

UNIVERSITI TEKNOLOGI MARA

**THE CURRENT PRACTICES AND
DETERMINANTS OF INTERNAL
SHARIAH REVIEW QUALITY IN
MALAYSIAN ISLAMIC BANKS**

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ABSTRACT

With the emergence of Shariah-based businesses in financial sector, there is a need to ensure our banking affairs to be Shariah-compliant. The Islamic banking sector which adopts a different model of operation, without the Shariah-compliant system would make no different from the Conventional bank, thus affecting stakeholder's confidence and are exposed to many risks. The need for a different methodology for assurance purposes to govern the Islamic banking activities has led the Bank Negara Malaysia to introduce a Shariah Governance Framework in order to meet the higher expectation of stakeholders and increase the confidence among public. It is essential that check and balance mechanisms through the internal Shariah review which functions to certify the entire activities of Islamic banks. However, to achieve this objective, the following issues were identified which are the lack of Shariah governance and compliance control for Islamic banks, inadequate internal Shariah review practices as well as absence of guidance to conduct internal Shariah review. Thus, this study attempts to determine the factors influencing the quality of internal Shariah review in Islamic banks of Malaysia by considering the impacts from factors of Regulator, Shariah Committee, Management and Personnel. This study employed questionnaires survey and interview as methods of data and information collections. The questionnaire was sent to the respondents with Shariah related function from 15 Islamic banks. The result found that the Regulator and the Personnel factors had significant relationships to the internal Shariah review quality hence indicating the importance of these factors in determining the internal Shariah quality. On the other hand, the Shariah Committee and the Management factors were insignificant to the internal Shariah review quality. Apart from contributing to the existing literatures, this study might provide inputs to the policy maker to understand the factors affecting the quality of implementing the internal Shariah review, for the practitioners to have close working relationships with the policy maker to formulate a suitable application format on the internal Shariah review process and provides academicians benchmark for future studies in this area.

Keywords: *Internal Shariah review, Shariah Governance Framework, Islamic bank*

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

In recent times, the development of the Islamic financial system demonstrating the governance by Islamic law practices or better known in Arabic term as Shariah has gained more attention and more efforts were made by the Islamic financial institutions in order to be observed as complete Shariah-compliant chains. The behavior and operation of Islamic banks operating under the Islamic financial system has changed and the banks are now required to also comply with the rules and principles of Shariah. An Islamic bank, which is one of entities in the Islamic financial system, is required to operate within the Shariah compliance parameters. Its banking operations and business activities must be within the Shariah principles, rules and regulations set by the policy makers, regulatory authorities and other relevant bodies. The increase in the awareness for Islamic products encourages the need to have robust Islamic financial institutions in order to support the rise for Islamic banking (Shafii, Ali & Kasim, 2014). These are due to the growing demands from various parties such as regulators, stakeholders and customers who require an assurance on Shariah compliance and the accountability of the Islamic financial institutions to operate as entities that truly embrace the Islamic values based on the Shariah. Should there be an absence of Shariah compliance, it will affect public confidence and may expose the Islamic financial institutions to legal risk and image and reputational risk.

Besides trying to understand the system of checks and balances within the Islamic banks, this research study was an attempt to venture findings related to the internal Shariah review by referring to the studies made in Shariah audit and also ordinary audit. The application of Islamic laws and principles or Shariah in the Islamic financial system and in the way the Islamic banks conduct their activities has affected the audit and review activities of these banks. There are regulatory requirements for Islamic financial institutions to ensure the overall Shariah compliance aspects of their operations. The Shariah Governance Framework for Islamic Financial Institutions in