

Governance, religious assurance and Islamic banks: Do Shariah boards effectively serve?

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Abstract This study examines the quality of governance and religious assurance provided by Shariah boards (SBs) when undertaking the crucial compliance review required in fulfilling the expected ethical and social legitimacy of Islamic banks. To better understand the complex behavioural processes, we explore the governance role of SBs and assess issues related to competence, effectiveness and independence in the light of the newly adopted 2011 Malaysian Shariah Governance Framework (SGF). A series of semi-structured interviews were undertaken with key individuals in two well-established fully-fledged Malaysian Islamic banks. Our findings reveal that the newly implemented SGF has generally brought about some of the benefits hoped for by its regulatory architects. We find the quality of religious assurance to have been enhanced due to the emphasis placed on religious audit giving rise to improved credibility. However, we report the compliance review process to be inadequately undertaken with SBs still excessively reliant on internal officers implying possible independence compromise. We highlight concerns relating to (1) the general level of competency of individual SB members; (2) lack of technical banking and finance knowledge; and (3) SB members generally fulfilling a ceremonial role rather than undertaking vigilant monitoring. Our findings lead us to question the full impact of the new 2011 SGF and query the value and effectiveness of SBs. We make the call for the establishment of external religious auditors to render compliance assurance which could provide the much-needed impetus to improve governance and increase market and stakeholder confidence.

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1 Introduction

In the last few decades, the Islamic finance industry has made rapid progress with total global financial assets currently estimated to be around USD2trillion with a compounded annual growth rate (CAGR) of 17.3% (MIFC 2014, p. 2). The success of Islamic finance is also evident through its contribution to corporate social responsibility (Farag et al. 2014; Abdelsalam et al. 2014; Platonova et al. 2016) and economic development (Gheeraert 2014; Gheeraert and Weill 2015). In relation to the growth of the industry, Malaysia was reported to be the third largest in the world after Iran and Saudi Arabia and contributed approximately 21.9% of the total domestic banking assets while also accounting for 9.6% of global Islamic banking at the end of 2014 (IFSB 2015, p. 9). In particular, the Malaysian Islamic banking industry is acknowledged to be the most developed globally with a comprehensive governance framework in existence for its Islamic banks (Aziz 2012; MGCC 2015; IMF 2017). As such, establishing sound governance practices in Islamic banks would instil confidence in stakeholders (Chapra and Ahmed 2002; Grais and Pellegrini 2006a; IFSB 2006; Ginena 2014; Ullah et al. 2016), improve credit ratings (Grassa 2015) and enhance stock exchange performance of this alternative banking industry (Polato et al. 2016).

Despite their virtuous character, Shariah Boards (SBs) carry a heavy burden of responsibility for providing religious assurance which contributes to the robustness of the Islamic banking governance system as well as endorsing the religio-ethical legitimacy required by stakeholders (Bougatef 2015; Ullah et al. 2016). In addition, SBs are responsible for issuing an annual report on the religious compliance of the banks operations (Tomkins and Karim 1987; Karim 1990a, b; Maali et al. 2006; Ullah et al. 2016). It is, therefore, paramount that SBs demonstrate competence, independence and effectiveness as they play a key role in confirming to stakeholders of Islamic banks that an ethical system is in place allowing consumers to bank in accordance with their faith. However, previous studies have reported several concerns on the inherent deficiencies of SB role in relation to providing religious assurance (see for example Alhabshi and Bakar 2008; Rammal and Parker 2010; Hasan 2011; Hassan 2012; Ullah et al. 2016). Additionally, Hassan (2012) and Ullah et al. (2016) rightly allude to the lack of independence of SBs in delivering the crucial religious assurance since top management of Islamic banks were found to use several 'overt' and 'covert' practices to exert influence over decisions of SBs.

In this study, we investigate the quality of religious assurance provided by SBs when performing the religious compliance review process in the light of the newly implemented 2011 Malaysian Shariah Governance Framework (SGF). We use the interview method and focus on two large well established fully-fledged Islamic banks to gather valuable insight, allowing us to explore in greater depth the role of SBs in fulfilling the central obligation of ethical and societal legitimacy. In this context, Cooper and Morgan (2008) note that case study approaches

are especially useful in examining complex behavioral processes and addressing questions of how and why, whilst, Ahrens and Chapman (2006) highlight the potential for qualitative research to contribute to theory. By undertaking interviews with SB members and other key actors in the two selected Islamic banks, our study also directly contributes by responding to calls for qualitative research (see for example Spira 2002; Gendron and Bédard 2006; Turley and Zaman 2007; Beasley et al. 2009; Zaman and Sarens 2013; Everett et al. 2016) and presents the advantage of gathering more detailed information than typically is collected in quantitative research as mainly is the case for Islamic banking studies (see for example Alhabshi and Bakar 2008; Hasan 2011; Grassa 2015; Kanagaratnam et al. 2015; Mollah and Zaman 2015). To the best of our knowledge, a study focussing on the post 2011 implementation has not been previously undertaken and since Malaysia is a global leading player in Islamic finance, such a study would shed important light to prior literature and provide lessons for other Islamic jurisdictions.

Our study also provides a theoretical contribution in relation to SBs role in ensuring religious compliance since there are several competing theories regarding corporate governance and the various organs of governance (see for example, Kalbers and Fogarty 1998; Cohen et al. 2002, 2007b). We examine the religious compliance role of SBs using three main governance theoretical foundations, i.e. agency theory, stakeholder theory and legitimacy theory. However, some studies propose that the agency structure is ill-suited to the operations of Islamic banks as its application can potentially result in a trade-off between compliance to the Shariah and the protection of investor's rights (see for example Hasan 2009; Safieddine 2009). In particular, due to the wide spectrum of Islamic bank accountability, the Shariah broadens the concept of stakeholder interest and business legitimacy to include socio-religious compliance and ethics in the governance system of this alternative banking industry. In this research, we find that SB members, whose ultimate responsibility is to serve as agents to both shareholders and other stakeholders, were found not to be diligently performing their fiduciary duty of religious compliance as they remained heavily dependent on the outcome and results presented to them by internal officers thus compromising independence. Therefore, due to the conflict between current practice and theoretical exposition on the role of SBs, we suggest Islamic banks establish a clear line of separation in the responsibility of SBs by delegating the religious compliance role to an external auditor competent to undertake religious auditing whilst the SBs are to focus on their advisory role.

In the next section, we present our literature review along with a discussion on the concept of Shariah, issues surrounding the supervisory role of SBs and the current framework for Shariah governance of Islamic banks in Malaysia and presents the study's theoretical framework. In Sect. 3, we describe our research methodology and in Sect. 4, we provide analysis into the key features and functions of SB members and the extent of diligence applied when undertaking the all-important religious compliance review prior to providing their annual assurance report. Finally, Sect. 5 concludes the study by highlighting the salient issues surrounding this study.

