharia Audit Approach
- Coding 3: Sampling Methodologies

Theme: There is no one-size-fits-all approach to Internal Sharia Audit approach, and Islamic banks tailor their approach to suit their unique needs and priorities.

Table 23: Interviewees' answers for Question 15

Interviewee	Country	Answer
Interviewee 1	Bahrain	Currently, we select samples from activities, products, systems, or documentation and conduct audits based on the Sharia audit plan. While there's always room for improvement, I can't think of any specific enhancements at the moment.

Interviewee 2	Bahrain	We do test sample basis. By using the technology and the AI we could increase the sample size.
Interviewee 3	Kuwait	In my perspective, the results of the Sharia audit would remain consistent whether the focus is on individual products or departments. For instance, if the audit targets specific products, it should also encompass the pertinent departments related to those products concurrently. The critical factor is to establish a well-structured audit plan, delineating the areas to be covered throughout the year.
Interviewee 4	Kuwait	We conduct the Sharia audit based on a departmental approach. When initiating the audit, we request relevant documents from the respective departments and proceed with the audit based on the information provided by these departments.
Interviewee 5	Oman	We conduct our Sharia audit by focusing on individual departments, which allows us to comprehensively review the products associated with each department.
Interviewee 6	Oman	Our audit approach follows the internal Sharia audit plan, which has been approved by the Sharia committee. According to the plan, we choose a sample of transactions to verify compliance with Sharia principles. Our bank deals with both small and large transactions. For small transactions, we conduct a comprehensive 100% sample review. In the case of large transactions, we select a representative sample for assessment.
Interviewee 7	Qatar	Our approach involves sampling products and transactions, primarily collaborating with the commercial and operational teams. We do not engage with the risk function when it comes to Sharia audit.
Interviewee 8	Qatar	During the Sharia audit, we encompass all departments and products, selecting samples from each to ensure full compliance with Sharia principles.

Interviewee 9	Saudi Arabia	We follow risk based approach to conduct the Sharia audit.
Interviewee 10	Saudi Arabia	We use an internal Sharia audit risk approach as it provides indicators for the level of Sharia non-compliance risk within the Islamic bank. We have divided the Sharia non-compliance risk into four types: the risk of Sharia governance framework, the Sharia non-compliance risk of the investment, the risk of operations, and the risk of reputation. At the end of the year, we assess the risks that occurred for each type of these risks.
Interviewee 11	UAE	We conduct the Sharia audit using a risk-based approach, and during the audit, we examine the departments rather than focusing solely on products, which provides a more comprehensive approach.
Interviewee 12	UAE	We follow a risk-based approach, assessing risks when arranging the Sharia audit plan, resulting in risk ratings for each department. Once we conduct the audit for each department, we perform another risk assessment to determine where to focus more attention within the department. The Sharia audit is department-based rather than product-based to optimise departmental time and resources.
Interviewee 13	UAE	We start the Sharia audit with the highest-risk departments, such as sales and credit, and leave the lowest-risk departments, such as HR and IT, until the end.
Interviewee 14	UAE	We employ a risk-based approach for departments rather than products. The higher the risk associated with a function, the more attention we give to Sharia compliance. During our Sharia audits for each department, we assess the products they are responsible for, including examining documentation, systems, and the department's understanding of Sharia compliance. One challenge with this approach is that any Sharia issues we find may be limited to the department we are auditing and the specific product they

		handle. However, there may be Sharia issues in other departments that go unnoticed. If we were to conduct audits based on products, we could potentially highlight Sharia issues related to the product across different departments.

Analysis of the internal Sharia audit approach

1- Departmental vs. Product-Based Approach:

Some interviewees adopt a departmental approach, focusing their audits on specific departments within the organization. This allows for a comprehensive review of all activities and products associated with each department. In contrast, others prioritise a product-based approach, selecting samples of transactions or products for assessment. Each approach has its advantages and challenges, with the departmental approach offering a broader scope but potentially overlooking specific product-related issues.

2- Risk-Based Approach:

A significant number of interviewees utilise a risk-based approach to Sharia audit, where audits are prioritised based on the level of risk associated with each department or activity. This approach allows auditors to allocate resources more efficiently by focusing on high-risk areas first, ensuring that critical issues are addressed promptly.

3- Sampling Methodologies:

Many interviewees employ sampling methodologies to conduct Sharia audits, selecting representative samples of transactions or products for assessment. Some mention the use of technology and AI to increase the sample size, potentially enhancing the comprehensiveness of the audit process.

4- Continuous Improvement:

While some interviewees express satisfaction with their current audit approach, others acknowledge the need for improvement and suggest potential enhancements, such as utilising technology for sample selection or refining the risk assessment process. Continuous evaluation and adjustment of the audit approach are essential for optimising effectiveness and adapting to evolving regulatory requirements and industry best practices.

Overall, the responses show a variety of audit methods and approaches adapted to the specific needs and priorities of each Islamic bank. Eventually, all Islamic banks will issue a Sharia certificate at the end of the year to confirm their compliance with Sharia principles. However, the differences in Sharia audit approaches could significantly affect the actual Sharia compliance of these banks.

Question 16: Are there any documents you file for the Internal Sharia Audit (audit manual/an audit charter/audit plan)?

- Coding 1: Audit Manual
- Coding 2: Audit Charter
- Coding 3: Audit Plan
- Coding 4: Checklists and Lists of Documents

Theme: There are inconsistencies in the documents kept by the internal Sharia auditors, but there is a clear link between a strong internal Sharia audit function and better documentation maintained by this function.

Table 24: Interviewees' answers for Question 16

Interviewee	Country	Answer
Interviewee 1	Bahrain	Yes, we have a comprehensive Sharia review plan, conducted annually or semi-annually depending on the situation. The plan requires approval from the Sharia board to ensure their confidence in the audit process and the subsequent issuance of the annual certificate. Additionally, our Sharia audit encompasses lists of necessary documents for each department and product, as well as associated checklists, all endorsed by the Sharia committee. Furthermore, we possess an audit manual and audit charter.
Interviewee 2	Bahrain	Yes, all the mentioned documents Charter: independency, objectives, authorities & responsibilities Manual: organisational structure, Audit procedures, reporting.

		Plan: scope, audit universe, sample selection & risk assessment.
Interviewee 3	Kuwait	We have all of these documents, and further details about the contents of these are available in the Certified Sharia Advisor Certificate book.
Interviewee 4	Kuwait	We currently have an audit plan that outlines the departments to be audited, the timeframe for each audit, and the progress of completed audits.
Interviewee 5	Oman	We have a yearly audit plan that is approved by the Sharia board. This plan outlines the necessary audits to be conducted throughout the year.
Interviewee 6	Oman	We maintain two lists of documents for our internal Sharia audit process. The first list serves as guidance and includes documents such as the internal Sharia audit manual, the internal Sharia audit charter, and the internal Sharia audit plan. These documents provide us with direction and a framework for our audits. The second list consists of checklists that are tailored to each specific audit. These checklists help us ensure that we cover all relevant aspects of the audit in a systematic manner.
Interviewee 7	Qatar	We operate with an annual audit plan endorsed by the Sharia committee, encompassing the scope of work, the assessment of ongoing deals, and the deadlines for completing the Sharia audit. This plan is our sole guiding document.
Interviewee 8	Qatar	Indeed, we possess an internal Sharia audit manual, an internal Sharia audit plan, and an audit charter. Additionally, we maintain checklists and lists of required documents for each product and department.
Interviewee 9	Saudi Arabia	We have only internal Sharia audit plan and it includes what we are planning to audit during the year.
Interviewee 10	Saudi Arabia	We only have an audit plan that covers what we want to audit during the year, and it is approved by the Sharia committee and the management.

Interviewee 11	UAE	Yes, we have audit manual and audit charter and audit plan.
Interviewee 12	UAE	Yes, we have an internal Sharia audit manual, audit plan, and audit charter.
Interviewee 13	UAE	We have an audit manual, Sharia audit charter, and internal Sharia audit plan.
Interviewee 14	UAE	Yes, we have audit manual, audit charter and audit plan and Sharia policy.

Analysis the documentations used by the Sharia auditors

1- Audit Manual:

The audit manual outlines the organizational structure, audit procedures, and reporting mechanisms. It serves as a comprehensive guide for internal auditors, detailing the processes and methodologies to be followed during audits. Not all participant have a Sharia audit manual in their Sharia audit function such as the case in Kuwait and Saudi Arabia.

2- Audit Charter:

The audit charter defines the independence, objectives, authorities, and responsibilities of the Internal Sharia Audit function. It establishes the framework within which audits are conducted and delineates the scope of the audit function's activities. Also, not all participants mentioned they have audit charter which may weaken the Sharia audit function.

3- Audit Plan:

The audit plan delineates the scope of the audit, the audit universe, sample selection criteria, and risk assessment methodologies. The plan serves as a roadmap for audit activities, guiding auditors in prioritizing their efforts and resources effectively. All participants mentioned they have a Sharia audit plan which is very important to know what they should cover in their Sharia audit.

4- Checklists and Lists of Documents:

Checklists and lists of required documents provide guidance and structure for auditors during the audit process. These documents help maintain consistency and completeness in audit activities, facilitating thorough assessments of compliance with Sharia principles. Also, not all participants mentioned they have checklists and list of required documents which may create inconsistency in the way the Sharia audit conducted based on the auditors doing the Sharia audit.

Overall, the documentation maintained by Islamic banks for Internal Sharia Audit processes encompasses comprehensive frameworks and guidelines to ensure effective and systematic audit activities. These documents play a crucial role in maintaining consistency, transparency, and compliance with regulatory requirements in Sharia audit practices. However, based on the above responses, still a lot to be done when it comes to the documentations maintained by the internal Sharia auditors.

Question 17: Considering the rise of financial technology, does your department plan on or have already started encouraging modern technical software for the Sharia audit? If so, what is the software, and how could technology improve the Internal Sharia Audit work?

- Coding 1: Lack of Technological Integration
- Coding 2: Potential Benefits of Technology

Theme: There is a current lack of specialised technological solutions. However, there is recognition of the potential benefits and a willingness to explore opportunities for technological integration in the future.

Table 25: Interviewees' answers for Question 17

Interviewee	Country	Answer
Interviewee 1	Bahrain	The choice of technology would vary based on the Islamic bank. Unfortunately, we do not currently employ any specific technology for conducting the internal Sharia audit
Interviewee 2	Bahrain	We do not use a proper technology to conduct the audit but currently we have built our own excel sheet for planning stage. Also, we discussed with IT department the possibilities of having an internal Sharia audit software that could cover the planning, execution, reporting and follow up stages. Moreover, we got

		benefit from the new archiving system that could lead us to full access to transaction documents and apply e-audit process without requesting the original files.
Interviewee 3	Kuwait	In my perspective, we are currently distant from possessing adequate technology to facilitate the internal Sharia audit. Prior to adopting any technology, it is crucial to establish a well-defined process for conducting the Sharia audit. Without standardized processes and a unified approach to Sharia audit procedures, the implementation of effective technology remains unfeasible. Sometimes we use teammate audit software but this is relevant to normal audit not Sharia audit and we use it only to organise our work not to conduct the Sharia audit.
Interviewee 4	Kuwait	We do not utilise any technology for carrying out the internal Sharia audit.
Interviewee 5	Oman	We do not utilise any technology for internal Sharia audit.
Interviewee 6	Oman	No we do not use any technologies
Interviewee 7	Qatar	Currently, our approach doesn't involve utilizing technology. We rely on systems primarily for archiving purposes. However, there's significant potential for technology to greatly enhance the effectiveness of Islamic banking. Implementing technological controls on transactions could significantly enhance the assurance of Sharia compliance.
Interviewee 8	Qatar	We refrain from utilizing technology to carry out the Sharia audit; however, we employ certain systems to facilitate our tasks, including Salesforce and data storage.
Interviewee 9	Saudi Arabia	We currently do not utilize any technology for conducting the Sharia audit, but implementing technology would be highly beneficial.
Interviewee 10	Saudi Arabia	We do not use any technology to conduct the Sharia audit. However, we block our debit and credit cards to be used for non-Sharia-compliant activities.

Interviewee 11	UAE	Unfortunately, we do not utilise any technology to conduct the internal Sharia audit.
Interviewee 12	UAE	No, we do not utilise any technology to conduct the internal Sharia audit.
Interviewee 13	UAE	No we do not use any technology to conduct the sharia audit.
Interviewee 14	UAE	There isn't a specific technology used to conduct the Sharia audit. The technology primarily involves document storage and access.

Analysis of the use of technology in conducting sharia audits

1- Lack of Technological Integration:

All of the interviewees expressed that they do not employ specialised technology for Sharia audits. This suggests a gap in the integration of technological solutions to streamline audit processes within Sharia compliance frameworks.

2- Potential Benefits of Technology:

Despite the current absence of specialised technology, there is recognition of the potential benefits it could offer. These include enhancing efficiency, improving access to transaction documents, automating audit processes, and ensuring compliance with Sharia principles.

3- Custom Solutions and Discussions:

Some interviewees have taken initial steps towards technological integration by developing internal Excel sheets for planning stages or discussing possibilities with their IT departments for dedicated Sharia audit software. This demonstrates an awareness of the need for technological advancement and a willingness to explore potential solutions.

4- Relying on Existing Systems:

While not utilizing specific Sharia audit technology, some Islamic banks leverage existing systems primarily for archiving purposes. However, there is acknowledgment that these systems may not be tailored to address the unique requirements of Sharia compliance audits.

5- Potential for Improvement:

The responses highlight an opportunity for improvement in the adoption of modern technical software tailored for Sharia audits. Implementing such technology could enhance the effectiveness, accuracy, and reliability of Sharia audit processes, thereby strengthening overall compliance with Sharia principles in Islamic banking institutions.

Overall, while there is currently a lack of dedicated technological solutions for Sharia audits among the interviewed Islamic banks, there is recognition of the potential benefits and a willingness to explore opportunities for technological integration in the future.

Question 18: In your opinion, what potential benefits do you see in adopting an integrated approach to the Internal Sharia Audit for Islamic banks? How might such an approach contribute to the efficiency, effectiveness, and credibility of the audit function?

- Coding 1: Enhanced Efficiency and Effectiveness
- Coding 2: Improved Credibility
- Coding 3: Regulatory Enforcement and Standardization
- Coding 4: Comparability and Transparency

Theme: It is important to adopt integrated approaches to Internal Sharia Audit in Islamic banks to enhance efficiency, effectiveness, and credibility. Regulatory support, standardised guidelines, and collaborative efforts within the industry are crucial for realizing the full potential of such approaches and ensuring the continued integrity of Islamic finance.

Table 26: Interviewees' answers for Question 18

Interviewee	Country	Answer
Interviewee 1	Bahrain	Yes, adopting an integrated approach for Sharia audit could be highly beneficial for the industry. However, some Sharia auditors might have reservations about potential changes to their work processes.
Interviewee 2	Bahrain	Following the best practices is encouraged in internal Sharia audit field to enhance the audit procedures in a way that will increase the efficiency, effectiveness, and credibility of the audit function.
Interviewee 3	Kuwait	Indeed, adopting an integrated approach would be highly advantageous, while the absence of such an approach could potentially weaken the internal Sharia audit. Furthermore, lacking

		a standardized approach might lead to varying audit quality across Islamic banking institutions. The ultimate concern is the potential reputational risk for Islamic banks stemming from inadequate Sharia audit quality, possibly resulting in inadvertent financial support to charities and substantial losses for the bank. Finally we have to note that a weak approach to internal Sharia audit could mislead not the customers only but also the Sharia scholars of the bank as there is a rule in Sharia that "Judging something is a branch of conceptualising it" so Sharia scholars could give decision based on wrong concept of information provided by the Sharia auditors.
Interviewee 4	Kuwait	Having a unified approach for conducting the internal Sharia audit is crucial, but without regulatory enforcement, achieving such consistency might remain a challenge.
Interviewee 5	Oman	An integrated approach would be highly beneficial, yet its implementation seems unlikely without regulatory mandates to enforce it.
Interviewee 6	Oman	An integrated approach to Sharia audit would significantly enhance the comparability of Sharia audit reports. Presently, different Islamic banks vary in the depth and scope of their internal Sharia audits, leading to diverse levels of reporting. Despite these differences, the Sharia committee ultimately signs off on the compliance of the bank with Sharia principles. It is important to emphasize that the implementation of a unified approach hinges on proactive enforcement from both management and regulators.
Interviewee 7	Qatar	Certainly, the idea of adopting an integrated approach holds promise. However, for this approach to truly have an impact, regulatory enforcement is crucial. Otherwise, it might remain a theoretical concept without practical implementation.

Interviewee 8	Qatar	In my personal opinion, adopting a unified approach to internal Sharia audit would prove highly beneficial. Such an approach would not only streamline operations within Islamic banking, enhancing efficiency and effectiveness, but it would also bolster the sector's credibility and foster greater trust among stakeholders by demonstrating rigorous adherence to Sharia principles.
Interviewee 9	Saudi Arabia	Standardization is crucial in internal Sharia audits. A unified approach would prove highly beneficial, facilitating easier comparisons between different Islamic banks
Interviewee 10	Saudi Arabia	To be fair, I do not know. Currently, we do not have any integrated approach to conduct the Sharia audit. We do not know the advantages and disadvantages of having one approach for all Islamic banks.
Interviewee 11	UAE	The risk of internal Sharia audit breaches differs from other types of breaches. While in some regular breaches, the bank can manage them internally, when it comes to Sharia breaches, the bank may be required to donate any income from those transactions to charity. Therefore, it is crucial to maintain a consistent approach to internal Sharia audit. If a Sharia auditor adopts a relaxed approach and regulatory requirements are enforced or external investigations occur, the bank may need to donate income related to several years to charities.
Interviewee 12	UAE	There would be significant benefits if we had a standardized approach to conducting Sharia audits. This would enhance the credibility of the audit process and facilitate comparisons of Sharia compliance levels across all Islamic banks. Additionally, implementing a uniform approach could improve the efficiency and effectiveness of the internal Sharia audit department.
Interviewee 13	UAE	There is a new not-for-profit organisation that has started offering guidelines to Sharia auditors so they can conduct the internal

		Sharia audit in a standardized approach. However, there is still much to be done. Internal auditors have the same tools and techniques that they can use in any bank or institution they wish to work for, which is not the case for internal Sharia auditors.
Interviewee 14	UAE	Indeed, an integrated approach would be beneficial for the Islamic finance industry. Implementing a unified approach would enable better comparison among all Islamic banks and improve overall efficiency and effectiveness.

Analysis of adopting an integrated approach to conduct the Sharia audit

1- Enhanced Efficiency and Effectiveness:

Respondents highlight that an integrated approach would streamline operations within Islamic banking, leading to increased efficiency and effectiveness in conducting Sharia audits. By standardising audit processes and procedures, Islamic banks can eliminate redundancies and ensure consistency in assessing compliance with Sharia principles.