2 Related literature, Islamic banking in Malaysia and theoretical framework

2.1 Related literature

Islamic banks are established as ethical financial institutions with the fundamental requirement for their product and services to be wholly Shariah compliant. The concept of Islamic banking first emerged in the late 1940s but the pioneering effort in bringing Islamic banking principles into practice only became reality in 1963 with the development of the Mit Ghamer Savings Bank and the Nasser Social Bank in Egypt. However, the activities of these two banks were only attuned to collecting small savings and making direct investments in agricultural and industrial activities or to small local businesses and hence, were more akin to a social bank. In 1975, the Organisation of Islamic Cooperation (OIC) inaugurated an inter-governmental Islamic bank, known as the Islamic Development Bank (IDB), which was established with the sole purpose of fostering economic development and social progress among member countries and their Muslim communities in accordance with the Shariah laws. Now, there are over 300 Islamic banks offered across 75 countries and this market industry has grown 50 per cent faster than their conventional counterparts (The Banker 2015).

According to the Islamic faith, the Shariah is regarded as a divine law that is derived from two main sources—i.e., the Quran and Prophetic traditions and sayings (otherwise known as Hadith). In the absence of clear guidance from these two main sources, the Shariah is also derived from secondary sources which include: *ijtihad* (legal reasoning), *qiyas* (analogical reasoning), *istihsan* (juristic preference), *maslahah mursalah* (unrestricted public interest), and ‘*urf*’ (customary practice). This provides justification for scholars to utilise the *ijtihad* facility to provide Shariah rulings (i.e., otherwise known as a *Fatwa*). The interpretation of a *Fatwa* or ‘religious ruling’ is provided only by religious scholars based on Islamic doctrine, the four main schools of thought are the Shafii, Hambali, Hanafi and Maliki Schools of Jurisprudence¹ with the ultimate aim of meeting the “objectives of Shariah”.

The objectives of the Shariah were clarified by Islamic jurists such as Imam al-Ghazali amongst others as: faith; life; intellect; lineage; and, property (Kamali 2008) and was then applied in various contexts of a Muslims’ life including issues relating to human relations (*mu’amalat*). Other studies have concluded that the operations of Islamic banks promote the realisation of an Islamic financial system that is drawn from Islamic law (see for example Iqbal 1997; Zaher and Hassan 2001). Among others, Shariah law permits Islamic banks to operate business based on four principles: (1) risk-sharing or concept of equality; (2) materiality or economic value; (3) no exploitation whereby neither party nor the transaction should be exploited and (4), no financing of activities that are banned by the Quran (e.g., alcohol, pork products,

¹ It is worth noting that Malaysia follows the Shafii School of Jurisprudence whilst other Islamic countries in the Middle East and North Africa (MENA) and in South East Asia follow the remaining three Jurisprudential schools.

etc.). Additionally, Shariah law forbids Islamic banks in business dealing with elements of *riba* (interest), *gharar* (speculative trading) and *maysir* (gambling) as such activities lead to the conditions that may facilitate economic exploitation and unlawful profit (Naughton and Naughton 2000; Lewis 2007; Hassan and Lewis 2007; Hosain 2009).

When attention is turned to governance, there are various mechanisms in place to ensure that the integrity of the Islamic banking industry is upheld, including the appointment of competent SBs who are entrusted with the highest responsibility on aspects of religious compliance. Unlike their counterparts, assurance on religious compliance is unique to Islamic banks as it builds stakeholders confidence on religious legality of the products and services that banks provide. Several studies have, indeed, highlighted the key governance role of SBs in overseeing and monitoring the religious compliance aspect of Islamic banks (see for example Briston and El-Ashker 1986; Tomkins and Karim 1987; Karim 1990a, b; Banaga et al. 1994; Najeeb and Ibrahim 2014; Ginena 2014; Bougateg 2015; Almutairi and Quttainah 2017). These studies outline the duties of SBs in assuring that Islamic banking operations along with their products, contracts and management of *Zakat* comply with Islamic principles. Therefore, the issue of competency and independence of each SB are key governance features which demonstrate the reliability and soundness of SBs' role in assuring ethical legitimacy.² For this reason, members of SBs comprise of individuals who are experienced and qualified in various disciplines such as Islamic law, accounting, auditing and finance (see for example Gambling et al. 1993; AAOIFI 1997, para 7; Grais and Pellegrini 2006b; BNM 2011, p. 17; Ginena 2014) enabling them to competently manage and evaluate Islamic banking issues (Malik et al. 2011).

Moreover, given that the requirement of SB independence is consistent with the current practice of external auditors, several studies have documented that auditor independence is associated positively with the effectiveness of audit committees in issuing quality audit reports (Bédard and Gendron 2010; Kueppers and Sullivan 2010; Jamal and Sunder 2011; Dobija 2015). After all, issuing a quality audit report also requires the external auditor to be competent and transparent in providing complete and truthful information to enhance understandability and reduce information asymmetry among investors (Graham et al. 2005; Barth and Schipper 2007; Billings and Capie 2009). However, since Islamic finance broadens the governance function of SBs into a wider spectrum of religious compliance, SBs are not only accountable to provide an independent and transparent religious report to stakeholders but also to ensure religious compliance of banking operations. By religious compliance we argue that SBs has the single most important authority to conduct regular reviews and monitor assessment to ensure that Islamic banks do not contravene religious

² In our view, Levitt's (2000, p. 5) proposition that Audit Committees should be competent, committed, independent, and tough-minded and should be "one of the most reliable guardians of public interest" also apply to SBs in Islamic Banks. Without SBs, there is no existing mechanism available in Islamic finance that can endorse the ethical, institutional and religious legitimacy expected by stakeholders. Thus, SBs are a powerful mechanism that serves as the conscience of Islamic society.

principles governing its operations. When focussing on the issue of independence of SBs, several studies have claimed that the minimum supervision and monitoring role of SBs is due to lack of standardization in the governance of religious audit as well as a shortage of qualified and independent religious auditors in Islamic banks (see for example Garas and Pierce 2010; Najeeb and Ibrahim 2014; Othman and Ameer 2015). For instance, Rahman (2008) highlight that only a few Islamic banks undertake the crucial responsibility of reviewing and checking the transaction after the accomplishment of contracts and products noting that these could be due to a lack of regulation of the religious audit framework and the required expertise to perform this task.

Other empirical studies have also been undertaken on matters surrounding the role of SBs. For instance, Ullah et al. (2016) applied grounded theory to key stakeholders of three Islamic banks in two different countries (i.e., Pakistan and the United Arab Emirates). The authors report that individual religious scholars as well as SBs tend to play only a limited role in safeguarding and promoting religious principles as management of Islamic banks attempt to avoid the supervision and audit role of SBs. In doing so, managers do not truly uphold religious principles, but merely aim to seek religious certification for their banking products. In fact, Ullah et al. (2016) highlighted that some Islamic banks engage in recruiting liberal scholars to attain permissibility of action especially when dealing with Islamic transactions or financial contracts. The concern was raised because managers may attempt to dictate to SBs' decisions and opinions to tie up to their goal and objectives which is referred to by the authors as "Fatwa Shopping". This could well amount to 'managerial opportunism'. In an earlier study conducted by Garas (2012) on the key Islamic financial institutions (IFI) in the GCC countries, the researchers identified conflicts of interest in SBs and six specific independent variables: the SB executive position, SB remuneration, the relation between the SB members and board of directors (BOD) and the multiple memberships in Islamic funds, issuers of bonds and companies trading in capital markets. Garas (2012) asserts that a significant conflict of interest exists between executives and SB members, the membership in Islamic funds and the relation between the SB and the BOD. Furthermore, the study provides key evidence that the independence of SB should not be compromised if SB members do not hold any managerial position in the IFI and fixes SB remuneration.