2- Improved Credibility:

There is a consensus among interviewees that adopting a unified approach to Sharia audit would enhance the credibility of the audit function. Standardization would demonstrate rigorous adherence to Sharia principles, fostering greater trust among stakeholders, including customers, regulators, and Sharia scholars. This increased credibility is crucial for maintaining the integrity of Islamic banking institutions.

3- Regulatory Enforcement and Standardization:

Several respondents stress the importance of regulatory enforcement in achieving consistency and standardization across Islamic banks. Without regulatory mandates to enforce integrated approaches, achieving uniformity in Sharia audit practices might remain a challenge. Regulatory bodies play a critical role in promoting and overseeing the implementation of standardized audit frameworks.

4- Comparability and Transparency:

An integrated approach is seen as essential for enhancing comparability and transparency in Sharia audit reports. Standardisation enables easier comparisons between different Islamic banks, facilitating benchmarking and providing stakeholders with valuable insights into Sharia compliance levels across the industry.

5- Challenges and Opportunities:

While there is recognition of the benefits of an integrated approach, some respondents acknowledge challenges, such as the need for regulatory enforcement and the lack of standardized guidelines. However, there is optimism about ongoing efforts, such as the development of guidelines by not-for-profit organizations, to address these challenges and promote consistency in Sharia audit practices.

Overall, the responses underscore the importance of adopting integrated approaches to Internal Sharia Audit in Islamic banks to enhance efficiency, effectiveness, and credibility. Regulatory support, standardized guidelines, and collaborative efforts within the industry are crucial for realizing the full potential of such approaches and ensuring the continued integrity of Islamic finance.

7.3 SUMMARY

This chapter offers a comprehensive examination of internal Sharia audit practices within Islamic banks, drawing on insights provided by industry practitioners. Through an exploration of six key areas—current practices and challenges, regulatory framework, role of the Sharia audit department, attributes of effective Sharia audit, Sharia audit approach and operational procedure—the chapter explains the complex dynamics and changing landscape of Sharia audit functions.

The findings underscore the diversity of Sharia audit practices across Islamic banks, reflecting the complex interaction of organizational structures and regulatory frameworks. While some Islamic banks demonstrate robust frameworks and effective methodologies, others face challenges stemming from resource constraints, regulatory ambiguities, and the need for greater standardization.

At the heart of the discussion is the key role of regulatory oversight in shaping Sharia audit practices and ensuring compliance with Sharia principles. Regulatory frameworks serve as guides, providing a roadmap for navigating the complexities of Sharia compliance. However, practitioners advocate for regulatory frameworks that strike a balance between prescriptive mandates and flexible guidelines, enabling Islamic banks to adapt to evolving market dynamics while upholding Sharia principles.

Furthermore, the attributes of competence, independence, and confidentiality are key in ensuring the credibility and effectiveness of Sharia audit functions. Practitioners stress the importance of investing in continuous professional development, robust governance structures, and stringent confidentiality protocols to uphold the integrity of audit processes. Moreover, there is a consensus on the need for greater transparency and accountability in audit practices, fostering stakeholder confidence and trust.

Looking ahead, practitioners express a shared commitment to advancing Sharia audit practices through collaborative initiatives, knowledge sharing platforms, and industry-wide standardization efforts. By fostering a culture of continuous learning, innovation, and collaboration, stakeholders can collectively address emerging challenges, enhance regulatory compliance, and reinforce the credibility of Sharia audit functions.

In essence, the journey towards strengthening internal Sharia audit practices is complex, requiring a comprehensive approach that includes regulatory compliance, technological innovation, professional development, and collaborative partnerships. By accepting these key needs, Islamic banking institutions can navigate the complexities of Sharia compliance with confidence, integrity, and resilience, thereby reinforcing their commitment to ethical finance and sustainable growth.

The subsequent chapter will evaluate the regulatory requirements of Sharia audits across all GCC countries. Since Sharia audits are crucial for protecting the interests of customers who seek products compliant with Sharia, and are not viewed by management and shareholders as equally important as internal audits in Islamic financial institutions. This evaluation will use the internal Sharia audit standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions as a benchmark.

CHAPTER 8: ANALYSIS OF THE REGULATIONS OF THE INTERNAL SHARIA AUDIT IN THE GGC

8.1 INTRODUCTION

In chapter 5, it is evident that the regulations related to internal Sharia audit vary across the GCC countries. Each country has its own regulation, and these regulations differ from one another. It has been observed that the regulations in the GCC do not specify any punishment or penalty for failing to comply with Sharia requirements or for not implementing an appropriate Sharia governance framework.

The objective of this section is to analyse the harmonization between the GCC regulatory requirements for internal Sharia audit and to assess how well the regulations in the GCC align with the AAOIFI internal Sharia audit standard. Additionally, it aims to create a ranking of GCC countries based on the strength of their regulations related to internal Sharia audit. This ranking will complement the research findings from the interviews by adding a supplementary method of library research to the study. The library research method utilized in this section involves examining existing literature and governmental regulations to gain insights and information on the topic.

8.2 DEVELOPING INTERNAL SHARIA AUDIT INDEX

To ensure a clear understanding of the harmonization of regulatory requirements for internal Sharia audits in the GCC and the level of compliance between these regulations and the AAOIFI's internal Sharia audit standards, this study has employed a specific methodology. Internal Sharia audit indicators were developed, derived from AAOIFI's internal Sharia audit standards, and scored to provide a quantifiable ranking of the GCC countries. These indicators facilitate a comprehensive evaluation of how well the regulations align with AAOIFI's internal Sharia audit standards.

The study has developed 25 key indicators for best practices in internal Sharia audit requirements, which have been grouped into five distinct sections. The first section addresses the existence of a comprehensive framework for Sharia governance. The second section covers the Sharia audit approach and documentation. The third section focuses on independence and objectivity. The fourth section examines quality control and ethical requirements. The fifth section pertains to the human resources of internal Sharia audit. Under each section, there are various indicators derived from the AAOIFI internal Sharia audit standard. Each indicator is scored one if the regulatory requirement is referenced in the GCC regulations; if not, the indicator scores zero for the relevant country.

Benchmarks were identified from respective central bank regulations or government authority regulations governing Islamic banks. In Bahrain, the benchmark was Volume 2: Islamic banks which was issued the Central Bank of Bahrain. Similarly, in the UAE, the benchmark was the Sharia governance standard for Islamic financial institutions issued by the Central Bank of the UAE. Kuwait referenced the Instructions Concerning Sharia Supervisory Governance in Kuwaiti Islamic Banks issued by the Central Bank of Kuwait. Islamic banks in Saudi Arabia adhered to the Sharia Governance Framework for Local Banks Operating in Saudi Arabia, issued by the Saudi Arabian Monetary Authority. Qatar's benchmark was the Islamic finance rules issued by the Qatar Financial Centre Regulatory Authority. Lastly, Oman's benchmark was the Islamic banking regulatory framework issued by the Central Bank of Oman.

This methodology allows for a thorough analysis of the harmonization of internal Sharia audit regulations in GCC countries, providing valuable insights into their effectiveness in promoting compliance with AAOIFI standards. It offers a clear and structured evaluation of internal Sharia audit regulations by utilizing specific indicators and a scoring methodology to rank GCC countries. The findings can promote consistency and transparency in the Islamic banking industry across the GCC.

The following table presents a summary of the primary indicators for best internal Sharia audit practices.

Table 27: Internal Sharia Audit regulatory requirements Indicators

Internal Sharia audit requirements indicators	Overall Score	Bahrain	UAE	Kuwait	Saudi Aribia	Qatar	Oman
A- The existence of comprehensive framework of Sharia governance							
The country has implemented precise regulations or guidelines to	1	1	1	1	1	1	1

effectively govern the operational dynamics of Islamic banks.							
The regulations require Islamic banks to comply with AAOIFI internal Sharia audit standard or AAOIFI Sharia review standard	1	1	0	0	0	1	0
The existence of a Sharia Supervisory Committee at the Central Bank to review the internal Sharia audit report	1	1	1	0	0	0	1
Each Islamic bank is required by the regulation to establish a Sharia Supervisory Committee, which has the responsibility of reviewing the internal Sharia audit report.	1	1	1	1	1	1	1
The regulations require the establishment of an internal Sharia audit department	1	1	1	1	1	1	1
The existence of fine and penalty for breaching the Sharia governance requirements	1	0	0	0	0	0	0
B- The Sharia audit approach and documentations							

The regulation refer to internal Sharia audit approach	1	0	0	0	0	0	0
Clear definition of internal Sharia audit function	1	1	1	1	1	1	1
The regulation highlighted the objective of the internal Sharia audit department	1	1	1	1	1	1	1
The regulation refer to internal Sharia audit plan	1	1	1	1	0	0	1
The regulation refer to the internal Sharia audit charter	1	0	0	0	0	0	1
The regulation refer to internal Sharia audit manual	1	1	1	1	0	0	0
The regulations mandate that Islamic banks must conduct an internal Sharia audit at least once every year	1	1	1	1	1	1	1
The regulation specifies a rating mechanism that an internal Sharia audit department can use to assess its level of adherence to Sharia principles.	1	0	0	1	0	0	0
C- The independence and objectivity							

The existence of the requirement to differentiate between the Sharia compliance function and internal Sharia audit	1	1	1	1	0	0	1
The existence of the requirement for the internal Sharia auditor to be independent from the management	1	1	1	1	0	0	1
The regulation specifies the party responsible for establishing the internal Sharia audit department.	1	1	1	1	0	0	1
The regulation specifies the reporting line of the internal Sharia audit department.	1	1	1	1	0	0	1
The regulation specifies who is authorised to access the internal Sharia audit report.	1	1	1	1	1	1	1
D- The quality control and ethical requirements							
The existence of the requirement to comply with the code of ethics issued by AAOIFI	1	0	0	0	0	0	0
The existence of the requirement to comply with	1	0	0	0	0	0	0

the code of ethics issued by IIA							
The existence of the requirement to comply with the internal Audit's Quality Assurance and Improvement Program (QAIP) published by the IIA	1	0	0	0	0	0	0
E- The human resources of internal Sharia audit							
The presence of fit and proper criteria for the head of internal Sharia audit	1	1	1	1	0	0	1
The regulation mandates that the internal Sharia auditor attends regular training to ensure their competency.	1	0	0	0	0	0	1
The regulation treats the resignation or dismissal of the head of internal Sharia audit with the utmost seriousness, and may require the disclosure of additional information to regulators in such cases.	1	1	1	0	0	0	1
Overall score	25	17	16	15	7	8	17

The indicators of internal Sharia audit regulatory requirements described above facilitate the researcher in categorising the strength of regulations into five distinct levels: "Underdeveloped

Regulations", "Emerging Regulations", "Improved Regulations", "Good Regulations", and "Best Regulations". The table presented below offers further elaboration on the descriptions of the five aforementioned categories.

Table 28: Regulatory requirements indicators scoring methods

Level of regulations	Score	Explanation
Underdeveloped Regulations	1 – 5	Countries that have a very minimal score of Regulatory requirements and necessitate prompt reform.
Emerging Regulations	6 – 10	Countries that have a minimal score of Regulatory requirements but they demonstrate favourable progress.
Improved Regulations	11 – 15	Countries that have a fair score of Regulatory requirements and indicate significant enhancement.
Good Regulations	16 – 20	Countries that have a good score of Regulatory requirements and typically adhere to fundamental aspects of sound regulatory requirements.
Best Regulations	21 – 25	The ideal Regulatory requirements that represent best practice of Internal Sharia audit regulatory requirements

Based on the above table, countries with stricter regulatory requirements enjoy higher esteem and appreciation not only from customers but also from the broader public. Countries that attain a score of 21-25 in internal Sharia audit regulatory requirements are classified as having "Best Regulations," embodying the optimal and exemplary regulation of internal Sharia audit requirements. "Good Regulations" designates countries that demonstrate a commendable score of internal Sharia audit regulatory requirements, while countries showing fair scores but exhibiting positive advancements are categorized as "Improved Regulations." Countries with scores ranging from 6-10 in disclosure indicators are placed in the "Emerging Regulations" category. Subsequently, the classification of "Underdeveloped Regulations" pertains to countries with extremely minimal scores, reflecting notably weak internal Sharia audit regulatory requirements.

8.3 ANALYSIS OF INTERNAL SHARIA AUDIT REGULATIONS IN THE GCC COUNTRIES

The analysis of regulations related to internal Sharia audit in the GCC countries reveals several key findings and areas of concern. The analysis focused on 25 indicators grouped into five categories: Sharia governance framework, Sharia audit approach and documentations, independence and objectivity, quality control and ethical requirements, and human resources of internal Sharia audit. The following this the examination of each category and its implications:

a- The existence of a comprehensive framework of Sharia governance

All countries in the GCC have implemented specific regulations to effectively govern the operational dynamics of Islamic banks. This indicates their commitment to creating a strong regulatory framework that ensures Islamic banks operate in accordance with Sharia principles. Among the GCC countries, only Bahrain and Qatar have achieved a score for requiring Islamic banks to comply with the internal Sharia audit standard or Sharia review issued by AAOIFI. This demonstrates Bahrain's and Qatar's dedication to aligning their regulations with international standards, thereby enhancing transparency and accountability in Sharia compliance and auditing. However, it is important to note that Qatar required Islamic banks to comply with an earlier version of AAOIFI’s internal Sharia review standard, not the latest version.

Bahrain, the UAE, and Oman have taken an additional step by establishing a Sharia Supervisory Committee at the country level in the Central Bank to review the internal Sharia audit report. This demonstrates their emphasis on independent oversight and evaluation of the audit process by a specialised committee, adding credibility to the internal Sharia audit function.

All GCC countries have recognised the importance of establishing a Sharia Supervisory Committee at the institution level, responsible for reviewing the internal Sharia audit report. This regulatory requirement ensures that there is an additional layer of scrutiny to promote adherence to Sharia principles within Islamic banks.

Regulations in all GCC countries uniformly mandate the establishment of an internal Sharia audit department within Islamic banks. This requirement reflects the recognition of the internal Sharia audit function as a crucial element in assessing and ensuring compliance with Sharia principles and guidelines.

However, it is noteworthy that none of the GCC countries have implemented fines or penalties for breaching Sharia governance requirements. This raises concerns about the effectiveness of the regulatory framework in incentivizing Islamic banks to take Sharia compliance seriously. It also raises questions about whether regulators conduct assessments related to Sharia compliance for Islamic banks similar to those related to other regulatory requirements, such as treating customers fairly or knowing your customers. Addressing this issue is important to emphasize the significance of adhering to Sharia requirements and to encourage a culture of compliance within the Islamic banking sector.

b- The Sharia audit approach and documentation

None of the regulations achieved the indicator of referring to an internal Sharia audit approach. The internal Sharia audit approach involves a comprehensive analysis of the internal audit process, including planning, risk assessment, fieldwork, findings and analysis, reporting, follow-up, and continuous improvement. The absence of reference to the audit approach in the regulations could potentially weaken the internal Sharia audit function in certain Islamic banks within the same country, as it may result in inconsistencies and variability in the audit process.

As noted in the previous chapter, some interviewees referred to a risk-based audit approach, while others mentioned a product-based audit approach, a departmental audit approach or sampling audit approach. The absence of a unified approach for conducting the annual Sharia audit could lead to discrepancies in Sharia compliance assessments, as different approaches might yield varying outcomes and cause inconsistencies both within the GCC Islamic banks and among Islamic banks within the same country. Regardless of the audit approach used, the Sharia Supervisory Committee at the institutional level would sign the certificate to confirm the bank is compliant with Sharia. However, a sampling audit approach differs from a departmental audit approach, as the former involves selecting only a sample, while the latter entails checking all departments.

All countries in the GCC have successfully achieved the indicator of defining the internal Sharia audit function. This signifies the recognition and establishment of a clear understanding of the role and responsibilities of the internal Sharia audit department within Islamic banks. Also, the regulations in all GCC countries have appropriately highlighted the objectives of the internal Sharia audit department. This indicates a shared understanding of the purpose and goals of the department in ensuring Sharia compliance within Islamic banks.

Saudi Arabia and Qatar did not achieve the indicator of referring to an internal Sharia audit plan in their regulations. This lack of inclusion may have an impact on the effectiveness of audit planning within the internal Sharia audit function in these countries. Without a defined audit plan, there is a risk of inconsistent and ad-hoc approaches to conducting internal Sharia audits.

Only Kuwait and Oman have regulations that refer to the internal Sharia audit charter. This indicates their recognition of the importance of having a formal document that outlines the scope, authority, and responsibilities of the internal Sharia audit function. The absence of such a charter in other GCC countries may result in weaker Sharia audit function and potential inconsistencies and ambiguity in the implementation of the audit function.

Oman, Qatar, and Saudi Arabia did not achieve the indicator of referring to an internal Sharia audit manual in their regulations. This omission may also impact the clarity and consistency of audit procedures within the internal Sharia audit departments of these countries. On the other hand, the regulations in all GCC countries mandate that Islamic banks must conduct an internal Sharia audit at least once every year. This requirement emphasises the importance of regular auditing to assess and ensure Sharia compliance within Islamic banks. It is important to note that all Islamic banks are required to have a Sharia certificate signed by the Sharia Supervisory Committee, certifying that the bank remained compliant with Sharia principles during the audited financial year.

Only Kuwait has regulations that specify a rating mechanism for internal Sharia audit departments to assess their level of adherence to Sharia principles. This indicator highlights Kuwait's commitment to promoting accountability and measuring the effectiveness of the internal Sharia audit function. The absence of a rating mechanism in other GCC countries may limit their ability to systematically evaluate and improve the quality of internal Sharia audits.

c- The independence and objectivity

Both Saudi Arabia and Qatar lack a requirement to differentiate between the Sharia compliance function and internal Sharia audit, as indicated by the non-achievement of this indicator. In these countries, the internal Sharia audit department may be responsible for both the Sharia compliance function and the internal Sharia audit, particularly in the absence of regulatory requirements to separate these functions.

This situation creates a significant conflict of interest, as the same department could be involved in both the second and third lines of defence. While it may offer advantages for Islamic banks by eliminating the need to establish separate functions and saving on additional employee costs, it inevitably reduces the level of compliance with Sharia principles. This could also explain why some Islamic banks in these countries have fewer staff members in the Sharia department, with limited personnel handling all aspects related to Sharia as there is no proper enforcement from the regulators.

The regulations in Saudi Arabia and Qatar do not explicitly mention the independence of the internal Sharia audit department, in contrast to other GCC countries that have achieved this indicator. The absence of such a requirement raises concerns about the potential lack of independence of the internal Sharia auditors from the management of Islamic banks in these countries. Independence is crucial for ensuring unbiased and objective auditing practices.

Both Saudi Arabia and Qatar do not specify the party responsible for establishing the internal Sharia audit department, in contrast to other GCC countries that have achieved this indicator. This omission creates a significant conflict of interest, as it does not clearly assign responsibility to the appropriate governing body, such as the board of directors, audit committee, or Sharia committee, for establishing the internal Sharia audit department. The lack of clarity regarding the responsible party may lead to potential conflicts of interest and undermine the effectiveness of the audit function. The issue was clearly highlighted in the previous chapter, where one interviewee noted that one requirement for an Islamic bank in Saudi Arabia to be a member of a university is to facilitate the dismissal of the Sharia auditor in case of a disagreement between the auditor and management.

Similarly, the regulations in Saudi Arabia and Qatar do not require a specific reporting line for the internal Sharia audit department, unlike other GCC countries that have achieved this indicator. This absence of a reporting line creates a conflict of interest, as there are no regulatory barriers preventing the internal Sharia audit department from reporting to the Chief Financial Officer (CFO). Such a reporting line may compromise the independence of Sharia auditors and breach the principles of independence and objectivity. Other GCC countries have addressed this issue by requesting clear independent reporting lines for the internal Sharia audit department.

The regulations of all GCC countries have achieved the indicator of specifying who is authorised to access the internal Sharia audit report. This indicates a recognition of the importance of controlling access to audit reports, ensuring confidentiality, and preventing unauthorised disclosure of sensitive information. By clearly defining the authorised recipients of the internal Sharia audit report, the regulations promote confidentiality, transparency and accountability in the auditing process.

d- The quality control and ethical requirements

None of the GCC countries have achieved the indicator requiring compliance with the code of ethics issued by AAOIFI. This indicates a lack of uniformity in ensuring adherence to ethical standards within the Islamic banking sector across the GCC. The AAOIFI's code of ethics sets out principles and guidelines that promote integrity, professionalism, and ethical behaviour among Sharia auditors.

Similarly, all GCC countries have not achieved the indicator of requiring compliance with the code of ethics issued by the IIA. The IIA's code of ethics serves as a global benchmark for internal auditors and emphasizes fundamental principles such as integrity, objectivity, confidentiality, and competence. The non-uniform adoption of this requirement within the GCC suggests variations in ethical standards and the promotion of professional conduct among internal Sharia auditors.

Additionally, all GCC countries have not implemented the requirement to comply with the Internal Audit's QAIP published by the IIA. The QAIP provides a framework for establishing quality assurance processes within internal audit functions, including ongoing monitoring, periodic internal assessments, and external assessments. By not mandating the adoption of the QAIP, GCC countries miss out on the opportunity to enhance the quality, effectiveness, and reliability of internal Sharia audits through systematic review and improvement.

There is a clear lack of comprehensive regulations regarding quality control and ethical requirements in all GCC countries pertaining to internal Sharia audits. This gap highlights the absence of a regulatory mandate for establishing quality assurance programs specifically designed for internal Sharia auditors. Such programs would involve independent reviews of Sharia audit work, adherence to professional standards, ongoing training and development, and the establishment of clear audit methodologies and procedures. By implementing quality assurance processes, organizations can enhance the consistency, reliability, and effectiveness of internal audits, ultimately maximising the value derived from the internal audit function.

The absence of regulatory requirements explains why the majority of interviewees highlighted the lack of compliance with ethical standards and quality assurance. Without enforcement from regulators, Sharia auditors may face additional pressure if they choose to comply, as there is no external mandate from regulators or the business to support these standards.

e- The human resources of internal Sharia audit

Both Saudi Arabia and Qatar have not achieved the indicator of having fit and proper criteria for the head of the internal Sharia audit. In these countries, anyone approved by the management can assume the role of the head of the internal Sharia audit. This lack of specific qualifications and work experience requirements for the head of the internal Sharia audit raises concerns about the competency and expertise of individuals leading this crucial function. In contrast, all other GCC countries have established specific qualifications and work experience criteria for the head of the internal Sharia audit. For instance, in countries like the UAE and Oman, the appointment of the head of the internal Sharia audit must be approved by the central bank, ensuring a higher level of scrutiny and expertise in the role.

The regulations in Oman, the latest country in the GCC to regulate Islamic banking, have achieved the indicator of mandating regular training for internal Sharia auditors to ensure their competency. However, other GCC countries have failed to achieve this indicator. Regular training plays a vital role in keeping Sharia auditors updated with evolving industry practices, regulations, and emerging risks. The absence of a regulatory requirement for regular training in some GCC countries raises concerns about the potential knowledge gaps among internal Sharia auditors, which could impact the quality and effectiveness of their audits.

Finally, only Bahrain, the UAE and Oman have achieved the indicator of treating the resignation or dismissal of the head of the internal Sharia audit with utmost seriousness and requiring the disclosure of additional information to regulators in such cases. This indicates that these countries recognise the importance of maintaining independence and transparency within the internal Sharia audit function. Without this indicator, there is a risk that an Islamic bank dissatisfied with the findings of its internal Sharia auditor may dismiss the Sharia auditor and replace them with someone more accommodating or accepting of the Islamic bank's Sharia non-compliance issues. Such a practice undermines the objectivity and independence of the internal Sharia audit and may compromise the integrity of the audit process.

These findings highlight the variations in human resource requirements for internal Sharia audit across the GCC countries. The absence of fit and proper criteria for the head of the internal Sharia audit in Saudi Arabia and Qatar, the lack of mandatory training requirements in most GCC countries, and the limited seriousness given to the resignation or dismissal of the head of the internal Sharia audit in many countries call for attention and potential reforms. Standardising qualifications, implementing mandatory training programs, and emphasising the independence and seriousness of personnel changes within the internal Sharia audit function can contribute to enhancing the expertise, credibility, and objectivity of Sharia audits in the Islamic banking sector.

8.4 ANALYSIS OF THE OVERALL RATING SCORE OF THE GCC COUNTRIES

The analysis of internal Sharia audit regulatory requirements reveals the progress and areas for improvement among GCC countries. Based on above scoring method, the regulatory frameworks have been categorised into five distinct levels: "Underdeveloped Regulations," "Emerging Regulations," "Improved Regulations," "Good Regulations," and "Best Regulations." The following are the results for the countries:

1- Bahrain and Oman: Good Regulations (Score: 17)

Bahrain and Oman have achieved a score of 17, placing them in the "Good Regulations" category. This score indicates that both countries have established strong regulatory frameworks for internal Sharia audits, adhering to key aspects of sound regulatory practices. Their comprehensive governance structures and high level of compliance with best practices distinguish them as leaders in the GCC, ensuring that Islamic banks operate in alignment with Sharia principles.

Bahrain stands out with its mandatory compliance to AAOIFI internal Sharia audit standards, which ensures that Islamic banks adhere to internationally recognized best practices. The establishment of Sharia Supervisory Committees at both the Central Bank and individual banks further enhances oversight and governance. Additionally, Bahrain provides a clear definition of the internal Sharia audit function, which supports accountability and clarity in audit processes.

On the other hand, Oman excels in emphasizing the independence of internal Sharia auditors, ensuring a necessary separation from management that enhances objectivity in the audit process. The regulatory framework in Oman also prioritizes ongoing training for internal Sharia auditors, fostering continuous professional development and maintaining high standards of practice. Together, these distinct strengths contribute to the overall regulatory effectiveness of both countries in promoting Sharia compliance in Islamic banking.

2- UAE: Good Regulations (Score: 16)

The UAE, with a score of 16, is also in the "Good Regulations" category. This reflects a well-developed regulatory environment that meets most essential requirements for internal Sharia audits. The UAE demonstrates robust adherence to Sharia governance and audit practices. However, the slight gap compared to Bahrain and Oman suggests that while the UAE's framework is strong, there are specific areas that could benefit from further enhancement.

In contrast to Bahrain and Oman, the UAE lacks a mandatory requirement for the implementation of a Sharia audit charter, which is crucial for defining the scope and authority of internal audits. Additionally, while both Bahrain and Oman emphasize regular training for Sharia auditors, the UAE's regulations do not mandate such training, potentially impacting the competency and effectiveness of its auditors over time. Furthermore, Bahrain's stronger focus on AAOIFI standards and Oman's emphasis on auditor independence set them apart, indicating that the UAE has room for improvement in these key areas to strengthen its regulatory framework further.

3- Kuwait: Improved Regulations (Score: 15)

Kuwait, with a score of 15, falls into the "Improved Regulations" category. This score reflects a fair and improving regulatory framework for internal Sharia audits, indicating significant enhancements and progress towards stronger Sharia governance. However, Kuwait still lacks certain critical elements that are present in the frameworks of its GCC counterparts, such as a central Sharia supervisory committee and specific requirements for audit documentation.

When compared to the UAE, Bahrain, and Oman, Kuwait's regulatory environment shows notable gaps. Unlike Bahrain and Oman, which have established Sharia Supervisory Committees to enhance oversight, Kuwait does not yet have a centralized body to ensure compliance and governance. Additionally, while the UAE, Bahrain, and Oman emphasize the importance of implementing a Sharia audit charter and regular training for auditors, Kuwait's framework lacks these critical components. This absence not only hinders the clarity and effectiveness of the audit process but also affects the competency of Sharia auditors.

Despite these shortcomings, Kuwait's score of 15 reflects a commitment to improving its regulatory framework. However, addressing the identified gaps is essential for elevating Kuwait's regulations to the level observed in Bahrain, Oman, and the UAE, which consistently demonstrate more robust and comprehensive governance structures.

4- Qatar and Saudi Arabia: Emerging Regulations (Scores: Qatar - 8, Saudi Arabia - 7)

Qatar and Saudi Arabia are categorized as having "Emerging Regulations," with scores of 8 and 7 respectively. While both countries have made some progress in establishing regulatory frameworks for internal Sharia audits, their frameworks remain underdeveloped. Notably, Qatar's slightly higher score indicates a marginally more advanced regulatory environment compared to Saudi Arabia; however, both nations face similar challenges. Key areas for improvement include the establishment of central Sharia supervisory bodies, clearer differentiation between Sharia compliance functions and internal Sharia audits, and stronger adherence to international standards like those set by AAOIFI.

When compared to other GCC countries, the gaps in Qatar and Saudi Arabia's regulatory frameworks become more evident. Bahrain, Oman, and the UAE showcase more robust systems with established Sharia Supervisory Committees and comprehensive guidelines that facilitate effective internal audits. In contrast, Qatar and Saudi Arabia lack these critical components, which are essential for ensuring rigorous oversight and governance of Islamic banking practices. Furthermore, while countries like Bahrain and the UAE emphasize the importance of auditor independence and training, Qatar and Saudi Arabia have not yet implemented such standards, underscoring the need for further development.

In summary, although Qatar and Saudi Arabia have made strides toward establishing regulatory frameworks for internal Sharia audits, they remain significantly behind their GCC counterparts. Addressing these gaps is essential for both countries to strengthen their regulatory environments and align more closely with the best practices observed in Bahrain, Oman, and the UAE.

8.5 AREAS OF DEVELOPMENT FOR ALL COUNTRIES

It is evident that all GCC countries have several critical areas of development in their internal Sharia audit frameworks. The following key areas were underdeveloped, with all countries in the GCC receiving a zero score, highlighting significant gaps that need to be addressed to enhance the effectiveness and consistency of the internal Sharia audit across the region:

1- Compliance with Ethical Standards (AAOIFI and IIA Codes of Ethics):

None of the GCC countries require compliance with the code of ethics issued by AAOIFI or IIA. This absence of ethical guidelines leaves a critical gap in ensuring that internal Sharia audits are conducted with the highest standards of integrity, professionalism, and ethical behaviour. Enforcing these ethical standards would promote consistency in Sharia audits and enhance the credibility and trustworthiness of the Islamic banks. GCC banking regulators should prioritize integrating these codes into their regulatory frameworks to ensure that all Sharia auditors adhere to internationally recognized ethical guidelines.

2- Quality Assurance and Improvement Program (QAIP):

No country in the GCC has regulations that mandate compliance with the IIA's QAIP. This program is essential for maintaining and enhancing the quality of internal audits, including Sharia audits, by providing a framework for continuous improvement. Introducing compliance with QAIP requirements by law would ensure that internal Sharia audits are regularly evaluated and improved upon, thereby increasing their effectiveness and reliability. This would also align the internal audit functions within Islamic banks with global best practices.

3- Internal Sharia Audit Approach:

All GCC countries lack regulatory references to a standardized internal Sharia audit approach. This omission can lead to inconsistencies in how internal Sharia audits are conducted, potentially resulting in varying levels of Sharia compliance across different banks and even within the same country. Establishing a clear and standardized audit approach, which includes planning, risk assessment, execution, reporting, and follow-up, is crucial for ensuring that all Islamic banks adhere to the same high standards of Sharia compliance. Regulators should develop regulations that outline a uniform audit approach to enhance consistency and comparability across the sector.

4- Fines and Penalties for Breaching Sharia Governance Requirements:

None of the GCC countries have implemented fines or penalties for non-compliance with Sharia governance requirements. This lack of enforcement mechanisms may undermine the seriousness with which Islamic banks approach Sharia compliance, potentially leading to lapses in governance. Introducing fines and penalties would serve as a strong deterrent against non-compliance and reinforce the importance of adhering to Sharia principles. Regulatory bodies should consider implementing such measures to ensure that Islamic banks maintain rigorous standards of Sharia governance.

5- Human Resources and Training for Internal Sharia Audit:

With the exception of Oman, all other GCC countries do not mandate regular training for internal Sharia auditors. Continuous professional development is crucial for auditors to stay updated on the latest Sharia standards, regulatory changes, and audit practices. Regulatory frameworks should include provisions for mandatory ongoing training and development for internal Sharia auditors. This would ensure that auditors maintain the necessary competencies and are well-equipped to perform their duties effectively.

8.6 SUMMARY

This chapter has provided an in-depth analysis of the regulatory frameworks for internal Sharia audit requirements across GCC countries, revealing notable differences in the comprehensiveness and implementation of these regulations. By evaluating the adherence to 25 key indicators derived from the AAOIFI internal Sharia audit standard, the study has highlighted varying levels of regulatory maturity among the six countries.

Bahrain and Oman are distinguished by their robust regulatory frameworks, which closely align with fundamental best practices for internal Sharia audits. The UAE also exhibits a strong regulatory environment but falls marginally short of Bahrain and Oman in certain aspects. Kuwait shows significant progress with its "Improved Regulations" status, yet still has areas needing enhancement to reach the level of Bahrain, Oman, and the UAE. Qatar and Saudi Arabia, categorized under "Emerging Regulations," display minimal regulatory requirements and necessitate substantial reforms to improve their Sharia audit practices.

A critical finding across all countries is the universal absence of mandatory compliance with the AAOIFI and IIA codes of ethics, the lack of a standardized internal Sharia audit approach, and the non-existence of quality assurance programs. Additionally, the lack of fines and penalties for breaches in Sharia governance, along with insufficient provisions for the continuous professional development of Sharia auditors, further underscores the need for comprehensive regulatory enhancements.

Chapter 9: ENHANCING SHARIA AUDIT STANDARDS IN ISLAMIC FINANCE

9.1 INTRODUCTION

The preceding chapter presented a comprehensive analysis and the resulting findings derived from the library search methodology. The purpose of employing this method was to acquire a more extensive understanding of the regulatory requirements in the GCC and to compare the comprehensiveness of these requirements across GCC countries. The analysis revealed a noteworthy observation: although there are common aspects among these countries, there are significant differences in the regulatory requirements for internal Sharia audits. Despite some similarities, much work remains to be done across all GCC countries to enhance the regulatory framework for internal Sharia audits.

This chapter endeavours to provide a more profound understanding of the three research questions outlined in Chapter 1, Section 2 (specifically questions 1, 2, 3 and 4).

Therefore, this chapter delves into the intricacies of AAOIFI's Sharia audit standards within the Islamic banking sector, exploring perspectives from senior members of AAOIFI's Governance Committee and a regulatory advisor with extensive experience in central banks across the GCC. The objective was to comprehensively understand the benefits, challenges, strategies, concerns, and future prospects associated with adopting and implementing the internal Sharia audit standard set by AAOIFI.

The interviews provided profound insights into the landscape of Sharia audit standard and regulatory perspective, identifying pivotal benefits such as alignment with Sharia principles and standardisation for comparability. However, they also shed light on critical challenges, including regulatory understanding and enforcement dynamics. Strategies to encourage adoption and compliance were outlined, emphasising regulatory involvement, Sharia scholar engagement, and market-driven initiatives.

9.2 ANALYSIS OF DATA COLLECTED VIA INTERVIEW WITH A SENIOR MEMBER OF AAOIFI'S GOVERNANCE AND ETHICAL COMMITTEE

The interview with the senior member of AAOIFI was divided into six sections as follows:

H1: Benefits and Importance of the Internal Sharia Audit Standard:

Question 1: What are the primary benefits and advantages of adopting AAOIFI's internal Sharia audit standard for Islamic banks? Why do you think that some practitioners have reservations about the standard's ability to meet their expectations?

This question to explore the primary benefits and advantages of adopting AAOIFI's internal Sharia audit standard. It is also to investigate why some practitioners may have reservations about the standard's effectiveness. By understanding these benefits and concerns, the research aimed to assess the alignment of current practices with AAOIFI's guidelines and identify areas where practices may diverge from recommended standards.

The interviewee highlighted the following in his answer:

1- Need for Internal Sharia Audit

The interviewee emphasises the crucial role of an internal Sharia audit within Islamic banking institutions. They stress that claiming to be an Islamic bank entails the responsibility of providing assurance of Sharia compliance to various stakeholders, including customers, shareholders, regulators, and staff.

Quote:

"In my view, when any Islamic bank claims to be an Islamic bank, they have responsibilities to provide assurance to their stakeholders... to provide this assurance they must have an independent internal Sharia audit function."

2- Alignment with Sharia Principles

The interviewee draws a parallel between the necessity of the Sharia compliance function and internal Sharia audit function. They highlight the need for an assurance mechanism to ensure all operations align with Sharia, both pre and post transactions, indicating the role of the Sharia compliance and Sharia audit functions.

Quote:

"Islamic banks have to do the same to ensure that they are in line with Sharia principles. Therefore, they need an assurance mechanism, and they must have an internal mechanism to ensure their work is compliant with Sharia."

3- AAOIFI's Standardisation for Comparability

Implementing AAOIFI's internal Sharia audit standards is advocated for creating a standardised framework across Islamic banks. This standardisation facilitates comparability and enables stakeholders to understand an Islamic bank's compliance level irrespective of its location.

Quote:

"AAOIFI’s internal Sharia audit standard ensures that the Sharia audit reports can be compared between Islamic banking institutions, creating a level playing field for everyone."

4- Ongoing Improvement and Development

The interviewee highlights AAOIFI's commitment to continuously improve its standards, ensuring they remain relevant and up-to-date. Collaborative efforts with Islamic Finance Services Board (IFSB) and the plan to issue guidelines and a handbook for both internal and external Sharia audits underscore this dedication to development.

Quote:

"AAOIFI is always improving its standards to align them with today's requirements, and there will soon be news related to the updated internal Sharia audit standard."

5- Challenges in Implementation

The interviewee acknowledges challenges in implementing the current high-level internal Sharia audit standard. These challenges include the complexity of the standard, lack of understanding among regulators, inconsistent implementation, and the need for more detailed guidelines for effective implementation.