Discussion on the governance of SBs was also highlighted recently by researchers such as Mollah and Zaman (2015) who examined the effect of SBs and corporate governance on the performance of Islamic banks from 25 countries for the period 2005–2011. They claim that SBs provide a positive impact on performance of Islamic banks but there is still much need for further improvement in the effective oversight and monitoring role of SBs. In an earlier study, Alhabshi and Bakar (2008) conducted a survey to examine the prevalence of SBs of institutions offering Islamic financial services across several jurisdictions. The study highlighted that SBs have inherent deficiencies when fulfilling the religious compliance review role in relation to the development of Islamic financial products. Similar findings were further highlighted in a survey conducted by Hasan (2011) to examine the current governance practices of IFIs in Malaysia, UK and the GCC countries. The study revealed that SBs have minimum participation in conducting their review task as 58% of the SBs

delegated their religious compliance review function to be carried out by the internal religious compliance unit.

Additionally, Rammal and Parker (2010) conducted interviews to investigate the role of SBs in IFIs in Pakistan and their study highlighted grave concern on the credibility of SBs deliberating on Islamic banking issues and the limited pool of religious knowledge amongst the participants of Islamic banks that would then create a conflict of interest between SBs and management. Interestingly, Hassan (2012) conducted in-depth interviews with 46 key leaders in the Malaysian Islamic banking industry to identify the role, independence and the effectiveness of the religious compliance review of SBs. The study revealed that under the GPS-1 regime (discussed in the next section), Islamic banking operations in Malaysia experienced weaknesses in the quality of religious assurance provided by SBs as the religious compliance review function of SB was found to be mainly undertaken by internal officers and results presented to SB for approval. Hassan (2012) reported that SBs issued their religious assurance without proper due diligence as SBs were found to rely heavily on the result performed by internal officers with top management found to be over-ruling decisions of SB. Therefore, the arguments brought forward indicate that the quality of religious assurance could be improved with the adoption of the new 2011 Malaysian SGF framework which places substantial emphasis on the religious audit function to enhance the governance process and ultimately the credibility of SB, this is the subject of the next section.

2.2 Islamic banking in Malaysia

Malaysia is regarded as a leading country for promoting Islamic banking and finance and operates a dual-layer Shariah governance and regulatory framework. At the individual Islamic bank level, the governance of bank operations is supervised by an independent SB whereas supervision at the macro level is undertaken by the Shariah Advisory Council (SAC) of the Central Bank of Malaysia or Bank Negara Malaysia (BNM). It was discussed earlier in Sect. 1 that the governance system of Malaysian Islamic banking has experienced several stages of improvement. In 2005, the BNM, introduced the 'Guidelines on the Governance of Shariah' otherwise known as GPS-1. Following GPS-1, central requirements were imposed by the BNM which required Islamic banks to have SBs with a minimum of three members responsible to ensure that the business transactions are religious-compliant. GPS-1 also set the limit on membership of SBs to be not more than one bank with appointment of its members being subject to approval of BNM. To determine the extent of the authority of the central religious body, the SAC was authorised with mandated power on its governance role in the recent amendment to the Central Bank of Malaysia Act 2009 in which the resolutions issued by the SAC are binding on all Malaysian IFIs (BNM 2009). This Act repealed the earlier Central Bank of Malaysia Act 1958 which provided regulations for the licensing of the banking sector.

In 2011, the BNM introduced its SGF aimed to enhance the role of the BODs, SBs and management alike in relation to the governance of Islamic banking operations. Since the implementation of SGF in 2011, the quality of religious

assurance provided to the stakeholders by Islamic banks is expected to have been enhanced. This proposition is made on the basis that the new SGF places emphasis on the accountability of key organs of an Islamic bank in undertaking their governance function. The SGF further stipulates the minimum requirement for SB membership to be at least five with most members to have a religious educational background. The SB members are also required to be accountable and responsible for their decisions, views and opinions related to religious matters. In strengthening religious compliance and disclosure, the SGF also recommends for Islamic banks to establish Shariah audit and to develop an effective Shariah audit plan according to their particular business objectives, scope, personnel assignment, sampling, control, policies and procedures. Meanwhile, the management of Islamic banks are expected to provide accurate information about the business transactions and operations to the SBs. The SGF has also outlined the importance of religious compliance and religious research functions aimed at the attainment of a religious compliance-based operation environment in Islamic banks.

Meanwhile, in June 2013, the Islamic Financial Services Act (IFSA) was introduced as an empowering mechanism to support the implementation of religious principles and an operational standard for IFI's, including penalties in the case of non-compliance. Amongst issues highlighted relate to the appointment and qualifications of SB members and accountability of respected parties on the religious assurance of Islamic banking operations. For example, Section 30 of IFSA highlights the appointment and qualifications of SB members in IFIs. In this regard, under the new Act, banks may apply directly to the BNM on the establishment of their SBs to advise and oversee all operations, activities and affairs of the banks and to ensure that activities comply with Islamic law (BNM 2013, para 30). In relation to qualification of SB members, there is a provision for members to meet all standards and requirements that are specified by BNM and other international regulatory body that has significantly influenced the financial reporting of Malaysian Islamic banks including Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFIs) and Islamic Financial Services Board (IFSB). For example, AAOIFI clearly spell out the role of SB's as "the governance authority who are entrusted with the duty of directing, reviewing and supervising the activities of the IFIs in order to ensure that they are in compliance with Islamic Shariah rules and principles" (AAOIFI 1997, para 2). In a similar context, the IFSB recommended for the Islamic bank to establish an effective governance mechanism for obtaining and applying rulings from SB as well as on monitoring religious compliance aspects including the ex-ante and ex-post of financial transactions and the operations of Islamic Financial Services (IFSB 2006, para 47). To ensure the effective religious compliance procedure, SBs are required to have sufficient knowledge in Shariah as well as knowledge in law, accounting, economics, finance and audit (AAOIFI 1997, para 7; IFSB 2009, para 30; BNM 2011, p. 10). The mixed knowledge and background of SB members provides an effective SB composition on its commitment to ensure operations of Islamic banks are fully Shariah-compliant. As stated in the IFSA 2013, Islamic banks shall, at all times, ensure that business activities and transactions are religiously compliant. In the event of failure of Islamic banks to comply with the above provisions this shall

make SB members liable to imprisonment for a term not exceeding 8 years or to a fine not exceeding twenty-five million ringgits or both (BNM 2013, para 29).

More recently, the Guideline on Financial Reporting for Islamic Banking Institutions have been revised and became effective on 1 January 2014 to better facilitate users of financial statements to evaluate and assess the financial position and performance of Islamic banks. This new guideline, referred to as GP8-i, provide recommendations for the financial statement (i.e., statement of financial position, statement of comprehensive income) of Islamic banks to have separate disclosure and to be prepared in accordance with Malaysian financial reporting standards (MFRS). In meeting the provision of religious compliance stated in the SGF, this GP8-i also requires Islamic banks to disclose the SB report as part of the annual report and signed by not less than two SB members.