Quote:

"Initially, AAOIFI's approach was to present the standard to the regulators, who would then implement it based on their specific needs. However, we have observed that this implementation process is not consistently occurring, as both market players and regulators often lack the capacity to fully implement the standards. In cases where the standard is implemented, it is often used as guidance by regulators without strict enforcement mechanisms. Additionally, both regulators and Islamic banking institutions frequently claiming lack the capacity to effectively implement the standard, and regulators face challenges in supervising its implementation".

Conclusion

The analysis highlights the importance of the internal Sharia audit, emphasising alignment with Sharia principles, standardisation for comparability, ongoing improvement, and challenges in implementation. AAOIFI's efforts towards continuous development and collaboration with other bodies reflect a commitment to enhancing Sharia compliance within the Islamic finance industry. Addressing implementation challenges through comprehensive guidelines is identified as a crucial step for effective Sharia audits and compliance.

H2: Understanding the Regulatory Landscape:

> Question 2: From your perspective, why do you think most regulations in the GCC do not mandate compliance with the internal Sharia audit standard issued by AAOIFI? And what potential risks or challenges may arise due to the absence of mandatory compliance with this standard?

This part of the interview focused on why most GCC regulations do not mandate compliance with AAOIFI's internal Sharia audit standards. In cases like Bahrain, even when compliance is required for Islamic banks, regulators do not check or investigate the level of compliance. It examined the potential risks and challenges associated with the absence of mandatory compliance, revealing the extent of variability in regulatory frameworks and the impact on internal audit practices across different GCC countries.

The interviewee highlighted the following:

1- Regulatory Challenges and Capacity Constraints

The interviewee highlights the primary concern of regulators, emphasising the lack of capacity and understanding among both regulators and Islamic banking institutions regarding the AAOIFI Sharia audit standard. The capacity issue is seen as a barrier to the enforcement of these standards.

Quote:

> *"The main concerns raised by regulators are the lack of capacity among both regulators and Islamic banking institutions, as well as the regulators' limited understanding of the Sharia standards issued by AAOIFI."*

2- Enforcement and Compliance Dynamics

The interviewee elaborates on the varying enforcement dynamics across different GCC countries. Some countries adopt AAOIFI audit standard but face challenges in effective enforcement due to insufficient regulatory capacity. Additionally, there's a perception that the Sharia auditor function is viewed as a cost centre, influencing the commitment to its effective implementation.

Quote:

> *"In my view, the capacity exists, but there is a lack of enforcement due to a misunderstanding of the importance of ensuring compliance with Sharia principles."*

3- Perception of Sharia Auditor and Consumer Protection

The interviewee points out the perception of the Sharia auditor function as a cost centre, potentially undermining its importance within Islamic banking institutions. The absence of a dedicated and effective Sharia function can pose reputational risks and consumer protection issues, affecting not only the bank but also the broader country’s financial system.

Quote:

> *"From the perspective of Islamic banking institutions, they may have the capacity, but they often perceive the Sharia auditor as a cost centre. In some cases, the Sharia auditor may request the Islamic bank to donate money to charities if transactions are not conducted in*

the right way. Consequently, from the management's viewpoint, why should they maintain a function that costs them extra and may ask for donations if there is no enforcement from regulators? Management may not consider the Sharia department as critical to the success or failure of the bank"

4- Systemic Risk and Consumer Protection

The interviewee emphasises the potential systemic risk associated with inadequate Sharia compliance mechanisms. If an Islamic bank claims Sharia compliance without a robust mechanism, it could breach consumer protection and pose a significant risk to the stability of the financial system.

Quote:

"If major Sharia non-compliance issue arises in one bank, it could create a domino effect and lead to similar problems in other Islamic banks. According to AAOIFI's perspective, any country where 15% or more of their financial system is based on Islamic banks is of systemic importance. There are numerous countries in the GCC and around the world where more than 15% of financial transactions are Sharia-compliant. Therefore, regulators should view the matter in this way"

5- Harmonization Challenges and Perspective Expansion

The interviewee sheds light on the lack of harmony in the Sharia governance framework across different countries. The problem is attributed to a narrow understanding of Sharia compliance by regulators. They advocate for a broader perspective, including aspects like consumer protection and systemic risk, to drive effective implementation.

Quote:

"I believe this problem will persist as long as regulators fail to understand that it is not solely about Sharia compliance but is about protecting customers and the economy."

Conclusion

The analysis underscores the critical challenges in the regulatory landscape, including capacity constraints, enforcement dynamics, perceptions of the Sharia auditor function, and the need for a broader perspective encompassing consumer protection and systemic risk. Addressing these challenges is imperative for ensuring effective implementation of the internal Sharia audit standard and promoting consumer protection and stability within the Islamic finance sector.

H3: Encouraging Adoption and Compliance:

Question 3: What strategies or initiatives can be undertaken to encourage Islamic banks to voluntarily adopt and comply with the internal Sharia audit standard?

This part explored strategies and initiatives that could encourage Islamic banks to voluntarily adopt and comply with the internal Sharia audit standard. This included examining potential measures for improving ethical compliance and enhancing the quality assurance of internal Sharia audits.

The interviewee highlighted the following:

1- Perception of Compliance and Legal Framework

The interviewee underscores a common perception of Sharia compliance as a religious duty, akin to prayers or fasting. However, they emphasise the need for a legal framework in business relationships to ensure accountability and prevent deceptive practices in contracts. The role of the board of directors in enforcing Sharia compliance is highlighted.

Quote:

> *"Unfortunately, both Islamic banks and regulators often perceive compliance with Sharia as they would view prayers, fasting, or giving to charities from a religious perspective. When it comes to the relationship between two human parties, there must be a legal framework to ensure accountability and prevent misleading or deceptive practices in contracts."*

2- Role of the Board of Directors

The interviewee emphasizes that the primary enforcer of Sharia compliance, including the role of the internal Sharia auditor, should be the board of directors. The board is accountable for the bank's actions and must ensure that the internal Sharia department has the necessary capacity and resources for compliance.

Quote:

> *"Therefore, the primary enforcer of Sharia compliance, including the role of the internal Sharia auditor, should be the board of directors."*

3- Enforcement as the Driving Force

The interviewee points out that voluntary adoption of standards may not be effective and suggests that enforcement, driven by regulators, is essential. They propose that regulators should require compliance mechanisms, qualified internal Sharia auditors, and regular reporting. Penalties for non-compliance are seen as a critical aspect of this enforcement approach.

Quote:

> *"Therefore, in my view, the only way to make it work is through regulatory enforcement, where regulators require Islamic banks claiming compliance with Sharia to provide mechanisms to ensure compliance and impose penalties for breaching these requirements."*

4- Role of Sharia Committees and Scholars

The interviewee highlights the role of Sharia committees and scholars in enforcing compliance. They emphasise that Sharia scholars should not sign Sharia certificates without ensuring full compliance and a proper mechanism for enforcement. This underscores the importance of the adoption of standards and the enforcement of compliance.

Quote:

> *"There is also a significant responsibility in the hands of the Sharia committee members because if they enforce the requirements of AAOIFI, Islamic banks may implement these requirements."*

Conclusion

The analysis highlights the need for a shift in perception, where Sharia compliance is not just a religious duty but also viewed through a legal framework. The crucial role of the board of directors, the necessity of enforcement driven by regulators, and the importance of involvement from Sharia scholars at the institutional level are emphasised. This approach is seen as essential to encourage the adoption and compliance with the internal Sharia audit standard within Islamic banks.

H4: Addressing Concerns and Obstacles:

Question 4: What are some common concerns or objections from Islamic banks regarding implementing the internal Sharia audit standard issued by AAOIFI?

This part of the interview addressed common concerns and objections from Islamic banks regarding the implementation of AAOIFI's internal Sharia audit standard. By identifying and understanding these barriers, the research sought to propose solutions and explore the most effective approaches to internal Sharia audit in the context of the GCC.

The interviewee highlighted the following:

1- Capacity as a Common Objection

The interviewee identifies a recurring objection raised by Islamic banks and regulators, which is the issue of capacity. Islamic banks often assert that they lack the capacity to implement the internal Sharia audit standard effectively. However, the interviewee questions this claim, especially for well-established banks, suggesting that capacity should have been built over their years of operation.

Quote:

> *"They will always use the capacity card and claim there is no capacity... after more than around 50 years of operation, if Islamic banks do not have the capacity, it is unlikely that they will have it in the next 50 years."*

2- Regulatory Oversight and Capacity

The interviewee raises a critical concern about how regulators can effectively oversee and regulate Islamic banks if they lack the capacity to ensure compliance. They question how regulators can license and supervise Islamic banks without having the necessary capacity. They also emphasise the importance of regulators having clear plans to develop the required capacity.

Quote:

> *"If you are regulating Islamic banking, licensing Islamic banks, and supervising them, how can you do that without having the necessary capacity? Even if you are, what are your plans to create the required capacity?"*

Conclusion

The analysis highlights a prevalent concern among Islamic banks and regulators regarding capacity limitations to implement the internal Sharia audit standard. The interviewee questions the legitimacy of this concern, especially for established banks, and stresses the critical role of capacity in effective regulatory oversight and compliance. The need for clear plans to address these capacity concerns is emphasised to ensure successful implementation of the Sharia audit standard.

H5: Future Outlook and Potential Developments:

Question 5: What steps can be taken to further promote harmonisation and standardisation of internal Sharia audit practices?

This part explored steps that could be taken to further promote harmonisation and standardisation of internal Sharia audit practices across the GCC. This inquiry aimed to provide recommendations for enhancing the overall effectiveness of Sharia audits and aligning practices with evolving international standards.

The interviewee highlighted the following:

1- Enhancing AAOIFI Standards

The interviewee highlights the necessity for AAOIFI to continuously improve and enhance its standards. This reflects a proactive approach to address evolving challenges and to maintain relevance and effectiveness in the dynamic landscape of Islamic finance.

Quote:

> *"First, AAOIFI has to further enhance its standards, and work is in progress to address this issue."*

2- Regulatory Focus on Protecting Customers and Systemic Stability

The interviewee emphasises that regulators should approach Sharia compliance with a focus on protecting customers and maintaining systemic stability. This perspective applies not only to Muslim-majority countries but also to non-Muslim nations. The need for capacity building, enforcement of standards, and penalties for non-compliance is stressed.

Quote:

> *"Even in non-Muslim countries, they should look at Sharia compliance from the perspective of protecting their customers... ensure that the system is immune from systemic risks, and customers' rights are safeguarded."*

3- Role of Sharia Scholars and Enforcement

The interviewee highlights the influential role of Sharia scholars in enforcing Sharia requirements. They should use their authority to set timelines for management to achieve compliance with AAOIFI standards. Furthermore, if an Islamic bank lacks a proper Sharia governance framework, Sharia scholars should refrain from signing the Sharia certificate, ensuring a more robust and effective Sharia audit.

Quote:

> *"Sharia scholars need to utilise their power to enforce Sharia requirements... rely solely on management would result in weak Sharia audits and a lack of market harmonisation."*

Conclusion

The analysis highlights three essential steps to promote harmonisation and standardisation of internal Sharia audit practices. These steps involve continual enhancement of AAOIFI standards, a regulatory focus on customer protection and systemic stability, and the active role of Sharia scholars in enforcement, ensuring a robust Sharia audit framework. These measures aim to further strengthen Sharia compliance within the Islamic finance industry.

H6: Integrated Audit Approach:

> Question 6: In your opinion, what potential benefits do you see in adopting an integrated approach to internal Sharia audit for Islamic banks? How might such an approach contribute to the credibility of the internal Sharia audit?

This section examined the potential benefits of adopting an integrated approach to internal Sharia audit. It considered how such an approach might contribute to the credibility and effectiveness of internal Sharia audits within Islamic banks. This exploration aimed to identify how integrating different audit approaches could address current challenges and improve overall compliance and audit quality.

The interviewee highlighted the following:

1- Comprehensive Compliance with Sharia Principles

The interviewee highlights that an integrated approach is essential for ensuring comprehensive compliance with Sharia principles. It's not limited to transactions alone; it encompasses all aspects of the business, including products, documentation, systems, and employee practices.

Quote:

> *"When an Islamic bank claims to be a fully Sharia-compliant bank, all aspects of the business must be in line with Sharia, not just the transactions."*

2- Holistic Adherence to Sharia across Business Aspects

The interviewee provides examples to emphasise that Sharia compliance extends beyond financial transactions. It includes factors like fair contractual terms (e.g., legible terms and conditions), just employment practices (e.g., fair working hours), and overall ethical behaviour in all business aspects.

Quote:

"For example, if an Islamic bank asks you to sign terms and conditions with very small font that makes the words unreadable, it is not Sharia compliant... if the employment contracts state that staff are required to work 40 hours per week, but the bank consistently forces them to work additional hours without overtime pay, that would also be considered non-compliant with Sharia."

Conclusion

The analysis highlights the significance of an integrated approach to internal Sharia audit, emphasising that compliance with Sharia principles should encompass all aspects of an Islamic bank's operations, not just financial transactions. This approach ensures a comprehensive and holistic adherence to Sharia across various business dimensions, contributing to the efficiency, effectiveness, and credibility of the internal Sharia audit within Islamic banks.

9.3 ANALYSIS OF DATA COLLECTED VIA INTERVIEW WITH A REGULATORY ADVISOR FOR MANY CENTRAL BANKS IN THE GCC

The interview with the regulatory advisor presents a profound analysis of the benefits and challenges associated with the adoption of the AAOIFI internal Sharia audit standard within Islamic banks. The discussion explores the historical evolution of Sharia audit practices, shedding light on past practices that lacked maturity and clarity. The same questions that were asked to the senior member from AAOIFI have been used in this interview to get the view from the regulators' perspective.

H1: Benefits and Importance of the Internal Sharia Audit Standard:

> **Question 1: What are the primary benefits and advantages of adopting AAOIFI's internal Sharia audit standard for Islamic banks? Why do you think that some practitioners have reservations about the standard's ability to meet their expectations?**

The interviewee highlighted the followings:

1- Clear Separation and Independence:

The interviewee emphasised that a primary benefit of adopting AAOIFI's internal Sharia audit standard is the clear separation between audit and ongoing advice or compliance. This separation helps avoid conflicts of interest and ensures independence in the audit process. By having different experts handle each aspect, it reduces the likelihood of undue influence and ensures objective audits.

Quote:

> *"The biggest advantage is this separation between Sharia compliance and Sharia audit function to ensure there is no conflict of interest, to ensure there are different types of experts doing this line of work, and of course, independence is a huge matter when you talk about Sharia."*

2- Challenges and Expectations:

The interviewee acknowledged that some practitioners have reservations about the Sharia audit standard's ability to meet their expectations. They pointed out that AAOIFI's governance, audit, and accounting standards may not be on par with similar standards in conventional finance. The challenges lie in the depth and detail of the standards compared to industry standards in non-Islamic finance. The interviewee also mentioned limited resources and funding as obstacles faced by AAOIFI in further elaborating and refining these standards.

Quote:

> *"If you compare AAOIFI's standards to similar industry standards outside Islamic finance, like if you go now and look at the certificate in internal audit and look at their material and look at the detail and the depth of the standards... there is no way you can compare, and this is a big challenge."*

3- Perception and Resistance to Change:

The interviewee highlighted a division among practitioners regarding their perception of Sharia audit. Some practitioners perceive Sharia audit as a tick-box exercise, viewing all Sharia-related functions as a routine compliance check. This perception stems from the contentment of having an internal Sharia advisor who provides favourable assessments. The resistance to change is observed among those content with their existing Sharia compliance mechanisms, making it harder to widely adopt stricter audit standards.

Quote:

"The management of any Islamic banks see Sharia audit as a stamp or as a tick box exercise... if their Sharia board is not asking for more... the management see any improvement as an additional cost."

Conclusion:

In summary, the interviewee underscored the significant advantage of the clear separation between audit and ongoing advice in Sharia compliance, enhancing independence and mitigating conflicts of interest. However, challenges persist, including meeting practitioners' expectations concerning the depth and detail of AAOIFI standards compared to conventional finance standards. Additionally, a perception exists among some practitioners that Sharia audit is mainly about compliance, which impacts the push for change and the stricter adoption of audit standards. It's essential to address these challenges and perceptions to promote a more robust and effective internal Sharia audit framework in Islamic banks.

H2: Understanding the Regulatory Landscape:

> **Question 2: From your perspective, why do you think most regulations in the GCC do not mandate compliance with the internal Sharia audit standard issued by AAOIFI? And what potential risks or challenges may arise due to the absence of mandatory compliance with this standard?**

The interviewee highlighted the followings:

1- Lack of Awareness and Understanding by Regulators:

The interviewee highlights a significant challenge which is regulators' lack of familiarity and understanding of AAOIFI standards. This lack of understanding may cause fear and hesitation in directly adopting these standards. Instead, regulators might develop their own regulations based on AAOIFI standards but adapted to their specific context.

Quote:

"Regulators themselves don't understand AAOIFI Sharia standard ... So, many regulators would see the standard as useful to be compliant with for Islamic banks as long as they don't contradict their regulations."

2- Lack of Dedicated Islamic Banking Departments:

Another challenge mentioned is the absence of dedicated departments for Islamic banking within regulators/central banks. This indicates a gap in expertise and focus on Islamic finance matters, including the implementation and enforcement of specific Sharia audit standards.

Quote:

> *"And what potential risks or challenges may arise due to the absence of mandatory compliance with this standard?... Lack of dedicated departments for Islamic banking and finance within the regulators who take care of these very niche nitty-gritty details."*

3- Lack of Demand and Maturity in Sharia Audit:

The interviewee notes a lack of demand for stringent adherence to Sharia audit standard within the industry. This may be due to the current focus on classical Sharia understanding and the perception that existing practices are sufficient.

Quote:

> *"There is no real demand happening unless and until... the Sharia supervisory boards not happy with how things are happening and taking action."*

4- Risk of Inconsistent Implementation:

The lack of a standardised approach to Sharia audit across different Islamic banks and the potential for varied interpretations and implementations is seen as a risk. This can lead to challenges in comparing and evaluating the effectiveness of Sharia audits.

Quote:

> *"Technically, we don't have harmony in the way we work as a Sharia auditor... That also creates risk."*

5- External Sharia Audit and Regulatory Examination:

The importance of external Sharia audits and regulatory examinations to ensure adherence to Sharia audit standards is emphasised. The absence or inadequate scrutiny in this regard poses a risk to the integrity and accuracy of Sharia compliance within Islamic banks.

Quote:

> *"If you look at the scope of the external Sharia audit in most of these countries, you don't feel it like part of their role really is to challenge and assess how internal Sharia audit works."*

Conclusion:

The analysis reveals that challenges in the regulatory landscape primarily stem from the regulators' lack of understanding of AAOIFI standards, the absence of dedicated Islamic banking departments within regulatory bodies, limited demand for stringent Sharia audit standards, and potential inconsistency in implementation across Islamic banks. The interviewee stresses the need for consistency and stricter oversight of Sharia compliance, highlighting the importance of external Sharia audits and regulatory examinations in ensuring adherence to AAOIFI's Sharia audit standard. Addressing these challenges is crucial for promoting a standardized and effective Sharia audit framework within Islamic finance.

H3: Encouraging Adoption and Compliance:

Question 3: What strategies or initiatives can be undertaken to encourage Islamic banks to voluntarily adopt and comply with the internal Sharia audit standard?

The interviewee highlighted three key stakeholders in encouraging adoption and compliance with the internal Sharia audit standard: regulators, Sharia scholars, and market initiatives.

1- Regulatory Encouragement and Compliance:

The interviewee emphasised the critical role of regulators in encouraging compliance within Islamic banks. They stressed that Islamic banks are driven by compliance and regulations set by regulatory authorities. This involves providing legal requirements or financial incentives to align with Sharia principles. The interviewee suggested that regulations can be passed to make it a legal requirement for boards and senior management to ensure the implementation of an effective Sharia governance framework in line with AAOIFI's standards.

Quote:

"And this is where, you know, we have to look at where the requirements are coming from... change needs to be happening from the Sharia authorities, from the legal authorities, or financial incentives which will be provided by the regulatory authorities."

2- Sharia Scholar Involvement:

The interviewee pointed out the responsibility of Sharia scholars and boards in promoting Sharia compliance and governance within Islamic banks. They emphasised the need for Sharia scholars to expand their role beyond determining contract halal or haram to actively engaging in governance, risk management, and auditing. This transition signifies the importance of educating and empowering Sharia scholars to understand and assess the impact of breaches from a Sharia perspective.

Quote:

"You know, the Sharia scholars at intuitional level has a responsibility in this... they have to look at governance... keep educating themselves."

3- Market Initiatives and Public Ratings:

The interviewee also discussed the potential impact of market initiatives, including public ratings of banks based on Sharia compliance and best practices. They proposed a rating tool or methodology that highlights the adherence of banks to Sharia governance standards. This approach could influence the banker mentality by linking Sharia compliance to business success and shareholder satisfaction.

Quote:

"So coming up with a rating tool or a rating methodology... then will affect business. If this affects business, then banks will take action."

Conclusion:

In summary, the interviewee underscored the necessity of regulatory involvement, active engagement of Sharia scholars, and market-driven initiatives to encourage Islamic banks to adopt and comply with the internal Sharia audit standard. These strategies collectively aim to create a conducive environment for Islamic banks to uphold Sharia principles and enhance their governance frameworks. It's evident that a multifaceted approach involving regulatory mandates, scholarly guidance, and market influences is crucial to drive compliance within the Islamic banking sector.

H4: Addressing Concerns and Obstacles:

Question 4: What are some common concerns or objections from Islamic banks regarding implementing the internal Sharia audit standard issued by AAOIFI?

The interviewee highlighted three common concerns and objections.

1- Lack of Capacity and Awareness:

The interviewee highlighted a significant concern within Islamic banks regarding the lack of capacity and awareness about the AAOIFI standards. They emphasised that the standards are not as comprehensive or detailed as those in conventional finance, making it challenging for regulators to use them as a reference. The interviewee also stressed the need for greater sophistication and depth in the standards, particularly in areas like audit, governance, and risk.

Quote:

"Yeah. So as I told you, there's a lack of capacity, lack of awareness... there is a lack of sophistication for regulators to make it the reference."

2- Absence of Dedicated Departments and Regulatory Risks:

The absence of dedicated departments within central banks focused on Islamic banking was noted as another obstacle. The interviewee expressed concern that without specific departments and regulatory frameworks in place, implementing and regulating the AAOIFI standards becomes difficult. They stressed the importance of dedicated departments to understand and regulate these standards effectively.

Quote:

"In addition to the lack of capacity and lack of awareness, there's also the absence of dedicated departments within Islamic central banks, on Islamic banking... they would never get it updated."

3- Challenges with AAOIFI Standards:

The interviewee pointed out that the AAOIFI standards themselves face challenges. They mentioned the relatively recent introduction of these standards, suggesting that their recent adoption contributes to the hesitancy and challenges in implementation. Moreover, the interviewee highlighted the need for timely updates to standards to keep them relevant and effective in regulatory processes.

Quote:

"The AAOIFI's internal Sharia standard itself is very new... So it's like a four-year standard... when the current regulations were development and approved... they looked at the previous AAOIFI's internal Sharia review standard which at more than 10-year standard."

Conclusion:

In summary, the interviewee identified significant concerns and obstacles faced by Islamic banks when implementing the internal Sharia audit standard issued by AAOIFI. These include a lack of capacity and awareness, the absence of dedicated departments within central banks, and challenges with the AAOIFI standards themselves. The interviewee emphasised the need for more detailed and sophisticated standards, dedicated regulatory departments, and timely updates to standards to address these concerns and facilitate smoother implementation within the Islamic banking sector. Addressing these challenges would contribute to a more effective and efficient adoption of Sharia audit standards.

H5: Future Outlook and Potential Developments:

Question 5: What steps can be taken to further promote harmonisation and standardisation of internal Sharia audit practices?

The interviewee highlighted the following:

1- Importance of a Multi-stakeholder Approach:

The interviewee emphasised the need for a multi-stakeholder approach to promote harmonisation and standardisation of internal Sharia audit practices. They highlighted that various entities, including lawmakers, regulators, stakeholders, consumers, communities, banks, and Sharia scholars, play crucial roles in this process. The engagement of multiple stakeholders ensures a comprehensive and effective approach to improving Sharia audit practices within Islamic banking.

Quote:

> *"So it's not like one stakeholder will go on their own. You need Sharia scholars to promote this... a multi-stakeholder approach will help..."*

2- Regulatory Involvement and Guidelines:

The interviewee mentioned the role of regulators and lawmakers in setting guidelines and regulations to promote harmonisation in Sharia audit practices. They anticipated that regulatory bodies might issue guidelines on Sharia governance in response to scandals or emerging issues, underscoring the evolving awareness of regulatory entities regarding the importance of effective Sharia governance frameworks.

Quote:

> *"I wouldn't be surprised in some years' time, where the regulators... may issue some guidelines on Sharia governance if we have a scandal or something."*

3- Responsibilities of Internal Stakeholders:

The interviewee stressed the responsibilities of various internal stakeholders within Islamic banks, including Sharia scholars at institutional level, Sharia audit departments, and audit committees. They highlighted the need for proactive engagement and collaboration between Sharia officials and audit committees to ensure effective Sharia audit practices. By involving the audit committee and emphasising the seriousness of Sharia audit, improvements can be made in the existing processes.

Quote:

"It's also the role of these Sharia scholars in these banks to highlight this very clearly to the audit committee and engage with them."

Conclusion:

In summary, the interviewee emphasised the importance of a multi-stakeholder approach involving regulators, lawmakers, Sharia scholars, banks, and other stakeholders to promote harmonisation and standardisation of internal Sharia audit practices within Islamic banking. They anticipated regulatory guidelines and stressed the proactive involvement of internal stakeholders, particularly the collaboration between Sharia scholars and audit committees, to enhance the effectiveness of Sharia audit practices. A collective effort from various stakeholders is seen as fundamental to achieving meaningful improvements in Sharia audit standards and practices.

H6: Integrated Audit Approach:

Question 6: In your opinion, what potential benefits do you see in adopting an integrated approach to internal Sharia audit for Islamic banks? How might such an approach contribute to the credibility of the internal Sharia audit?

The interviewee highlighted the following:

1- Standardisation and Consistency:

The interviewee stressed the necessity of an integrated approach to internal Sharia audit. They highlighted the importance of having a standard structure and criteria for conducting Sharia audits across different banks. This consistency would facilitate auditors in understanding the audit process and conducting audits effectively by benchmarking against established criteria.

Quote:

"That's definitely the need of the day... there is more or less a standard structure of the audit report, right?"

2- Comprehensive Audit Criteria and Methodology:

The interviewee discussed the various aspects that an integrated approach should encompass, including Sharia audit criteria, benchmarking, audit scope, and methodology. They emphasised that an integrated approach should cover every aspect of the audit, from criteria and benchmarks to risk-based audit methodologies. This comprehensive approach ensures thorough and effective audits.

Quote:

> *"First of all, what is the Sharia audit criteria? So what are we benchmarking against already? Is it only AAOIFI Sharia standards or is it the Sharia boards Fatwas and AAOIFI Sharia standards or the higher Sharia authority from the central bank? From there, you build your audit tests. Also, the scope of the audit, as you rightly mentioned. So the scope, some of them say it's only a department or some of them, it's only a product, some of them it's and then the methodology of doing the audit."*

3- Enhanced Credibility and Collaboration:

The interviewee highlighted that adopting an integrated approach would enhance the credibility of the internal Sharia audit. Collaborative efforts between Sharia auditors, audit departments, and audit committees within different banks are essential. They emphasised the need for proactive collaboration to ensure effective implementation of Sharia audit standards, thereby enhancing the credibility of the audit process.

Quote:

> *"It will create credibility definitely... You need the Sharia auditors to be willing to work together in different banks, and they have to work with audit departments within their banks and also with the audit committee to improve this."*

Conclusion:

In summary, the interviewee strongly advocated for an integrated approach to internal Sharia audit for Islamic banks. They highlighted the importance of standardisation, consistency, comprehensive audit criteria, and methodologies in achieving effective audits. Additionally, the interviewee emphasised that such an approach would significantly contribute to enhancing the credibility of internal Sharia audit. Collaborative efforts and proactive engagement from various stakeholders were seen as essential elements for the successful implementation of this integrated approach. This approach is perceived as a pivotal tool to ensure that Sharia compliance is rigorously adhered to in Islamic banking practices.

9.4 COMPREHENSIVE ANALYSIS OF AAOIFI GOVERNANCE COMMITTEE AND REGULATORY ADVISOR INTERVIEWS

The interviews with a senior member of AAOIFI’s Governance and Ethical Committee and a regulatory advisor provided valuable insights into the benefits, challenges, strategies, concerns, and potential future developments associated with adopting and implementing AAOIFI’s internal Sharia audit standard within Islamic banks. Combining the perspectives from both interviews, we can gain a complete understanding of the state of AAOIFI’s Sharia audit standard, regulatory dynamics, and the potential trajectory of the Islamic finance sector.

9.4.1 Benefits and Importance of Internal Sharia Audit Standard

Both interviewees emphasize the key role of Sharia compliance within Islamic banking institutions. The senior AAOIFI member highlighted the comprehensive standards issued by AAOIFI covering pre-transaction, post-transaction, and external audits to ensure compliance with Sharia, emphasising the need for adherence. Implementing these standards provides a standardised operational framework, promoting global harmonisation and enabling transparent comparison of Sharia audit reports among Islamic banks. In contrast, the regulatory advisor emphasised the importance of clearly separating the internal Sharia audit and compliance functions, underscoring independence and addressing challenges in detail compared to conventional standards. Additionally, they highlighted the resistance to change and varying perceptions within the industry.

9.4.2 Understanding the Regulatory Landscape

The interviews underscored the challenges within the regulatory landscape. These include a lack of regulatory understanding and capacity, inconsistent enforcement dynamics, a perception of Sharia audit as a cost centre, and potential systemic risks. Harmonisation challenges due to varying interpretations of Sharia compliance were also noted.

9.4.3 Encouraging Adoption and Compliance

The strategies to encourage Islamic banks to adopt and comply with the internal Sharia audit standard highlighted the importance of regulatory involvement, active engagement of Sharia scholars, and market-driven initiatives. The regulatory advisor stressed regulatory encouragement, Sharia scholar involvement, and market initiatives such as public ratings based on Sharia compliance.

9.4.4 Addressing Concerns and Obstacles

Both interviews highlighted concerns and obstacles, including lack of capacity and awareness, absence of dedicated Sharia departments in the central banks, challenges with AAOIFI standards, and the relatively recent introduction of the standards. Addressing these concerns through better standards and dedicated regulatory focus was emphasised.

9.4.5 Future Outlook and Potential Developments

The interviews pointed towards a multifaceted approach involving various stakeholders for promoting harmonisation and standardisation of internal Sharia audit practices. This includes a multi-stakeholder approach, regulatory involvement and guidelines, and proactive responsibilities of internal stakeholders such as Sharia boards and audit committees.

9.4.6 Integrated Audit Approach

Both interviewees advocated for an integrated approach to internal Sharia audit for Islamic banks, highlighting the need for standardization, comprehensive audit criteria and methodology, and enhanced credibility through collaboration between stakeholders.

9.5 KEY IMPORTANT NOTES

- Importance of Sharia Compliance: Both interviews underscore the critical role of Sharia compliance within Islamic banking institutions, emphasising alignment with Sharia principles and the need for effective Sharia audit practices.
- Regulatory Involvement is Crucial: Regulatory bodies play a pivotal role in promoting and enforcing Sharia audit standards. Encouragement, guidelines, and legal requirements are essential for compliance.

- **Stakeholder Collaboration is Key**: In promoting Sharia audit standards, a multi-stakeholder approach involving regulators, Sharia scholars, banks, and other stakeholders is vital for success.
- **Challenges Require Strategic Solutions**: Challenges such as lack of capacity, inconsistent enforcement, and resistance to change necessitate strategic solutions involving better standards, dedicated departments, and proactive engagement.
- **Integrated Approach Enhances Credibility**: An integrated approach to Sharia audit enhances credibility through standardisation, comprehensive criteria, and collaborative efforts among Sharia auditors and internal stakeholders.

9.6 SUMMARY

The understanding and implementation of AAOIFI's Sharia audit standard represent a pivotal aspect of the Islamic finance sector, ensuring the integrity and adherence to Sharia principles. The perspectives shared by the AAOIFI Governance Committee member and the regulatory advisor emphasised the necessity of ongoing improvement, harmonisation, and enhanced credibility within the Sharia audit process.

Strategic steps forward involve regulatory bodies taking an active role, evolving Sharia audit standards to meet industry expectations, and fostering collaboration among stakeholders. These measures will not only address existing challenges but also push the Islamic finance sector towards a future where a robust Sharia audit framework is fundamental, engendering trust and stability within the industry. A concerted effort involving regulators, scholars, Islamic banks, and auditors is crucial to achieving this collective vision and advancing the landscape of Sharia audit standards in Islamic finance.

CHAPTER 10: THE FINDINGS AND CONCLUSION

10.1 INTRODUCTION

This chapter serves as a key component of this thesis, providing a comprehensive overview of the research, its key findings, and actionable recommendations aimed at enhancing internal Sharia audit practices in the GCC market.

Despite its critical role, internal Sharia audit has been notably underexplored sufficiently in academic research. Much scholarly attention has historically been directed towards Sharia Supervisory Committees and the broader governance framework, thereby leaving the internal Sharia audit insufficiently examined.

The insights from this fieldwork shed light on the current challenges, gaps, and issues inherent in the processes of internal Sharia audit. Drawing on these findings, this chapter will propose actionable guidelines and policy recommendations aimed at establishing an effective framework for internal Sharia audits. These recommendations are designed to significantly contribute to the advancement of Sharia audit practices within the Islamic banking sector, fostering greater transparency, compliance, and robustness in internal audit practices.

10.2 OVERVIEW OF THE RESEARCH METHODOLOGY

This research employs a qualitative methodology, using semi-structured interviews and documentary analysis to investigate internal Sharia audit practices in GCC Islamic banks. The study focuses on evaluating current practices, analysing regulatory frameworks, and developing guidelines for improving the Sharia audit framework. An inductive approach is used to develop theory from empirical data, addressing gaps in existing theories. Data collection includes interviews with Sharia auditors, an AAOIFI representative, and a regulatory advisor, alongside documentary analysis of relevant regulations. Thematic analysis of the data informs recommendations for an effective internal Sharia audit framework.

10.3 THE MAIN FINDING OF THE RESEARCH

This section provides an overview of the main findings of the research, addressing the research questions posed in Chapter 1. The insights presented here are based on a blend of methodologies: 14 interviews with professionals specialising in internal Sharia audit, a detailed documentary analysis of the regulatory requirements across the GCC, and two semi-structured interviews with a senior member of AAOIFI and a regulatory advisor for GCC central banks.

The research has successfully met its objectives, delivering significant results. The findings are directly connected to the research questions, offering a comprehensive understanding of internal Sharia audit practices within the GCC. Each question has been thoroughly explored through the collected data, revealing both the current state of practices and the challenges encountered in the field. This in-depth approach has yielded valuable insights, providing a clearer and more detailed view of the internal Sharia audit environment and achieving the study's objectives.

10.3.1 The current internal Sharia audit practices in Islamic banks across the GCC

A series of interviews were conducted with Sharia audit practitioners from Islamic banks across the GCC, as well as with a senior member of AAOIFI and a regulatory advisor. The responses revealed significant disparities in Sharia audit practices across the region.

In countries like Qatar and Saudi Arabia, it is not uncommon for a single individual to handle multiple Sharia-related roles within an institution. This person may oversee Sharia compliance, internal Sharia audit, act as the secretary for the Sharia supervisory committee, and also be responsible for product development and staff training in Islamic banking. This consolidation of roles contrasts sharply with the practices observed in the UAE and Oman, where there is a clear separation between the second and third lines of defence. In these countries, Islamic banks must allocate distinct functions for Sharia compliance and internal Sharia audit. Specifically, Sharia compliance falls under the second line of defence, while internal Sharia audit operates independently as part of the third line of defence.

Despite this structural similarity between the UAE and Oman, there are notable differences in implementation. In Oman, internal Sharia auditors and Sharia compliance officers report to Sharia reviewers who manage all Sharia-related aspects within the bank. This setup may results in an outcome similar to that found in Qatar and Saudi Arabia despite separating the Sharia compliance from Sharia audit functions.

The research also identified challenges faced by practitioners in Sharia audit roles, particularly the difficulty in finding qualified personnel. This role requires expertise in both Sharia and conventional banking practices, which makes recruitment challenging. As a result, many Islamic banks rely on staff with conventional banking backgrounds, impacting the effectiveness of internal Sharia audit practices.

When asked about compliance with AAOIFI’s internal Sharia audit standards, most practitioners acknowledged the importance of adhering to these standards but highlighted several difficulties. These include the lack of regulatory requirements to comply with AAOIFI standards, the additional costs involved, and limited interest from bank management in pursuing compliance beyond obtaining annual Sharia approvals.

It is worth noting that some practitioners highlighted concerns with AAOIFI’s internal Sharia audit standard, particularly regarding its adequacy and effectiveness when compared with the audit standards issued by the Institute of Internal Auditors. Others noted challenges in practically implementing AAOIFI's internal Sharia audit standard, citing difficulties in reconciling the standard with the existing regulatory framework.

In the interviews with the practitioners, the researcher concluded that the enforcement of internal Sharia auditors will primarily come from regulators rather than other stakeholders. Management perceives internal Sharia auditors as imposing restrictions on their work, while the Board views the function as a cost without significant financial value for the business. Consequently, Sharia auditors are not given the same treatment as internal auditors by the management or the Board. Therefore, the primary authority to enforce Sharia audits lies with regulators, who aim to protect customers' interests and ensure they receive the desired products.