2.3 Theoretical framework

As discussed in the introduction, corporate governance for financial institutions such as banks exhibit different features due to the opacity and regulatory nature of the industry (Ciancanelli and Gonzalez 2001; Andres and Vallelado 2008; Wilson et al. 2010; Mollah and Zaman 2015; Mollah et al. 2016). It is therefore important for financial institutions to be well regulated and for effective corporate governance to be implemented as such mechanisms are instrumental in promoting stability of the financial system as well as enhancing social welfare (Grais and Pellegrini 2006b). Similar arguments are deemed relevant when discussing Shariah governance in Islamic banks. Nevertheless, the distinguishing feature and portfolios of Islamic banks requires additional corporate governance mechanisms that ensure adherence to religious principles in their business operations and transactions. Hence, we examine the quality of religious assurance in Islamic banks using agency, stakeholder and legitimacy theoretical foundations.³ The agency theory is generally defined as the contractual relationship between the shareholder as the principal and the managers as the agent who are given authority to perform services on behalf of the principal (e.g., Jensen and Meckling 1976; Fama and Jensen 1983). However, the agency problem arises due to information asymmetry between shareholders and management (Agrawal and Knoeber 1996; Heath and Norman 2004). In such cases, it would provide management with scope to engage in self-dealing opportunistic behavior at the expense of shareholders (see for example Culpán and Trussel 2005; Djankov et al. 2008; Cline and Williamson 2016).

Conversely, both the stakeholder and legitimacy theories postulate a much broader concept of corporate governance to be applied in organizations. The

³ Besides the theories mentioned above, the institutional theory also considers changes in organisational processes over time (Cohen et al. 2002, 2007b) and how governance structures “fulfil ritualistic roles that help legitimise the interactions among the various actors within the corporate governance mosaic” (Cohen et al. 2007b, p. 11). Furthermore, Kalbers and Fogarty (1998, p. 131) argue that “organizational structures...become symbolic displays of conformity and social accountability”. In other words, some governance activities and structures may be driven by a desire to foster legitimacy as in the case of Islamic banks and the intricate workings of SBs.

stakeholder theory provides greater latitude in widening the corporate governance concept as management not only acts in the interest of shareholders but also pursues interests of other stakeholders (Freeman 1994; Berry and Rondinelli 1998; DesJardins and McCall 2004; Letza et al. 2004; Solomon 2007; Collier 2008; Garcia-Torea et al. 2016). Meanwhile, the legitimacy theory can be translated into the way an organization commits itself to adopting corporate social behavior in its governance system to ensure compliance of values and norms of respective societies in which organizations operate (Suchman 1995; O'Donovan 2002; Deegan and Unerman 2006; Golant and Sillince 2007). The above arguments provide a claim that the integrity of the organization would be undermined if business operations are found to have less legitimate social behavior (Dowling and Pfeffer 1975). Interestingly, Deephouse and Carter (2005) elucidate that organizational legitimacy and organisational reputation are two concepts representing assessments of an organisation by a social system. Legitimacy also has influence on organisational theories such as institutional theory (see Meyer and Rowan 1977), resource dependence theory (Pfeffer and Salancik 1978) and organisational ecology (Carrol and Hannan 1989). However, it was the frequent appearance of this concept which prompted scholars such as Suchman (1995, p. 571) to observe that legitimacy is “an anchor-point of a vastly expanded theoretical apparatus addressing the normative and cognitive forces that constrain, construct, and empower organisational actors”. Thus, management has gained reputation in formulating various strategies to maintain the legitimacy of business operations leading to an enhancement of confidence in organisational stakeholders (Ashforth and Gibbs 1990; Patten 1992; Suchman 1995; Deegan et al. 2000; Phillips et al. 2004; Khan et al. 2013).

In this paper, we maintain that from an Islamic banking perspective, legitimacy and reputation can be viewed as a concept that is complex and multi-dimensional and is linked to a variety of stakeholders having significance of being the ‘be all and end all’ of an Islamic bank’s survival. This is because without religious or ethical legitimacy, Islamic banks become meaningless as they require societal legitimacy to attract constituent support. Several studies have also highlighted that agency theory when applied in a conventional setting tends to limit the accountability of a bank’s operations to that of investors alone whereas the Islamic perspective broadens this to include moral integrity, an appropriate socio-political environment and religious compliance (Archer et al. 1998; Chapra and Ahmed 2002; Beekun and Badawi 2005; Safieddine 2009; Belal et al. 2015; Ullah et al. 2016; Almutairi and Quttainah 2017). The next section outlines the research methodology used.

3 Research methods

The aim of this study is to examine the effectiveness of the religious compliance review and the quality of the religious assurance process post 2011 Malaysian Shariah Governance Framework. We investigate issues related to competency, experience and independence of SBs and employ a qualitative approach using in-depth interviews to gather evidence. The use of in-depth interviews allowed us to discover interviewee ideas and perceptions and to ascertain specific factors that underpin

their responses such as reason, feeling, opinion and beliefs (see for example; Lewis and Ritchie 2003, p. 143; Turner 2010). At the time of the study, there were 16 fully-fledged Islamic banks and 7 conventional banks offering Islamic windows in Malaysia. For this study, we selected two fully-fledged Islamic banks to meet our research design. We use a dual case study approach to expand the knowledge and experience in providing valuable insight of the phenomenon rather than averaging the effect across a number of cases (see for example; Kennedy 1979). Yin (2009) asserts that case studies allow researchers to find the characteristics of real life events such as individual life cycles, small group behaviour, organizational and managerial processes. Following Saeed and Izzeldin (2016) and My Phan et al. (2016), our sample selection of the case study is based on the level of profit efficiency determined by the reported net profit. Saeed and Izzeldin (2016) provided evidence that there is no trade-off between risk and efficiency in Islamic banks as their investment and financial products are based on a profit sharing paradigm unlike the interest based paradigm of conventional banks. In terms of bank efficiency, the two Islamic banks in our sample show relatively similar net profits for the financial year end 2015 indicating similar commitment of both Islamic banks in preserving the quality of their Shariah portfolio thus portraying robust governance mechanisms for assurance of religious compliance. Our use of in-depth interviews in the case study also has the benefit of providing a deeper consideration and not just surface understanding on the quality of religious assurance provided.

Fortunately, our interview participants are the key actors with experience of both 'pre' and 'post' implementation of the new SGF in their institutions. This provided the opportunity of eliciting views directly from the people who had immense knowledge, experience and familiarity of the subject matter. We used several sources of information to frame our questions, including (a) our prior knowledge of role and function of SB members (b) previous academic literature (c) the professional literature (e.g. Central Bank regulations along with AAOIFI and IFSB guidelines on Governance). We pre-tested our research instrument on several academics and bankers to ensure that our questions were appropriate and there was no room for ambiguity. We modified several of our questions in the light of their feedback which was found to be invaluable.