This perception can be linked to agency theory, where the role of Sharia auditors is seen as a constraint on management’s autonomy, thereby leading to resistance. However, from the perspective of stakeholder theory, the role of Sharia auditors should be valued as it ensures that the bank’s operations are in line with the Sharia standards and the religious values of its shareholders and customers. The need for regulatory enforcement thus underscores the gap between the theoretical ideals of stakeholder governance and the practical realities observed in the industry.

In the interviews conducted with a senior member of AAOIFI's governance standards and an advisor to several regulators in the GCC, they highlighted that regular improvements to AAOIFI's standards are definitely required. However, management may have little incentive to comply with AAOIFI's standards as long as there is no regulatory mandate.

Overall, the findings suggest a lack of harmonization in internal Sharia audit practices both within individual countries and across the GCC, reflecting varied interpretations and implementations of Sharia audit practices. It is also evident that there are differences in the implementation of AAOIFI's internal Sharia audit standards across Islamic banks in the GCC.

10.3.2 Regulatory Frameworks and Internal Practices of Internal Sharia Audit in Islamic Banks Across GCC Countries

Two questions were utilized in semi-structured interviews with practitioners and one question with a senior member of AAOIFI and an advisor to the regulators in the GCC. Additionally, documentary analysis was vital in providing further details for this research question.

In the interviews conducted with the practitioners, all participants acknowledged the regulatory requirements or guidelines for internal Sharia audit practices. However, challenges remain regarding the clarity, robustness, and enforcement of regulatory requirements. This challenge can be understood through agency theory, where the regulators act as principals aiming to ensure that Islamic banks, as agents, adhere to Sharia principles. The lack of clarity and enforcement weakens this principal-agent relationship, allowing banks more discretion, which could lead to conflicts of interest or non-compliance with Sharia standards.

Also, all participants acknowledged that the regulators do not conduct investigations to ensure compliance with the regulations, and consequently, there are no clear penalties for breaching these requirements. The absence of strict regulatory enforcement in some GCC countries aligns more with the Anglo-Saxon governance model, which tends to emphasize market-driven governance and often places less emphasis on stringent regulatory oversight.

It is worth noting that the interviews conducted with Sharia audit practitioners reveal a lack of harmonization in regulatory requirements concerning internal Sharia audit practices in the GCC. There are also concerns about the comprehensiveness and specificity of existing regulations, noting gaps in detailing the roles, responsibilities, and processes associated with internal Sharia audits.

Interestingly, Islamic banks in Saudi Arabia are not allowed to have the word "Islamic" in their name, as this would imply that other banks are not Islamic, which would be considered a breach of the country's constitution, which requires that everything must be in line with Sharia. Therefore, in Saudi Arabia, what is issued by the regulators are merely guidelines that can be implemented by any bank operating in the country, with no penalty for non-compliance.

The regulatory approach in Saudi Arabia, where guidelines are provided without strict enforcement mechanisms, further exemplifies the Anglo-Saxon model of governance. This model relies on the self-regulation and discretion of individual institutions rather than imposing stringent, centralized control. This contrasts with the European model seen in countries like Bahrain, UAE, and Oman, where there is a centralized Sharia supervisory committee within the central bank. This centralized approach is more in line with the European governance model, which emphasizes oversight, regulation, and protection of broader stakeholder interests.

From the documentary analysis, it is noted that all Islamic banks are required to have their internal Sharia committee. However, only three countries in the GCC—Bahrain, UAE, and Oman—have a centralized Sharia supervisory committee in the central bank. This committee improves regulatory requirements for Islamic banks, as before the regulator issues any regulations, they consult with the centralized Sharia committee to ensure no negative impact on the Islamic banks operating in the country.

Regarding ensuring compliance with regulatory requirements, most Islamic banks have a Sharia compliance department working as the second line of defence to ensure compliance with Sharia while coordinating with the bank's regulatory compliance department, as seen in the UAE. However, in Qatar and Saudi Arabia, this responsibility lies with the Sharia department, which is responsible for everything related to Sharia in the Islamic bank.

In the interviews conducted with a senior member of AAOIFI's governance standards and an advisor to several regulators in the GCC, they highlighted that when it comes to regulators, they claim to lack the capacity to enforce compliance with AAOIFI standards. The counterargument is that if, after 50 years, they still do not have the capacity, it is unlikely they will develop it in the future. Even if they genuinely lack the capacity, there should be a plan in place to build it. According to both interviewees, there is a misunderstanding among regulators about the importance of Sharia compliance. They recommended that regulators establish a specific department responsible for advising from a Sharia perspective.

Considering that the Islamic banking industry is still in its early stages compared to the conventional banking system, the findings of this research reveal a lack of harmonization in the regulatory frameworks and internal practices of internal Sharia audits in the GCC. There is still much to be done by regulators across the GCC and by the Islamic banks themselves to improve the work of internal Sharia auditors.

10.3.3 Roles and responsibilities of the internal Sharia audit department within the Islamic banks in the GCC

The research asked a specific question to internal Sharia auditors and conducted a documentary analysis of GCC regulations. This was to determine whether the roles and responsibilities of internal Sharia auditors are consistent across Islamic banks in the region.

From the semi-structured interviews, it was clear that every Islamic bank in the GCC has a function dedicated to ensuring compliance with Sharia principles. This task is primarily the responsibility of internal Sharia auditors. However, there are differences; for instance, in Qatar and Saudi Arabia, internal Sharia auditors may be responsible for all Sharia-related aspects within the bank. This can include product development, Sharia training, Sharia compliance, and performing internal Sharia audits.

In contrast, in the UAE, the role of internal Sharia auditors is more focused. They mainly assess the bank’s compliance with Sharia principles independently, help the internal Sharia supervisory committee with issuing Sharia certification, and ensure proper controls are in place to prevent future issues.

All GCC regulations provide a clear definition of internal Sharia audit and explicitly outline the objectives of this function. However, in some cases, regulators have not limited the internal Sharia auditors to performing audits alone, which explains the greater flexibility observed in Qatar and Saudi Arabia.

The research shows that the core responsibility of internal Sharia auditors is to independently verify adherence to Sharia principles and alignment with Fatwas issued by the Sharia committee. However, there is no uniformity in roles and responsibilities across the GCC. In some countries, the role can extend to encompass all Sharia-related activities within the bank, indicating diverse regulatory and operational frameworks.

It was noted that management views Sharia auditors as a cost centre, as they may request the management to donate money to charities or restrict their activities. Therefore, management may lack the incentive to distinguish the second line of defines from the third line when it comes to Sharia governance. If there is no regulatory requirement to separate these lines, management is unlikely to do so. However, many regulators, according to interview conducted with a senior member of AAOIFI, treat Sharia compliance in Islamic banking similarly to prayer and fasting. This highlights a flawed approach, considering the financial implications between parties and the need for government intervention to protect the interests of all stakeholders.

Based on the above, the research reveals that the roles and responsibilities of internal Sharia audit departments differ among Islamic banks in the GCC. In some countries, they may be responsible solely for internal Sharia audit, while in others, their duties could encompass everything related to Sharia, such as conducting Sharia compliance, product development, and Sharia compliance training.

10.3.4 Measures to ensure the competence, independence, and confidentiality of the internal Sharia audit department within the Islamic banks of the GCC

Six questions were posed during the semi-structured interviews: two focused on independence, two on competence, and two on confidentiality. Additionally, the documentary analysis of GCC regulations examined these three aspects to determine if they were adequately addressed by regulators.

The findings indicate that most GCC countries have mechanisms in place related to the competence of internal Sharia auditors. However, in some countries, internal Sharia auditors have never received any training related to auditing or Sharia. Despite the importance of evaluating internal Sharia auditors to enhance their competence, many assessments are conducted solely by the Sharia Supervisory Committee. This limits the development of Sharia auditors from an auditing perspective, as the Sharia committee possesses knowledge in Sharia but may lack sufficient expertise in auditing.

In some cases, such as in Bahrain, Saudi Arabia, and Qatar, the CEO assesses the Sharia auditors, raising questions about the independence and effectiveness of internal Sharia audits in these countries. The most important qualifications and skills for internal Sharia auditors are knowledge in Sharia, such as the Certified Sharia Advisor and Auditor qualification from AAOIFI, and auditing qualifications, such as the Certified Internal Auditor credential from the IIA.

Regarding the fit and proper criteria for internal Sharia auditors, interviews revealed that Sharia auditors must possess a comprehensive understanding of all aspects of banking, including knowledge in banking operations, audit skills, and, importantly, Sharia knowledge. Expertise in only one area will not suffice for a Sharia auditor to perform effectively. Interestingly, some interviewees noted that the only requirement to perform the job is approval from the institution's Sharia committee, as is the case in Saudi Arabia. In contrast, in the UAE, after the Islamic bank selects the Sharia auditor, approval is required by the central bank to ensure the auditor is competent enough for the role.

From the documentary analysis, it is evident that Saudi Arabia and Qatar have not met the criteria for having fit and proper standards for the head of internal Sharia audits. In these countries, anyone approved by management can assume the role, which raises concerns about the competency and expertise of those leading this crucial function. Conversely, other GCC countries, such as the UAE and Oman, have established specific qualifications and experience criteria for this position. In these countries, the appointment of the head of internal Sharia audits must be approved by the central bank, ensuring a higher level of scrutiny and expertise.

Oman's regulations, as the latest in the GCC to regulate Islamic banking, mandate regular training for internal Sharia auditors to ensure their competence. However, other GCC countries have not implemented this requirement. Regular training is essential for keeping Sharia auditors updated with evolving industry practices, regulations, and emerging risks. The absence of a regulatory requirement for regular training in some GCC countries raises concerns about potential knowledge gaps among internal Sharia auditors, which could impact the quality and effectiveness of their audits.

The results from the interviews and documentary analysis reveal inconsistencies regarding independence, the complex interplay of organizational dynamics, regulatory requirements, and governance mechanisms in shaping the establishment and operation of internal Sharia audit departments within GCC's Islamic banks. In some countries, the CEO holds significant power in appointing and dismissing the internal Sharia auditor, as seen in the case of Saudi Arabia, where, in one instance, an Islamic bank does not appoint a Sharia auditor unless he or she is a member of the teaching staff at a university. This creates a situation where, if there are disagreements with the bank's management, the auditor can be dismissed and return to their academic position, raising concerns about the power dynamics and lack of independence of Sharia auditors in this country.

In Bahrain, the central bank requires Islamic banks to comply with AAOIFI's governance standards. At the same time, regulations require internal Sharia auditors to report to both the CEO and the Sharia committee, creating a conflict between the regulations and AAOIFI's standards. In contrast, in the UAE, regulators are involved in the appointment and dismissal of Sharia auditors, which grants strong power and independence to the Sharia auditors. However, management often treats Sharia auditors as police officers rather than as part of the team. Despite this, Sharia auditors in the UAE's Islamic banks have full independence, which helps in providing unbiased Sharia audit reports. As a result, the findings and recommendations of the Sharia auditors are more likely to be trusted by both internal and external parties, including regulators and customers.

It was also noted that, in some cases, internal Sharia auditors are responsible for everything related to Sharia compliance at the Islamic bank, effectively working in both the second and third lines of defence, as seen in Qatar. This situation could lead to a conflict of interest, where the Sharia auditor might find themselves auditing their own work, potentially leading to biased reporting and a lack of critical assessment. Additionally, this could cause role confusion, with internal Sharia auditors spending time on operational tasks rather than focusing on Sharia assurance activities.

The study also reveals that in all cases, the internal Sharia auditors have full and unrestricted access to all documents and records needed to conduct the Sharia audit plan. However, despite having this full and unrestricted access, there were no written policies on how internal Sharia auditors should maintain confidentiality of the information they access. In some cases, the Sharia auditors sign a confidentiality agreement before accessing the information needed to conduct the audit. In other cases, the Islamic banks rely on the employment contract signed with the Sharia auditor, where if the auditors do not maintain confidentiality, the bank can take disciplinary actions against them.

The above findings indicate that there are shortcomings, inconsistencies, and weaknesses in the areas of competency, independence, and confidentiality of internal Sharia auditors within the GCC's Islamic banks, which may result in weaknesses in the Sharia governance framework and could lead to reputational risk.

10.3.5 Extent of ethical compliance and quality assurance support for internal Sharia audit functions in GCC Islamic banks

Two inquiries were made to the practitioners of internal Sharia audit in the GCC's Islamic banks, and a documentary analysis of the regulations explored the regulatory requirements for compliance with ethical standards and quality assurance.

The findings reveal that the majority of Islamic banks in the GCC do not comply with any audit ethical standards, and the regulatory requirements do not enforce compliance with these standards. The findings reveals that more development is required in this area from all stakeholders, including AAOIFI, the regulators, and the management of the Islamic banks. This is a crucial area where similarities exist among the majority of Islamic banks in the GCC, but it weakens the Sharia auditors in this regard. When Sharia auditors comply with ethical standards, it improves trust among all stakeholders and will help Sharia auditors remain honest and straightforward in their reporting, even when faced with pressure from management to alter their findings. This, in turn, will uphold the credibility of the Sharia audit report.

Regarding quality assurance, it is important for Sharia auditors to consider it, as it would enhance the consistency, reliability, and effectiveness of the Sharia audit. However, the interviews and regulatory analysis reveal a complete absence of formal quality assurance in Sharia audit practices in the GCC, as well as a lack of regulatory requirements for conducting quality assurance of the Sharia audit.

The absence of regulatory requirements to comply with ethical standards and conduct quality assurance explains why the majority of interviewees highlighted the lack of compliance. It was evident that without enforcement from the regulators, Sharia auditors may face additional pressure from management if they choose to voluntarily comply, as this may require additional costs for management. Moreover, management is generally not very interested in high-quality Sharia audit reports as long as the Islamic bank is certified as Sharia compliant.

Based on the above, the research reveals a lack of implementation of ethical standards and the absence of quality assurance, which could significantly reduce the overall reliability of internal Sharia audits within the GCC's Islamic banks.

10.3.6 Most suitable and effective approach to internal Sharia audit for Islamic banks in the GCC

Four specific questions were formulated and discussed during the semi-structured interviews. The primary objective was to assess the existing audit approaches and operational procedures to determine if there is any harmonisation in conducting Sharia audits across the GCC. Additionally, the documentary analysis of regulatory requirements for internal Sharia audits included a dedicated section on Sharia audit approaches and documentation.

The study reveals significant differences in the Sharia audit approaches and operational procedures across the GCC. According to the interviewees, there is no one-size-fits-all method. Some interviewees indicated that they conduct departmental Sharia audits to review all departments within the Islamic banks, while others adopt a product-based approach, focusing solely on the products offered by the banks. Another approach, cited by a significant number of interviewees, is the risk-based Sharia audit, which concentrates on Sharia non-compliant high-risk areas. Finally, a few interviewees mentioned the use of sampling methodology, particularly in cases where only one person is responsible for all Sharia-related matters within the bank, making it impossible to cover everything comprehensively.

The challenge is that regardless of the approach used—whether it focuses on departments, products, samples, or risk based approach - these audits typically conclude with the same result: that the Islamic banks are compliant with Sharia.

When it comes to the documentation of Sharia audits, the essential documents identified include the Sharia audit manual, Sharia audit charter, Sharia audit plan, and checklists, along with a list of required documentation. While all interviewees confirmed the existence of a Sharia audit plan, very few acknowledged the presence of the other key documents. This lack of comprehensive documentation may increase the risk of non-compliance with required standards, pose challenges in quality control and review, complicate training and on boarding processes for new Sharia auditors, and potentially lead to a decline in the overall quality of the Sharia audit.

Regarding the use of technology, all participants recognized its potential benefits; however, they highlighted the current lack of technological integration in their practices. The primary reasons for this include the absence of technology specifically tailored to Sharia audits due to the lack of standardization in the Sharia audit practices, limited support from management to explore new technological options, a lack of technical skills among Sharia auditors, and high costs or budget constraints.

The majority of interviewees agreed that adopting a standardized approach to conducting Sharia audits would enhance their efficiency and effectiveness. It would also improve credibility, enabling customers to compare Islamic banks based on their compliance with Sharia. However, they noted that enforcement of such a standardized approach is unlikely to come from within the banks, as there is no business justification for adopting a single method. Instead, they suggested that the main influence on the approach and its enforcement should come from regulators.

The documentary analysis reveals that none of the regulators in the GCC provide specific guidance on an internal Sharia audit approach. Additionally, some regulators do not explicitly require Islamic banks to have a Sharia audit plan, Sharia audit manual, Sharia audit charter, or a checklist for Sharia audits. This lack of regulatory mandate leaves it up to the discretion of the Islamic banks whether or not to implement these essential documents.

The interviews conducted with AAOIFI's senior member and an advisor to regulators in the GCC revealed that an integrated approach to internal Sharia audit is required in the Islamic finance industry. Both interviewees advocated for this integrated approach for Islamic banks, emphasizing the need for standardization, comprehensive audit criteria and methodology, and enhanced credibility through collaboration among stakeholders.

The findings from both the semi-structured interviews and the regulatory analysis indicate that a significant number of Sharia auditors in GCC Islamic banks are operating within an unclear and ambiguous audit framework. The absence of a standardized approach to conducting Sharia audits may lead to inconsistencies and disparities in how Islamic banks are assessed across the GCC. For instance, one Sharia auditor might conduct a high-level audit focusing only on a limited number of products, while another might undertake a comprehensive audit covering all aspects of the bank's operations, including products, services, contracts, and overall activities.

Based on the above, the research reveals that there are benefits to adopting an integrated approach to internal Sharia audit in Islamic banks. However, there is currently inconsistency in audit approaches, which could result in one Islamic bank being deemed Sharia-compliant based on a less thorough Sharia audit, while another might face more scrutiny. Such disparities may expose Islamic banks to significant Sharia non-compliance risks and reputational damage, especially if the robustness of the Sharia audit process and approach becomes a matter of public concern.

Overall, the findings of this research reveal significant gaps in the harmonisation and robustness of internal Sharia audit practices across the GCC, highlighting a lack of compliance with AAOIFI standards and weak regulatory enforcement. This aligns with existing literature, which has predominantly focused on broader Sharia governance and the role of Sharia Supervisory Committees, often neglecting the operational complexity and the crucial role of internal Sharia audits.

Prior studies emphasised the importance of regulatory frameworks in ensuring effective governance, yet this research uniquely reveals the perception among practitioners and regulators that Sharia compliance is viewed as a voluntary religious commitment rather than a legal or financial obligation, such as the commitment to comply with anti-money laundering regulations or treating customers fairly. This misunderstanding underscores a critical misinterpretation of Islamic banking by regulators, contradicting theoretical models that advocate for Sharia compliance as the foundation for these banks' existence and its importance to consumer trust.