We undertook 14 interviews using semi-structured interview questions and details of our participants are shown in Table 1 below.⁴ Our participants are senior officials who are highly knowledgeable, have vast experience and who play a dominant role in their respective Islamic banks. To maintain anonymity, we identify the two Islamic banks participating in our study as Bank A and Bank B with interviewees comprising of SB members, Chief Executive Officers (CEOs), Heads of Religious Departments and Internal Auditors. Our interviews lasted approximately 90 min on

⁴ In a conventional setting, several qualitative studies focussing on corporate governance issues opted for case study approach. For instance, Turley and Zaman (2007) used a single case study and interviewed nine individuals. Gendron and Bédard (2006) interviewed three Audit Committee Chairs whilst Spira (1999, 2002) interviewed 21 individuals. In this present study, we believe that the 14 interviews undertaken in the two major institutions are sufficient to provide us with in-depth understanding on how SBs undertook their crucial religious governance roles.

Table 1 Background information of interviewees

No.	Gender	Position	No. of years in current position	Shariah qualification	Other qualification
<i>BANK A</i>					
1.	Male	CEO	3 months	–	Banking knowledge
2.	Female	<i>RB</i> member (1)	5 years	Shariah qualified	–
3.	Male	<i>RB</i> member (2)	2½ years	Shariah qualified	Legal expert
4.	Male	<i>RB</i> member (3)	5 years	Shariah qualified	Legal expert
5.	Male	Head of religious review	5 years	Shariah qualified	Islamic finance
6.	Male	Religious review officer	2 years	Shariah qualified	Islamic finance
7.	Male	Religious audit officer	15 years	Shariah qualified	Accounting and audit expert
<i>BANK B</i>					
8.	Male	CEO	6 years	–	Banking and finance
9.	Male	Chairman of <i>RB</i> (1)	11 years	Shariah qualified	IT expert
10.	Male	<i>RB</i> member (2)	6 years	Shariah qualified	–
11.	Male	<i>RB</i> member (3)	12 years	Shariah qualified	Legal expert
12.	Male	Head of religious department	7 years	Shariah qualified	Islamic finance
13.	Female	Deputy manager of religious department	7 years	Shariah qualified	Islamic finance
14.	Female	Chief of internal audit	6 years	–	Accounting, finance and audit expert

average. We used a standardised checklist to guide our interviews and each interviewee was assured of confidentiality and anonymity. Given the specificity of many of the responses we received, we believe that our participants were truthful in their responses. Our interviews were undertaken between June and August 2015, almost 4 years after the implementation of the new SGF to allow us to obtain perceptions of its impact. We also observed how our participants responded to the questions raised. After obtaining the data from the interview sessions, we transcribed the data to attain general ideas of what the interviewees were responding to and to further reflect on its meaning before the data was encoded. Coding of the data is the process of managing the data into segments of text before being generated into information and serves as the formal representation of analytic thinking (Rossman and Rallis 1998, p. 171). Also, data coding is not just an analysis of data and data interpretation but allows researchers to axial code by identifying the link between the data to the idea and from the idea to all the data relating to that research (Richards and Morse 2007, p. 137). As in the work of earlier qualitative studies (see example Anderson-Gough et al. 2005; Jørgensen and Messner 2010), the codes in our study were derived from our research questions, theoretical framework and related literature. We then categorized the data and generated the themes based on the data coding. When analysing the data, we adopted thematic analysis suggested by Boyatzis (1998) which proved to have increased the traceability and assisted verification of the analysis. Hence, the process of developing codes, generating themes and analysis of the data were undertaken using Atlas.ti, which is a computer assisted qualitative data analysis software documented to have been widely used in accounting and management qualitative studies (see for example; Kend and Katselas 2013; Schäffer et al. 2015; Teixeira et al. 2016).

4 Findings and discussion

This section presents the findings from our interview data on the effectiveness of the SB in providing religious assurance thereby endorsing the ethical legitimacy post implementation of the 2011 Malaysian SGF framework. It was highlighted earlier in Sect. 1 that both the stakeholder and legitimacy theories imply that SBs should be accountable in providing transparent and independent assurance to stakeholders in relation to religious compliance of Islamic banks. Therefore, the competency and capability of SB in issuing quality religious assurance should ensure a strong dynamic in the governance system of an Islamic bank and add value for stakeholders. Also, this study highlights some evidence on the current practice of SBs in performing their all-important religious advisory and compliance review role.

4.1 Knowledge and competency of SB members

The competency of SB members is important in ensuring an effective governance mechanism in Islamic banks in achieving legitimacy of their operations. It is the

inclusion of both religious and non-religious scholars⁵ in the composition of the SB which could enhance the competency and capabilities of SBs in providing quality religious assurance. For instance, if SB members have the benefit of being well-versed in both Shariah and non-Shariah knowledge this would then enable them to deliberate on religious matters and other issues pertinent to Islamic banking and operations, such as finance. However, the feeling generated was that greater emphasis on both religious knowledge and banking knowledge was required because even a CEO highlighted that the provision of religious assurance should be made by SB members who have strong religious background and good banking experience. This CEO, of Bank A, remarked:

Previously, our SB members only comprised of people from religious and legal backgrounds. Now, we (the bank) also search for SB members who have expertise in banking operations which is ideal. However, I am still satisfied if all SB members have strong knowledge in Islamic law to enable them to deliberate on religious matters.

A similar sentiment was also expressed by the CEO of Bank B that the combination and consolidation of various backgrounds in the governance structure of SBs would enhance the governance role of the SB on their commitment to provide quality religious assurance of the Islamic bank operations. This CEO highlighted:

When appointing a SB, we try to maintain a balance and require a combination of experience and qualifications in the field of law, fiqh (jurisprudence), finance and accounting. The nomination of SBs would not only be selected by the BOD as the appointment is also subject to the approval of Bank Negara Malaysia (BNM).

However, discussions held with interview participants of both banks revealed several major concerns relating to some weaknesses of SB members when performing their governance and oversight function, i.e., the religious compliance review. SB members of both banks reported lack of knowledge in banking operations and not having a financial background. This was stated to result in difficulties for SB members when fulfilling their responsibilities of reporting religious compliance to stakeholders. The Chair of the SB of Bank B remarked:

It is difficult for me to attest to the financial report because we (SB members) have a lack of understanding on the discussion of subject matters. We have to ask for assistance from bank officers to explain the issues pertaining to the operations of the Islamic bank.

A similar argument was communicated by the SB members of Bank A relating to concerns on the need of non-religious experts as they can contribute to the

⁵ By non-religious scholars, we mean those SB members who are not qualified religious scholars per se, but instead, serve on the SB due to their proficiency in law, business, finance or accounting. In Malaysia, unlike elsewhere in the Islamic world, there is a stipulation that in every SB, there must be a member that has a non-religious background (BNM 2011, p. 10).

governance role of the SB in numerous ways. In providing quality religious assurance, the non-religious experts may provide consultancy to other SB members on matters related to Islamic banking issues. The SB member of Bank A with expertise in both religion and legal matters remarked:

In a case when the bank deals with legal documentation, our SB members who possess strong knowledge in Islamic law along with our legal expert will actively provide advice on particular issues.