Additionally, while the literature identifies resource and independence issues in overall Sharia governance and Sharia Supervisory Committees as challenges, this study provides novel insights into the systemic undervaluation of internal Sharia audit functions, which face similar issues but are further exacerbated by cost concerns from management and a lack of understanding by regulators regarding their critical role. Furthermore, the findings advance the discourse by shedding light on regulatory requirements as well as the operational and procedural aspects of internal Sharia audit approaches to effective Sharia compliance, necessitating a reassessment of regulatory priorities and enforcement mechanisms in the GCC.

10.4 DISCUSSION OF FINDINGS

This thesis discusses internal Sharia audit practices in GCC Islamic banks. It reveals no harmonisation in Sharia audit practices across the region, and none of the countries fully comply with AAOIFI's internal Sharia audit standards. This indicates a need for improvement in regulatory frameworks for internal Sharia auditors in the GCC.

The research also highlights that Sharia auditors are seen as a cost center by bank management, resulting in insufficient investment in technology, training, and compliance with ethical standards. Moreover, Sharia auditors are viewed differently from internal auditors, with limited power to enforce Sharia controls, particularly when they report only to the Sharia committee. Best practice would involve reporting to the board audit committee while maintaining a dotted reporting line to the Sharia Supervisory Committee.

There is no single, standardised approach to Sharia audits. Some auditors use comprehensive approaches, while others rely on high-level sampling. This inconsistency further emphasises the need for standardised guidelines, such as those from AAOIFI, to allow comparison across banks.

Regulators in the GCC are not enforcing Sharia compliance with the same severity as other regulatory issues like money laundering or fraud. This creates risks, including potential reputational and systemic risks, which could be mitigated through stronger enforcement. The research suggests that regulators must take Sharia compliance more seriously, and the responsibility for improving Sharia audit practices should start with them.

10.5 RECOMMENDATIONS

Based on the findings of this research, this section will outline targeted recommendations derived from the best practices and insights gathered throughout the study. The research primarily focuses on the current internal Sharia audit practices within Islamic banks, highlighting the associated challenges and examining the regulatory frameworks, the role and responsibilities of internal Sharia audit departments, and the mechanisms of competence, independence, and confidentiality. Additionally, it provides a general assessment of the internal Sharia audit departments and evaluates the Sharia audit approach and operational procedures.

To address these findings, the recommendations will be categorized into several key areas: recommendations for regulators and policymakers, recommendations for standard-setting bodies such as AAOIFI, recommendations for Islamic banks' management, recommendations for Sharia scholars and internal Sharia auditors, and recommendations for customers. These recommendations aim to enhance the effectiveness, consistency, and credibility of internal Sharia audits across the GCC, fostering improved compliance and governance in the Islamic banking sector.

10.5.1 Recommendations for Regulators and Policymakers

10.5.1.1 Strengthen Regulatory Frameworks:

- Mandatory Sharia Audit Standards: The research highlights that without enforceable regulatory mandates, the Sharia audit function may not achieve its full potential. Sharia audit must therefore be prioritized by regulators and regarded as a crucial aspect of financial transactions, rather than merely a matter of religious observance. Regulators should implement clear and enforceable regulations requiring Islamic banks to adhere to Sharia standards, such as those established by AAOIFI, as a foundational step. Any disagreements or discrepancies regarding AAOIFI standards should be addressed and resolved by a centralized Sharia Supervisory Committee at the national level, ensuring consistency and adherence across the country. The agency theory supports this approach, as it reduces the potential for management to act in ways that might not align with the interests of stakeholders.

- Enforce Other Components of the Sharia Governance Framework: For any country that allows Islamic banks to operate within its financial system, a centralized Sharia Supervisory Committee should be established at the national level, within the central bank. This committee should require all Islamic banks to have an independent Sharia Supervisory Committee, a Sharia Compliance Department in the second line of defence, and an independent Internal Sharia Audit Department in the third line of defence. Additionally, it should enforce the requirement for conducting external Sharia audits, as outlined in figure 9.
- Resolving Disagreements: In cases of disagreement between AAOIFI audit standard (or other standard-setting bodies), regulatory requirements, and the practices an Islamic bank wishes to implement at the institutional level, the bank's Sharia Supervisory Committee should consult the centralised Sharia Committee. This centralised body would provide a binding decision, ensuring consistency in Sharia audit practices across the country's Islamic banking sector.
- Penalties for Non-Compliance: Introduce financial penalties and sanctions for Islamic banks that fail to comply with the Sharia audit requirements. This could include fines, suspension of licenses, or other punitive measures to ensure compliance is taken seriously. These fines could also help regulators operate and fund activities related to the Sharia aspects of Islamic banks.
- Dedicated Sharia Department at Country Level: It is recommended that each regulator establish a dedicated Sharia department within central banks or regulatory authorities focused on Islamic banking. This department will assist regulators and the centralized Sharia supervisory committee in implementing Sharia governance requirements tailored to suit the regulations and the specific needs of each country.
- Capacity Building: regulators should invest in the development of specialized Sharia compliance units within regulatory bodies. Provide training and resources to equip

regulators with the skills needed to effectively oversee Sharia compliance in Islamic banks.

- Regular Inspections and Audits: Similar to audits related to money laundering and fraud, regulators should conduct regular inspections and audits of Islamic banks to ensure adherence to Sharia audit standards. This could include surprise Sharia audits to assess real-time compliance.
- Transparent Reporting: Mandate that Islamic banks publicly disclose their Sharia audit approach, findings and compliance status to enhance transparency and accountability. This could also help build trust among customers and stakeholders.
- Impose Fees on Islamic Banks: Regulators could impose fees on Islamic banks, if needed, to fund necessary activities such as the costs associated with regulatory Sharia auditors or the fees for the centralized Sharia supervisory committee.
- Certification of Sharia Auditors: Regulators must establish minimum requirements for the fit and proper criteria for Sharia auditors. Once Sharia auditors are selected by Islamic banks, the regulators should certify them to ensure they possess the necessary skills and knowledge to conduct Sharia audits. Additionally, if a Sharia auditor is dismissed by an Islamic bank, the regulator should conduct an exit interview to ensure the dismissal is not related to disagreements over the Sharia aspects of the bank, as seen in cases such as the UAE.
- Set Fit and Proper Criteria for the Head of Internal Sharia Audit: Regulators should establish and enforce specific fit and proper criteria for the heads of internal Sharia audit departments (such as the case in UAE). Clear regulatory requirements for qualifications and certification would help ensure that only competent professionals are appointed to these critical roles, thereby enhancing the integrity and effectiveness of the internal Sharia audit function.

10.5.1.2 Promote Harmonization Across the GCC:

- Standardization of Practices: Work with standard-setting bodies like AAOIFI to harmonize Sharia audit practices across the GCC. This could involve the development of region-wide guidelines that ensure consistency in Sharia compliance across all Islamic banks. This approach also reflects stakeholder theory, ensuring that all stakeholders across the GCC region benefit from consistent Sharia governance practices.

- Enforce Compliance with AAOIFI’s Governance Standards: In the GCC, some countries mandate compliance with either AAOIFI's Sharia standards (such as in the UAE) or AAOIFI's accounting and auditing standards (such as in Oman). Regulators should also enforce compliance with AAOIFI’s governance standards to enhance the Shaira audit practices as without strong Sharia audit the Islamic bank may not fully compliant with either AAOIFI’s accounting standards or its Sharia standards. Implementing these standards uniformly would promote better governance practices and ensure a more robust regulatory framework within the GCC.

10.5.2 Recommendations for Standard-Setting Bodies (e.g., AAOIFI)

10.5.2.1 Develop Comprehensive Sharia Audit Standards:

- Detailed Guidelines: Provide more detailed guidelines on Sharia audit processes, documentation, and ethical standards. These guidelines should be adaptable to various banking contexts while ensuring consistency in Sharia compliance.
- Collaboration between AAOIFI and IIA: It is recommended that AAOIFI explore opportunities for collaboration with the IIA to develop joint standards that better align with both Islamic finance principles and global best practices in auditing. This collaboration could help create comprehensive standards specifically tailored to the needs of Sharia auditors while maintaining rigorous audit quality and consistency.
- Quality Assurance Framework: Introduce a quality assurance framework for Sharia audits that includes peer reviews, continuous training, and standardized audit procedures. This would help ensure the reliability and accuracy of Sharia audits.

10.5.2.2 Enhance Training and Certification:

- Certification Programs: Establish mandatory certification programs for internal Sharia auditors to ensure they possess the necessary knowledge and skills. This could include a focus on both Sharia principles and modern auditing techniques. The fees to obtain these certifications would help AAOIFI in it is operations and continues improvement.

10.5.2.3 Sharia Compliance Rating Agency:

- Sharia Governance Rating Tool and Methodology: It is recommended that AAOIFI or another professional body develop an international Sharia governance rating tool and methodology, akin to those used by credit rating agencies. This tool would assess Islamic banks' adherence to Sharia governance standards, providing ratings similar to credit ratings. Introducing awards, such as recognizing the "Best Islamic Bank for Compliance with AAOIFI's Sharia Audit Standard," could incentivize Islamic banks to prioritise Sharia compliance. This approach would link Sharia adherence to the success and reputation of Islamic banks, thereby influencing the industry's mentality and fostering greater shareholder satisfaction

10.5.2.4 Facilitate Technological Integration:

- Guidelines for Technology Use: Develop guidelines on the integration of technology in Sharia audits, including the use of Sharia audit software and data analytics tools. This would help Islamic banks modernize their audit practices while ensuring they remain Sharia-compliant.

10.5.2.5 Create a Comprehensive Sharia Audit Approach

- Engage with Stakeholders: Standard-setting bodies like AAOIFI should facilitate dialogue with key industry stakeholders—including Sharia auditors, Sharia scholars, and regulators—to develop a global Sharia audit approach for Islamic banks. These bodies should strive to build consensus on a unified internal Sharia audit framework that can be widely adopted across jurisdictions. The audit approach must be announced to stakeholders and be available publicly.
- Offer Training and Capacity Building: Once a comprehensive audit approach is developed, standard-setting bodies should establish training programs for Sharia audit practitioners and offer certification programs. This will ensure that practitioners are well-equipped to implement the Sharia audit approach effectively and consistently.

10.5.3 Recommendations for Islamic Banks' Management

10.5.3.1 Invest in Sharia Audit Functions:

- Resource Allocation: Sufficient resources, including budget, staff, and technology, should be allocated to strengthen the Sharia audit function. This includes investing in specialized software, training programs, and hiring additional qualified Sharia auditors. The bank's management should link Sharia compliance to profitability, as customer perception of genuine Sharia compliance could lead to a shift toward Islamic banks, especially in the GCC, where the majority of the population is Muslim. Conversely, breaches of Sharia compliance could result in customer loss and, ultimately, decreased profits.
- Ethical Standards Compliance: Ensure that Sharia auditors adhere to strict ethical standards by implementing a code of conduct and providing regular ethics training. This will help maintain the integrity and credibility of the Sharia audit process. Islamic banks can also publish their code of ethics to their customers, which will encourage more customers to engage with banks that uphold high ethical values.
- Quality Assurance: Implement robust quality assurance processes within the Sharia audit function, including regular peer reviews, internal assessments, and continuous improvement initiatives.

10.5.3.2 Enhance the Role and Independence of Sharia Auditors:

- Reporting Structure: Establish a dual reporting structure for Sharia auditors, where they report both to the board’s audit committee and the Sharia Supervisory Committee. This ensures that they have the necessary authority and independence to carry out their duties effectively.
- Create Separation Between Sharia Compliance and Sharia Audit: To enhance the independence of Sharia auditors, it is recommended to establish a clear separation between the Sharia compliance function, which should be positioned in the second line of defence, and the internal Sharia audit function, which belongs to the third line of defence. From a governance perspective, it is unacceptable for a single individual to be responsible for all aspects of Sharia-related activities, including the development of product structures from a Sharia perspective and subsequently auditing those same products. This separation ensures objectivity, mitigates conflicts of interest, and strengthens the overall Sharia governance framework within Islamic banks.

- Collaboration with Sharia Scholars: Encourage closer collaboration between Sharia auditors and Sharia scholars to ensure that audit practices align with both regulatory requirements and Sharia principles.

10.5.3.3 Promote a Culture of Sharia Compliance:

- Leadership Commitment: Ensure that the board and senior management demonstrate a strong commitment to Sharia compliance, making it a core aspect of the bank's mission and operations.
- Expert in Sharia at Board Level: At least one member of the board in Islamic banks should have advanced knowledge in Islamic finance to ensure that the decisions made by the board are compliant with Sharia principles.
- Sharia Compliance-Related Objectives for the CEO: The CEO, being accountable to the board of directors, should have specific objectives related to compliance with Sharia principles. This would ensure that any intentional breaches or lack of proper support from the CEO could affect their objectives and potentially impact their bonus.
- Sharia Compliance Training: Everyone joining an Islamic bank should attend mandatory Sharia compliance training as part of their induction program. The induction should cover, at a minimum, a basic overview of Islamic finance, the Sharia governance framework within the Islamic bank, and an explanation of the products offered by the bank from a Sharia perspective.
- Regular Awareness Programs: Develop regular awareness programs for all staff on the importance of Sharia compliance and the role of the Sharia audit function. This would foster a culture of compliance throughout the organization.

10.5.4 Recommendations for Sharia Scholars and Internal Sharia Auditors

10.5.4.1 Ensure Comprehensive Understanding of Auditing Principles:

- Training in Modern Auditing Techniques: Sharia scholars and internal Sharia auditors should seek continuous education in modern auditing practices to enhance their effectiveness in the Sharia audit function. This includes understanding risk-based auditing, sampling methodologies, and the use of technology in audits.

- Collaborate on Standard Development: Engage actively with standard-setting bodies like AAOIFI to contribute to the development of comprehensive and practical Sharia audit standards.
- Improved Knowledge and Skills: A common challenge identified by many participants is the shortage of qualified individuals for Sharia audit teams. To address this, it is essential that prospective Sharia auditors possess a blend of expertise in both internal auditing and advanced Sharia knowledge. Additionally, they should enhance their understanding of banking practices and attain proficiency in English, as most banking documentation is now in English, even within the GCC region. Self-investing in education and training programs that address these needs will help build a skilled workforce capable of performing effective and compliant Sharia audits.

10.5.4.2 Agreeing on Internal Sharia Audit Approach:

- Uniform Sharia Audit Practices: Sharia auditors and scholars should collaborate to establish a unified internal Sharia audit approach, ensuring consistent audit practices across all Islamic banks in the region. This uniformity would standardize Sharia audit standards, documentation, and procedures, thereby facilitating easier comparisons between Islamic banks both within the same country and globally. A single, agreed-upon internal Sharia audit approach would also reduce the risk of hidden Sharia non-compliance, enhancing transparency and customer confidence.
- Enhance Technology for Sharia Auditors: Once a uniform Sharia audit approach is agreed upon, Islamic banks can invest in advanced technology tools specifically designed for internal Sharia audits. These tools could include software for sampling selection and artificial intelligence applications, which would significantly improve the efficiency and effectiveness of the Sharia audit processes. Such technological advancements would not only enhance the quality of Sharia audits but also ensure consistency in compliance practices worldwide.

10.5.4.3 Maintain Independence and Integrity:

- Ensure Independence: Sharia auditors must maintain their independence by avoiding involvement in the day-to-day activities of the Islamic bank, particularly situations where one individual is responsible for all Sharia-related matters. Sharia auditors should firmly position themselves within the third line of defence. If they find themselves engaging in activities related to the second line of defence, they should report these concerns in the annual Sharia audit report to the relevant committees within the Islamic bank, such as the Board Audit Committee or the Sharia Supervisory Committee.

- Uphold Ethical Standards: Sharia auditors should adhere strictly to ethical standards, ensuring honesty, transparency, and objectivity in their audits. They should resist any pressure from management to alter findings.
- Reporting Discrepancies: Ensure that any discrepancies or non-compliance issues identified during the audit are reported accurately and promptly to the appropriate authorities, including the Sharia Supervisory Committee and regulatory bodies if applicable.

10.5.4.3 Advocate for Technological Integration:

- Leverage Technology: Encourage the adoption of technology in Sharia audits to enhance efficiency and accuracy. Sharia scholars should advocate for the development of technology solutions tailored to Sharia compliance needs.

10.5.4.4 The Annual Sharia Certificate:

- Rejecting the Signing of the Sharia Certificate: Members of the Sharia Supervisory Committee hold significant power at the end of each financial year, as Islamic banks must include a Sharia certificate in their annual report certifying compliance with Sharia principles. The Sharia Supervisory Committee can refuse to sign this certificate if the internal Sharia audit practices do not align with industry best practices. Although Sharia scholars on the Sharia Supervisory Committee might risk being replaced by the board for taking such a stance, if all well-known Sharia scholars collectively agree on best industry practices, the board of Islamic banks would be more likely to follow the scholars' recommendations.

10.5.4.5 Sharia Audit Documentations:

- Drafting Full Sharia Audit Documentation: All participants in the interviews confirmed the existence of a Sharia audit plan, but not all had the full set of required documents that any Sharia audit function must possess. Sharia auditors should ensure they have, at a minimum, the Sharia audit plan, Sharia audit manual, Sharia audit charter, list of required documents, and checklists. These documents play a crucial role in maintaining consistency, transparency, and compliance with regulatory requirements in Sharia audit practices.

10.5.5 Recommendations for Customers

10.5.5.1 Demand Transparency and Accountability:

- Informed Decision-Making: Customers should demand transparency from their Islamic banks regarding Sharia compliance. This includes requesting access to Sharia audit reports and understanding how their bank ensures adherence to Sharia principles.
- Awareness and Education: Educate themselves on the basics of Sharia compliance and the significance of Sharia audits. This knowledge will empower customers to make informed choices about their banking relationships.

10.5.5.2 Advocate for Stronger Sharia Compliance:

- Feedback and Advocacy: Provide feedback to Islamic banks about the importance of genuine Sharia compliance. Customers can also advocate for stronger regulatory oversight and the implementation of more rigorous Sharia audit standards.

10.5.5.3 Select Banks with Strong Sharia Practices:

- Evaluate Sharia Compliance: When choosing an Islamic bank, customers should consider the institution’s commitment to Sharia compliance, including its adherence to recognized standards and the robustness of its Sharia audit function. This can be done by reviewing the bank’s transparency in disclosing its Sharia practices and audit outcomes.

10.5 CONTRIBUTION OF THE RESEARCH

This thesis makes several significant contributions to the field of Islamic finance, particularly in the area of internal Sharia audit within Islamic banks in the GCC region. The research addresses critical gaps in the existing literature by exploring and analyzing the current internal Sharia audit practices, regulatory frameworks, and operational roles and responsibilities of internal Sharia audit departments across GCC countries. The findings and recommendations of this research contribute to the ongoing discourse on the harmonization of internal Sharia audit practices within the region.