Meanwhile, to improve the governance role of SBs, the BNM organised several mandatory training workshops for all SB members of the Islamic banks aiming to strengthen competency levels of individual members of the SB. In addition, both the Islamic banks under this study are reported to have taken further initiative to enhance the governance role of the SB by providing extra specialist training to their respective SB members. Such investment of knowledge and intensive training for the SB will improve the religious advisory role of SB who acts as a proxy for the stakeholders in ensuring the ethical and legitimate operations of Islamic banks. Our finding highlights the significance of investment in human capital as earlier studies elucidate that organizations with greater human capital stocks are likely to yield better business performance and sustain industry growth trends (see Becker and Huselid 2006; Subramony et al. 2008; Wang et al. 2009; Morris et al. 2017; Nawaz 2017). Notably, the competency and capabilities of the SB is expected to be enhanced with the Islamic banking workshops organized by BNM and individual Islamic banks. A SB member of Bank A highlighted this point and remarked:

The Bank had given their support and has full respect to the SB by allocating part of their financial budget for training and workshop of SB members.

This was also confirmed to be the case in Bank B where SBs were provided with special training courses. In fact, Bank B went further and collaborated with several educational institutions in expanding knowledge of SBs. The Chairman of SB of Bank B remarked:

I think most Islamic banks including my Bank (i.e., Bank B) have initiatives with academic institutes to provide training courses for SB members. In the practice of Bank B, the respective management organised a familiarization session to provide specialist training.

On a different scale the discussions with Bank B officials highlighted that stakeholder of Bank B was struggling to uphold the governance role of the SB with regards to adhering to the principles of Islamic law. In enhancing the understanding and awareness of the religious governance framework, the SB will educate their management and customers directly by exposing them to the knowledge of *Maqasid al-Shariah*. The CEO of Bank B highlighted this point and remarked:

This is the only Islamic bank that provides knowledge for their management and customers directly by inviting the SB as a speaker in a conference.

It can therefore be observed from the above discussion that the diversity in SB membership enhances integrity on the governance role of SBs in assuring the ethical-religious operations and identity of an Islamic bank. These findings are consistent with other empirical studies which highlighted that the shortage of qualified SB members lacking appropriate knowledge in Islamic and banking law could potentially have a negative effect on the governance system of Islamic banks and hinder stakeholder trust (see for example; Garas and Pierce 2010; Malik et al. 2011; Garas 2012; Grassa 2013; Ginena 2014). However, the responsibility of giving constructive advice and opinions on religious matters should be given only to the religious scholars who are qualified with religious background. Indeed, issuing a *Fatwa* is a heavy responsibility and only religious scholars are permitted to deliberate on religious issues. This religious qualification of SB members for these two Islamic banks was highlighted in Table 1 above.

4.2 Effectiveness of Shariah boards

Previous research conjectures that the SB is equated to serve as a religious auditor (Briston and El-Ashker 1986; Karim 1990a; Grais and Pellegrini 2006a; Garas and Pierce 2010; Grassa 2013) and a religious scholar (Archer et al. 1998; Safieddine 2009; Hasan 2009; Ullah et al. 2016) in IFIs and its prominent role serves as an additional governance mechanism intended to ensure the prudence of Islamic banking thereby increasing the level of confidence among stakeholders. In fact, the SB plays an essential role in performing the ex-ante religious compliance and ex-post religious compliance task. In the ex-ante religious compliance task, the Islamic bank may seek advice from SBs on religious compliance matters. Meanwhile, in the ex-post religious compliance task, SBs are required to perform their governance functions in directing, monitoring and reviewing the works carried out by management to ensure that all activities comply with the tenets codified in Islamic law.

In relation to a discussion of an ex-ante religious compliance task, the interview participants of Bank A revealed that the responsibility of providing a religious ruling must be given to those who are well-versed in Islamic law. For example, when developing a new product, the SB should consider many aspects and issues relating to religious compliance before any judgment and justification can be made. In this regard, religious assurance should only be made in accordance to Islamic principles laid down in religious texts. It is important to note that SB resolutions may influence the governance system in the industry and development of Islamic banks as Islamic banks are held accountable for implementing SB decisions. The SB member of Bank A, whose expertise and background is in religious affairs remarked:

SBs act like a National Fatwa Committee and their functions are to issue *Fatwas* (i.e., Islamic legal rulings). As such, the membership of SB members is compulsory to comprise of people from Islamic law backgrounds.

Participants from Bank B also highlighted that the SB plays a crucial role in participating discussions relating to religious issues. Also, as SB members, they

are accountable to ensure competency in issuing Islamic rulings to the bank. Thus, it is important for SB members to have knowledge, appropriate qualifications, and expertise in Islamic jurisprudence. A SB member of Bank B, an expert in Islamic law, highlighted this point and remarked:

As members of the SB, we have complete authority to issue a *Fatwa* and provide religious assurance on the activities of the Islamic bank. The ability to assess the religious issues is instrumental for SBs in performing their roles.

Indeed, the philosophy underlying the stakeholder perspective entails that the SB acts as an independent appraisal function in ensuring religious compliance from the initial process of developing a new product until the product is ready to be offered to customers. Hence, the capability of SBs in governing their advisory role will contribute to the innovation of Islamic banking product development and increase Islamic banking market share. At this point, the approval of Islamic banking products and services should be obtained from the SB. Before the SB issues the resolutions and endorses the product, a review of the product cycle should be undertaken by the SB. In this regard, the SB has been given access to review the operations of the Islamic bank including documentation, transactions and operations. From the above discussion, it is apparent that the SB understanding on the knowledge of Islamic banking product development is crucial. The SB member of Bank A highlighted this point and remarked:

Before the bank offers the product to customers, the SB will deliberately discuss and advise on product development pertaining to Islamic principles. Then, they will identify whether the product is highly recommended and permitted by religion or not....

Interestingly, the Chief Internal Auditor of Bank B made an argument that the appointment of the SB should comprise of people from religious experts only as their primary role is to provide advice on religious issues. The officer indicated that only the religious scholar has the ability to provide deliberation and discussion on a matters relating to religious issues. Indeed, the function of the SB has been stipulated in the SGF for SB to be responsible in overseeing all the business and operations of Islamic bank. The officer provides a suggestion for the SB to focus on their advisory role while the religious auditing and religious compliance review functions should be given to the Internal and External Auditor. The Chief Internal Auditor highlighted this point and remarked:

If we look from the SGF guidelines, there are two main responsibilities of SB which include 'managing' *Zakat* and providing advice on issues relating to religious events. The involvement of External Auditors will provide a quality judgment on a true and fair presentation of the financial statements.

As such, the above remark gives rise for religious assurance to be issued by only religious scholars. In relation to the development and innovation of Islamic banking product and services, the Islamic banks are required to have the approval

Table 2 Religious compliance review role of religious boards

Interview participants	Religious compliance review				
	Policy and procedures	Product development	Documentation and transactions	System and software	Advertisement and promotion
<i>Bank A</i>					
CEO	✓	✓	✓	✓	✓
RB member (1)	✓	✓	✓	✓	✓
RB member (2)	✓	✓	✓	✓	✓
RB member (3)	✓	✓	✓	✓	✓
Religious audit officer	X	X	X	X	X
Religious review officer	✓	✓	✓	✓	✓
<i>Bank B</i>					
CEO	✓	✓	✓	✓	✓
RB chairman (1)	✓	✓	✓	✓	✓
RB member (2)	✓	✓	✓	✓	✓
RB member (3)	✓	✓	✓	✓	✓
Chief internal audit	X	X	X	X	X
Religious department officers	X	X	X	X	X

and endorsement from the SB before the product is offered to the customer. Hence, the capabilities of the SB in providing good religious advice and opinions could result in improving the soundness of the SB's governance roles and providing an excellent image of the development of Islamic banking.

Another important governance role of SB in providing the religious assurance is religious compliance review functions. The discussion held with the interview participants of both Islamic banks under this study made apparent that the SBs play a pivotal role in directing, monitoring and reviewing all documentation and activities of Islamic banks before the religious assurance is made. As the SB, they are given the ultimate authority to provide a quality religious assurance to the stakeholder that all operations of the respective Islamic bank are in compliance with religious law. Therefore, Islamic banks emphasise competency of SB members in performing these religious compliance review tasks. The religious compliance review roles of the boards—as reported by the interview participants of these two Islamic banks are summarised in Table 2.

The discussion held with the CEO of Bank A indicated that the SBs play a crucial role in determining and highlighting the religious non-compliance events (RNC) that occurred in Bank A. Even though Bank A experienced minimal RNC, the SB provided critical concern on the matter. The internal officers will assist the SB members in performing the religious compliance review task. The CEO of Bank A remarked:

In identifying the religious non-compliance events (RNC), the SB will delegate their religious compliance review functions to the internal officers. RNC of bank A is just a small fraction; probably around 20%.

Essentially, it is up to the SB to directly review and analyse the department with risk of potential religious issues. At this point, SBs already have the right to request further explanation on matters and may ask the department to re-submit their report. That department will then be responsible for making corrections according to what the SBs have suggested. A SB member of Bank B remarked:

We review their product manual from time to time after the product has been launched. We will look at their standard operating procedures (SOP), documentations and so on. We hope that the products offered not only follow the common law but also comply with the Islamic principles....

In fact, the CEO, SB members along with the Religious Audit Officer all expressed similar sentiments that the SB plays a crucial role in evaluating and assessing the report provided by internal officers. Nevertheless, in providing the religious assurance, the daily operations of the Islamic bank are subject to review and monitoring by the internal officer. The result will be reported to the SB for their approval. Then, the bank submits the SB decisions and resolutions to the BNM for their approval. The CEO of Bank A highlighted this point and remarked:

In the stage of product development, the Religious Reviewer and Religious Audit Officers would evaluate and rectify any religious issues on the product manual, the contracts and transactions and the results would then be submitted to the SB for approval.

Meanwhile, the Religious Review Officers shared their experience by stating that the SB will directly review the departments of the Islamic bank as well as the Treasury Department. For instance, the SB will examine how the Treasury Department defines and excludes the income from RNC and channels it to a fund named "Tabung Mawaddah" and the management of *Zakat*. Indeed, any income from forbidden activities (i.e.: *riba*, *usury*, *gambling* and all activities which are not permissible by Islamic law) cannot be recognised as profit in the financial statement and the income should be 'cleansed' by channeling these monies to other non-Islamic and charitable funds. The Religious Review Officer of Bank A remarked:

In some cases, the SB will come and review directly the particular department for further investigation. For instance, all the SB members came and reviewed directly the process and transactions carried out by Treasury Department....

In providing religious assurance, the SBs were given rights and access to all information, complete documentation, transactions, product manuals and operations of the Islamic bank. On this, the SB member of Bank A remarked:

We, as a SB, should oversee the overall operations of the Islamic bank. In the product development stage, we are given access to look at the entire process of the product manual. In fact, our SB was very strict because we want to be truly Islamic....

Generally, the discussion above suggests that it was crucial for the SB to play a supervisory role in monitoring the religious compliance of the Islamic bank.

Considering this, the management of the Islamic bank bears responsibility to provide accurate information and complete documentation to its SB. Thus, it is important for SB members to effectively communicate and engage with various parties within the bank to ensure that all operations are in accordance with Islamic law. In fact, the governing role of the SB can be refined even more with the assistance of internal officers as the daily operations of the Islamic banks are subjected to review and these reviews are undertaken by internal officers. However, several interview participants of both banks highlighted the inadequacy of religious compliance review roles undertaken by their SB. Therefore, our study provides direct evidence that SB members have less exposure in understanding technical business issues and financial matters to evaluate business activities conducted by management. Often, the practice is for SBs to delegate their religious compliance review function to internal officers. In such circumstances, SB members were observed to be heavily reliant on the work performed by internal officers when providing religious assurance. The Religious Review Officer of Bank A remarked:

At all times, the SB will not go through the entire process of the operations of the bank. Basically, the internal officer will table the results to the SB. In cases involving religious issues, the SB will request for further clarification and check the documentation....

Similar discussions were held with the Chief Internal Auditor and Head of the Religious Department in Bank B who questioned the competency of their SB when performing the religious compliance review task. The arguments made were that SBs are less credible in assessing and evaluating certain issues relating to Islamic banking operations due to the lack of Islamic banking knowledge among their SB members. Because of this, SBs appeared to be delegating their religious compliance review function to internal officers and subsequently, the results presented to the SB for approval. The Chief Internal Auditor also expressed grave concern about the work performed by the internal officers as they are responsible for reporting their findings to the CEO of the bank. In this regard, top management seems to have room for opportunistic behavior in influencing the results presented by the internal officer. It is worth noting that the SGF required Islamic banks to establish a religious audit as this will help in verifying the findings reported by internal officers to the SB. Therefore, this implementation of a religious compliance review and audit would effectively enhance the quality of religious assurance provided by the SB. The Head of the Religious Department of Bank B stressed this point and remarked:

The SB should oversee the operations of the Islamic bank as a whole. This includes effectively monitoring the implementation of the religious compliance audit and review functions.

Based on the above, it appears that often, the religious compliance review function had not been effectively undertaken by SB members of these two Islamic banks as they were overwhelmingly reliant on the findings presented to them by

internal officers. This argument is made on the basis that SBs have limited time in assessing the day to day operations of Islamic banks as SB members only work in a part-time capacity. Nevertheless, some of the interview participants were critical about the shortcomings in the role of SB's when performing the religious compliance review task. This is discussed in the following section.

4.3 Quality of religious assurance post SGF implementation

Overall, our interview participants revealed that the implementation of the new guidelines of the SGF in the Malaysian Islamic banking industry could enhance the quality of religious assurance issued by SBs. This proposition is made on the basis that the recent 2011 SGF guideline was perceived to be better than the earlier GPS-1 in terms of governance because of the inclusion of issues such as religious assurance, scope and responsibility, accountability and on other matters relating to bank operations. It was well understood that greater understanding and commitment of every party within the bank to uphold the holistic value of religious principles will ensure the religious compliance and thus fulfill the required religio-social legitimacy of its operations. The Religious Audit Officer of Bank A remarked:

Yes, the SGF covers almost all of the requirements. If we look at the guidelines of GPS-1, it only focused on the functions of the SB. However, the new requirement of SGF clearly spells out the function as well as the role of every single party to ensure religious compliance.