10.5.1 Analysis and Assessment of Internal Sharia Audit Practices

The research provides a comprehensive analysis and assessment of the current internal Sharia audit practices within Islamic banks across the GCC. By utilizing detailed documentary analysis and interviews with practitioners, the study reveals significant discrepancies in audit approaches, operational procedures, and documentation standards. This contribution is crucial as it highlights the lack of uniformity in practices, a gap that has not been sufficiently explored in prior research. The findings highlight the need for standardized practices to ensure consistency, reliability, and effectiveness in Sharia audits, setting the stage for future standardization efforts.

10.5.2 Critical Examination of Regulatory Frameworks

The thesis critically examines the regulatory frameworks governing internal Sharia audit practices in the GCC. The research uncovers varying degrees of regulatory oversight and enforcement across different countries, particularly regarding compliance with AAOIFI standards. This analysis highlights regulatory shortcomings that impede effective Sharia auditing and compliance. This contribution enhances the understanding of the relationship between regulatory frameworks and internal audit practices, aligning with stakeholder theory by advocating for a more uniform regulatory approach that considers the interests of a broad range of stakeholders. The research's call for uniformity reflects the European model's focus on regulatory harmonization, which enhances transparency and accountability in Islamic banking across the region.

10.5.3 Roles and Responsibilities of Internal Sharia Audit Departments

The research offers a detailed examination of the roles and responsibilities of internal Sharia audit departments within Islamic banks. The study identifies a diverse scope of duties assigned to Sharia auditors, including compliance monitoring, product development, and training. The findings indicate that the lack of a clear and consistent role definition undermines the effectiveness of Sharia audits. This contribution provides a basis for future policy recommendations aimed at clarifying and standardizing these roles, thereby enhancing the effectiveness and reliability of Sharia audits across the region.

10.5.4 Evaluation of Competence, Independence, and Confidentiality

The thesis evaluates the measures in place to ensure the competence, independence, and confidentiality of internal Sharia audit departments. This contribution is crucial as it emphasizes the need for stricter standards and enforcement mechanisms to safeguard the integrity of Sharia audits, thereby enhancing the credibility of Islamic banking practices. The research also highlights the importance of developing fit and proper criteria for internal Sharia auditors to ensure they possess the necessary skills and knowledge.

10.5.5 Ethical Compliance and Quality Assurance in Internal Sharia Audits

The research assesses the extent to which internal Sharia audit functions in GCC Islamic banks are ethically compliant and supported by quality assurance measures. The study reveals a need for improved ethical standards and quality assurance practices, contributing to a better understanding of how these elements impact the effectiveness of Sharia audits. This finding underscores the importance of implementing robust ethical guidelines and quality assurance processes to enhance the reliability of Sharia audits.

10.5.6 Recommendations for Effective Internal Sharia Audit Approaches

The thesis proposes a set of recommendations aimed at identifying the most suitable and effective approach to internal Sharia audits for Islamic banks in the GCC. These recommendations are based on the study's findings and include measures for harmonizing audit practices, enhancing regulatory oversight, and creating a comprehensive Sharia audit framework. The proposed guidelines are directed towards regulators, standard-setting bodies, Islamic banks' management, Sharia scholars, and auditors, contributing to the development of a more uniform and robust Sharia audit framework in the region.

10.5.7 Advancement in Technology and Innovation for Sharia Auditing

The thesis contributes to the field by advocating for the integration of advanced technology and innovation in Sharia auditing. It suggests the adoption of digital tools such as artificial intelligence and data analytics to improve the efficiency and effectiveness of Sharia audits. By proposing a uniform audit approach, the research facilitates the development of technology solutions tailored to Sharia auditing, which can be globally implemented to ensure consistency, reduce costs, and enhance real-time compliance monitoring.

10.6 LIMITATION AND AVENUES FOR FUTURE RESEARCH

10.6.1 Limitations of the Research

While this research contributes valuable insights into internal Sharia audit practices within Islamic banks in the GCC, it is subject to several limitations that present opportunities for future exploration.

10.6.1.1 Scope Limitation: Focus on Islamic Banks

The study exclusively targets Islamic banks, excluding other Islamic financial institutions such as investment banks and Takaful companies. These institutions have distinct operational structures and regulatory environments, which necessitate different approaches to internal Sharia audit. Future research could address this gap by exploring internal Sharia audit practices in these other Islamic financial sectors, thus broadening the understanding of Sharia compliance across various types of institutions.

10.6.1.2 Geographical Limitation: GCC Region

The research findings and recommendations are specific to the GCC region, where regulatory frameworks and cultural contexts are unique. While the insights may be applicable to Islamic banks in other regions, the generalizability is limited due to varying regulatory requirements and practices globally. Future studies could investigate how these findings might be adapted to different international contexts, examining the impact of diverse regulatory environments on the effectiveness and applicability of the proposed harmonization strategies.

10.6.1.3 Methodological Limitation: Exclusion of Quantitative Approaches

This study primarily employs qualitative research methods due to the limited number of Islamic banks in the GCC, many of which have minimal or no internal Sharia audit functions. The exclusion of quantitative methods, such as surveys, was necessitated by the depth of insight required. Future research could incorporate mixed-methods approaches or focus on many regions with a larger number of Islamic banks to integrate quantitative analysis, providing a broader and more comprehensive understanding of internal Sharia audit practices.

10.6.1.4 Focus Limitation: Internal Sharia Audit

The research concentrates on internal Sharia audit practices, as external Sharia audits are not yet widely practiced or mandated across many regions. This focus limits the scope of findings and recommendations. Future studies could explore the emerging field of external Sharia audits, investigating their potential role in enhancing Sharia compliance and overall governance within Islamic financial institutions.

10.6.2 Avenues for Future Research

Given these limitations, future research could explore several key areas:

- Internal Sharia Audit in Non-Banking Islamic Financial Institutions: Investigate how Sharia audits are conducted in institutions such as investment banks, Takaful companies, and other non-banking entities.
- Comparative Studies Across Different Regions: Explore the applicability and effectiveness of the research findings in Islamic banks outside the GCC, particularly in regions with different regulatory and cultural contexts.
- Incorporation of Quantitative Methods: Utilize survey-based or mixed-methods approaches in many regions with a larger number of Islamic banks to provide more generalizable findings.

- Development of External Sharia Audit Practices: Examine the potential benefits, challenges, and regulatory needs for implementing external Sharia audits within the Islamic finance industry.

These avenues for future research address the limitations identified in this study and offer pathways for enhancing the robustness and reliability of Sharia audit practices in Islamic finance.

10.7 CONCLUSION

In this chapter, we have provided a comprehensive review of the research methodology, key findings, recommendations, contributions, and limitations of this study on internal Sharia audit practices within Islamic banks in the GCC region.

The research methodology, grounded in qualitative approaches such as semi-structured interviews and documentary analysis, has effectively captured the complexities and variances in current internal Sharia audit practices. This methodology facilitated an in-depth exploration of Sharia audit practices and addressed the research questions by revealing critical insights into the operational realities of Sharia audits.

The main findings of the research underscore significant inconsistencies in internal Sharia audit practices across the GCC. These findings highlight deficiencies in adherence to ethical standards and the absence of robust quality assurance mechanisms. The gaps identified point to the urgent need for enhanced regulatory frameworks, greater investment in resources and training, and a more structured approach to Sharia compliance within Islamic banks.

To address these deficiencies, the research offers several recommendations aimed at improving internal Sharia audit practices. These include advocating for standardized regulatory measures, implementing uniform practices across Islamic banks, and fostering increased engagement from Sharia scholars and customers. These recommendations are designed to promote greater consistency, transparency, and effectiveness in Sharia audits and to better align with established standards such as those from AAOIFI.

The findings also carry significant theoretical implications. The research challenges the common belief that Sharia compliance is inherently robust due to its religious foundation and the presence of Sharia scholars within these financial institutions, revealing instead a gap between theoretical ideals and operational realities. It demonstrates that internal Sharia audits, often treated as secondary to conventional audits, require a theoretical reframing to emphasise their role in bridging ethical principles and governance practices. By extending the application of governance theories, such as agency and stakeholder theories, to the context of Sharia governance, this study highlights the importance of aligning ethical and operational dimensions within Islamic banks.

Furthermore, the findings suggest a need to adapt and expand existing Sharia governance models to incorporate a more explicit focus on internal audit practices as a critical element of effective Sharia governance. Internal Sharia auditors act as the eyes and ears of the Sharia Supervisory Committee; if the function is not strong enough, there could be a disconnect between Sharia decisions and actual practices.

The contributions of this research are substantial, providing valuable insights into the current state of internal Sharia audits and offering actionable guidance for stakeholders. The findings contribute to the broader discourse on Sharia compliance and governance within Islamic finance, particularly within the GCC context. By addressing critical gaps and offering practical solutions, this research advances the field and supports ongoing efforts to enhance the integrity and reliability of Sharia auditing practices.

However, the study is subject to several limitations. It focuses exclusively on Islamic banks, excluding other types of Islamic financial institutions such as investment banks and Takaful companies. Additionally, the research is geographically confined to the GCC region, and the exclusion of quantitative methods limits the scope of findings. The study also primarily addresses internal Sharia audits, leaving room for exploration into external Sharia audit practices.

These limitations suggest several avenues for future research, including investigating internal Sharia audit practices in non-banking Islamic financial institutions, expanding the research scope to include a broader international context, incorporating quantitative methods for more generalizable findings, and exploring the development and impact of external Sharia audits.

Overall, this chapter has summarised the study's comprehensive analysis, outlined its impact, and paved the way for future advancements in the field of internal Sharia audit practices. The research not only contributes to academic knowledge but also provides practical insights for regulators, the management of Islamic banks, and standard-setting bodies. Additionally, its theoretical implications underscore the necessity of evolving governance frameworks to integrate operational realities, reinforcing the importance of internal Sharia audits in enhancing the overall integrity of Islamic banking in the GCC and beyond

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APPENDICES

APPENDIX A: LETTER SENT TO PARTICIPANTS IN THE INTERVIEW

Subject: Request for PhD Interview

Dear xxx,

Asalaam Alikum,

I hope you are well. My name is Muhammad Saeed Fadloun, and I am currently pursuing my PhD in Business management at the University of Salford. I am writing to request an opportunity to conduct an interview with you as part of my research.

Your extensive expertise and knowledge in the field of Sharia audit is highly relevant to my PhD research. Specifically, my research is focused on internal Sharia audit in the context of Islamic banking. Given your experience in the Islamic banking industry, I am confident that your insights and perspectives would be invaluable in informing my research and contributing to its overall success.

I would be honoured to have the opportunity to ask you few questions about the internal Sharia audit and to benefit from your expertise. The interview will not take more than one hour and can be conducted via video call at your convenience. I am flexible with the time and date and can adjust my schedule to accommodate your availability.

If you are willing to participate in the interview, I will send you a list of interview questions that I have prepared beforehand. Additionally, I will also share my ethical approval letter from the University of Salford to ensure transparency about the research process.

I understand that your time is valuable, and I assure you that the information gathered from the interview will be used solely for academic purposes. I am also happy to provide a copy of my research proposal and any other relevant information that you may require.

Thank you for considering my request. I look forward to hearing from you soon.

Best regards,
Muhammad Saeed fadloun

APPENDIX B: SEMI-STRUCTURED INTERVIEW QUESTIONS

1- Current Internal Sharia Audit Practices

Question 1: What Internal Sharia Audit means at your Islamic bank?

Question 2: What are the challenges you might be facing in relation to Internal Sharia Audit?

Question 3: Does your bank comply with the internal audit standard issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI)? If yes/no, to what extent does implementing this standard improve your work?

2- Regulatory Framework

Question 4: Is the Internal Sharia Audit subject to any regulatory requirements? If yes, what will happen when an Islamic bank breaches these requirements?

Question 5: How do you stay updated with changes in regulatory requirements pertaining to Internal Sharia Audit? What mechanisms or processes do you have in place to ensure compliance with evolving regulations?

3- The Role of the Internal Sharia Audit Department

Question 6: What are the main roles and responsibilities of the Internal Sharia Audit department in your bank?

4- Mechanism of the Internal Sharia Audit

4.1. Competence

Question 7: Is the bank's Internal Sharia Audit staff trained on a regular basis? And is there any assessment or evaluation of the head of internal Sharia audit?

Question 8: What are the most important fit and proper criteria for the Head of the Internal Sharia Audit department?

4.2. Independence

Question 9: Who is responsible for setting up and dismissing the Internal Sharia Audit department?

Question 10: Who is responsible for the ongoing/day-to-day monitoring of the Islamic bank's overall activities and Sharia compliance environment?

4.3. Confidentiality

Question 11: Does the Internal Sharia Audit department have full and unrestricted access to all documents and records?

Question 12: What steps are taken to ensure the confidentiality of audit findings and sensitive information? How do you handle and safeguard the confidentiality of audit reports and related documents?

5- General Assessment of the Internal Sharia Audit Department

Question 13: Do you comply with any other audit or ethical standards? If so, what are the standards, and how do these standards improve your work?

Question 14: Is there any internal quality assurance or assessment conducted on your Internal Sharia Audit? If so, how do you conduct/assess such in-house quality checks?

6- Sharia Audit Approach and operational procedure

Question 15: Could you explain the current Internal Sharia Audit approach?

Question 16: Are there any documents you file for the Internal Sharia Audit (audit manual/an audit charter/audit plan)?

Question 17: Considering the rise of financial technology, does your department plan on or have already started encouraging modern technical software for the Sharia audit? If so, what is the software, and how could technology improve the Internal Sharia Audit work?

Question 18: In your opinion, what potential benefits do you see in adopting an integrated approach to the Internal Sharia Audit for Islamic banks? How might such an approach contribute to the efficiency, effectiveness, and credibility of the audit function?

APPENDIX C: SEMI-STRUCTURED INTERVIEW QUESTIONS WITH AAOIFI

1- Benefits and Importance of the Internal Sharia Audit Standard

Question 1: What are the primary benefits and advantages of adopting AAOIFI's internal Sharia audit standard for Islamic banks? Why do you think that some practitioners have reservations about the standard's ability to meet their expectations?

2- Understanding the Regulatory Landscape

Question 2: From your perspective, why do you think most regulations in the GCC do not mandate compliance with the internal Sharia audit standard issued by AAOIFI? And what potential risks or challenges may arise due to the absence of mandatory compliance with this standard?

3- Encouraging Adoption and Compliance

Question 3: What strategies or initiatives can be undertaken to encourage Islamic banks to voluntarily adopt and comply with the internal Sharia audit standard?

4- Addressing Concerns and Obstacles

Question 4: What are some common concerns or objections from Islamic banks regarding implementing the internal Sharia audit standard issued by AAOIFI?

5- Future Outlook and Potential Developments

Question 5: What steps can be taken to further promote harmonisation and standardisation of internal Sharia audit practices?

6- Integrated Audit Approach

Question 6: In your opinion, what potential benefits do you see in adopting an integrated approach to internal Sharia audit for Islamic banks? How might such an approach contribute to the credibility of the internal Sharia audit?

APPENDIX D: SEMI-STRUCTURED INTERVIEW QUESTIONS IN Arabic

1 -ممارسات التدقيق الشرعي الداخلي الحالية

السؤال 1: ماذا يعني التدقيق الشرعي الداخلي في بنكك الإسلامي؟

السؤال 2: ما هي التحديات التي قد تواجهها فيما يتعلق بالتدقيق الشرعي الداخلي؟

السؤال 3: هل يتوافق بنكك مع معيار التدقيق الداخلي الصادر عن هيئة المحاسبة والمراجعة للمؤسسات المالية الإسلامية (AAOIFI)؟ إذا كانت الإجابة بنعم/لا، إلى أي مدى يؤدي تطبيق هذا المعيار إلى تحسين عملك؟

2 -الإطار التنظيمي

السؤال 4: هل يخضع التدقيق الشرعي الداخلي لأي متطلبات تنظيمية؟ إذا كانت الإجابة بنعم، فماذا سيحدث عندما يخالف بنك إسلامي هذه المتطلبات؟

السؤال 5: كيف تظل على اطلاع دائم بالتغييرات في المتطلبات التنظيمية المتعلقة بالتدقيق الشرعي الداخلي؟ ما هي الآليات أو العمليات التي لديك لضمان الامتثال للوائح المتطورة؟

3 -دور إدارة التدقيق الشرعي الداخلي

السؤال 6: ما هي الأدوار والمسؤوليات الرئيسية لإدارة التدقيق الشرعي الداخلي في بنكك؟

4 -آلية التدقيق الشرعي الداخلي

4.1 .الكفاءة

السؤال 7: هل يتم تدريب موظفي التدقيق الشرعي الداخلي في البنك بشكل منتظم؟ وهل هناك أي تقييم أو تقويم لرئيس التدقيق الشرعي الداخلي؟

السؤال 8: ما هي أهم معايير الأهلية والصلاحية لرئيس قسم التدقيق الشرعي الداخلي؟

4.2 .الاستقلال

السؤال 9: من المسؤول عن إنشاء قسم التدقيق الشرعي الداخلي وإقالته؟

السؤال 10: من المسؤول عن المراقبة المستمرة/اليومية للأنشطة الإجمالية للبنك الإسلامي وبيئة الامتثال للشريعة؟

4.3 .السرية

السؤال 11: هل يتمتع قسم التدقيق الشرعي الداخلي بإمكانية الوصول الكامل وغير المقيد إلى جميع الوثائق والسجلات؟

السؤال 12: ما هي الخطوات المتخذة لضمان سرية نتائج التدقيق والمعلومات الحساسة؟ كيف تتعاملون مع تقارير التدقيق والوثائق ذات الصلة وتحافظون على سريتها؟

5 -التقييم العام لقسم التدقيق الشرعي الداخلي

السؤال 13: هل تلتزمون بأي معايير تدقيق أو أخلاقيات أخرى؟ إذا كان الأمر كذلك، فما هي المعايير، وكيف تعمل هذه المعايير على تحسين عملكم؟

السؤال 14: هل يتم إجراء أي ضمان للجودة الداخلية أو تقييم على قسم التدقيق الشرعي الداخلي؟ إذا كان الأمر كذلك، فكيف تقومون بإجراء/تقييم مثل هذه الفحوصات الداخلية للجودة؟

6 -نهج التدقيق الشرعي والإجراءات التشغيلية

السؤال 15: هل يمكنكم شرح نهج التدقيق الشرعي الداخلي الحالي؟

السؤال 16: هل هناك أي مستندات تقومون بتقديمها للتدقيق الشرعي الداخلي (دليل التدقيق/ميثاق التدقيق/خطة التدقيق)؟

السؤال 17: بالنظر إلى صعود التكنولوجيا المالية، هل تخطط إدارتكم أو بدأت بالفعل في تشجيع البرامج التقنية الحديثة للتدقيق الشرعي؟ إذا كان الأمر كذلك، فما هو البرنامج، وكيف يمكن للتكنولوجيا تحسين عمل التدقيق الشرعي الداخلي؟

السؤال 18: في رأيك، ما هي الفوائد المحتملة التي تراها في تبني نهج متكامل للتدقيق الشرعي الداخلي للبنوك الإسلامية؟ كيف يمكن لهذا النهج أن يساهم في كفاءة وفعالية ومصداقية وظيفة التدقيق؟