A similar argument was provided by a SB member of Bank B that the new structure and requirements in SGF promotes better governance practices. This SB member, who is a religious expert, remarked:

The SGF has enhanced the ability of Islamic banks to guarantee religious compliance on the operations and business dealings of particular Islamic banks. In our case, we have become pioneers among other banks in practicing the guidelines laid down in the SGF.

When referring to the proficiency and background of SBs as shown in Table 1, both of the banks participating in this research were found to have appointed competent SB members for the purpose of issuing religious assurance. Generally, SBs are supported in discharging their governance role from the various parties within the bank when undertaking the religious compliance process. Often, the tendency is for BODs to supervise and monitor the work performed by management so that all activities are undertaken according to the objective of various stakeholders and comply with Islamic principles. The discussion with the interview participants of the two different banks made apparent that the internal officers contribute to the governance role of SB as they are responsible in assisting the SB in ex-post religious compliance tasks. In avoiding and mitigating the occurrence of any religious non-compliance event, these two functions of audit and review highlighted in the SGF

will contribute in enhancing the monitoring and supervision role of SBs. A Religious Review Officer of Bank A highlighted this point by stating:

The new SGF clearly spells out the requirement for our Islamic bank to recruit new personnel and to establish religious audit and risk functions. Before this, in the GPS-1, the scope of internal officers was only to assist the SB in providing the religious assurance.

A discussion with our interview participants also highlighted that the enactment of the IFSA 2013 had expanded the recommendations outlined in the guidelines of the SGF. In ensuring religious compliance, IFSA required Islamic banks to appoint a capable religious auditor to carry out the audit functions relating to religious compliance. The SB member of Bank A remarked:

In a case where Islamic banks were not complying with the requirements stated in the SGF, we also discovered that they were not complying with the IFSA 2013. For our Bank, it is the SGF which would be the framework that enforces us to seriously develop religious audit in ensuring religious compliance.

Our interview findings present evidence that SB decisions were made without proper diligence as they were heavily dependent on the recommendations provided by internal officers. In such circumstances, it appears that SB members are observed to be rubber stamping. Such limitation of the SB role would lead to negative impact on the perception of stakeholders and jeopardize the reputation of this alternative banking industry. The reality is that current practice of providing assurance will not be deemed acceptable in the governance framework applied by External Auditors in a conventional setting. Hence, we maintain that SBs should primarily focus on their religious advisory role whilst the religious compliance task and the provision of the religious report are left to external religious auditors. By doing so, the process of religious audit as emphasised in the 2011 SGF could then ensure SB legitimacy in providing attestation for religious compliance (see Najeeb and Ibrahim 2014), since religious audit by its virtue would ensure that Islamic banking operations are conducted according to its objectives, social benefit and religious prudence.

5 Conclusion

This study provides evidence on the governance role of SBs when undertaking the crucial religious compliance review prior to providing assurance that Islamic banking operations are religiously and ethically compatible. In doing so, SBs are responsible to effectively and independently manage their religious compliance task to fulfill the societal legitimacy expected of Islamic banks stakeholders. We, therefore, investigated the current role of SBs using stakeholder and legitimacy theories which imply that Islamic banks shall always uphold ethical and religious compliance as a key operational characteristic to operate business and to demonstrate ultimate accountability to stakeholders. In such instances, this study reveals grave concern

about the inherent deficiencies of SB members in performing their task which is attributed to a lack of banking and financial knowledge. More than necessary, the SBs in the two Islamic banks under study were delegating the religious compliance review function to internal officers who then presented their findings to them for approval. Clearly, this practice goes against the grain of both the stakeholder and legitimacy theories as SBs from both the banks participating in our study were found not to have performed their religious governance role diligently. As a result, our view is that there should be clear lines of separation in responsibility of SB's, with the task of religious compliance be transferred to external religious auditors with the role of the SB to serve purely in an internal religious advisory capacity. Our study also draws some recommendations for the Malaysian regulatory bodies to take a more comprehensive approach to standardising the religious audit process and develop further specific effective religious audit tools as the existing framework only provides general recommendations allowing SBs with flexibility to operate ceremonially rather than fulfill their task diligently.

This study also provides insights into the processes of the religious compliance review and the provision of the subsequent religious assurance considering the newly adopted Malaysian 2011 SGF. Previous studies have not investigated this and from that perspective this study adds to existing literature by allowing a greater understanding of the current role and function of SBs and the dynamics of generating the all-important religious assurance designed to convey the expected institutional legitimacy to stakeholders and communicated in the religious compliance report published in banks annual reports. By focusing on the 2011 Malaysian SGF framework, this study allows identification of the current strengths and weaknesses of the Malaysian Islamic banking industry. Our findings suggest that because of the newly implemented SGF, the quality of religious assurance has improved due to the importance placed on religious audit which had contributed to enhancing SB credibility. From this perspective, it appears that the SGF did bring about some of the benefits hoped for by its central bank regulatory architects.

Finally, the results presented in this research have implications for other Islamic jurisdictions around the world especially those that are considering emulating a dual-governance central regulatory and governance system like that in Malaysia. This over-arching form of governance practice has its advantages in that a robust and sound governance system can be implemented which would standardize Islamic banking practice. As with other empirical studies, this study also has its caveats. First, not all the key figures in Islamic banks were willing to share their experience with us as they lacked time to entertain requests for interview. Second, this study focused only on the quality of religious assurance from the religious compliance review undertaken by SBs whereas there are other governance mechanisms in Islamic banks like religious audit and religious risk management that may also influence decisions of SBs. Therefore, future studies should be designed to investigate such areas to enable a fuller understanding of the governance process currently practiced not only in Islamic banks in Malaysia but also in other Islamic jurisdictions. In addition, since our study is based on two case studies of full-fledged Islamic banks in Malaysia, we believe that future research should be conducted which could examine important cultural and institutional variables. This should be undertaken either

by a comparative or multi-country examination utilising the rich and diverse cultural, religious and institutional differences in the Islamic world as this would provide fertile ground for a future research agenda.

For the time being at least, our findings suggest that although our interview participants were generally positive about the impact of the new governance framework, we report some genuine concerns and implications that would merit further regulatory attention. For instance, we recommend that Malaysian regulators need to address urgently some of the key issues identified in this study such as competence, independence and issues on the overall operational effectiveness of SBs to enhance governance practice and to close any expectation gap arising between SBs and Islamic bank constituents. This clearly is an important responsibility for regulators, especially if they desire stakeholders to believe that SBs are working to achieve the expected religious and governance legitimacy. After all, it is now well accepted that the *'raison d'être'* and *'modus operandi'* of SBs is to effectively serve as the conscience of Islamic society.

Compliance with ethical standards

Conflict of interest The authors declare that they have no conflict of interest.

Ethical approval All procedures performed in studies involving human participants were in accordance with the ethical standards of the institutional and/or national research committee and with the 1964 Helsinki declaration and its later amendments or comparable ethical standards.

Informed consent Informed consent was obtained from all individual participants included in the study.

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