



***ACCOUNTABILITY AND LEVEL OF COMPETENCY
OF THE SHARIAH SUPERVISORY BOARD IN
BANK MUAMALAT MALAYSIA BERHAD***

MOHD HADLI SHAH BIN MOHAMAD YUNUS

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By

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**Thesis Submitted to the Graduate School of Management,
Universiti Putra Malaysia, in Fulfilment of the Requirements for the
Degree of Master of Science**

June 2016

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DEDICATION

With love to Allah S.W.T.

This thesis is dedicated to:

my beloved wife, Emellia Abu Bakar, for her endless love, du'a, caring, support, understanding and patience to see me go this far;

my lovely children, Muhammad Hafiy Shah, Muhammad Hadif Shah and Rabi'atul Adawiyah, for their unconditional love that has given me energy and motivation to finish this thesis;

both of my parents, Allahyarham Haji Mohd Yunus Abdul Aziz and Hajjah Saemah Ahmed who never had any doubt in their son's potential;

both of my parent-in-laws, Haji Abu Bakar Idris and Hajjah Mariah Ahmad, and all my brothers and sisters, for their continuous love, support and understanding, and faith in my strength.



Abstract of thesis presented to the Senate of Universiti Putra Malaysia in
fulfilment of the requirements for the degree of Master of Science

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June 2016

Chair: Hasri Bin Mustafa @ Abdul Razak, PhD

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The establishment of Islamic banking and finance is prevailed by Shariah principles. In this regard, it is important to have a comprehensive, robust and well-functioning Shariah audit and governance to guarantee that all products and services offered by the Islamic Financial Institutions (IFIs) are widely acknowledged as Shariah compliant. The purpose of this study is to examine the role played by Shariah Supervisory Board (SSB) of an IFI in ensuring the accountability conception and the level of auditing competency is consistent with the Shariah principles. The focus of the study is on aspects of three issues, which are: Shariah compliance, accountability and level of auditing competency. In this study, the qualitative research method was applied and ethnographic research approach was employed so as to understand the social context on the accountability and level of competency amongst SSB. The data gathering process included three sources of empirical materials. First is through Bank Muamalat Malaysia Berhad's (BMMB's) website, newsletter and other publicly accessible materials. Second is by inconspicuous on-site observation: by participation in meetings, planning sessions and in other internal gatherings. Third is through observations and informal conversations supplemented by semi-structured interviews with the key respondents represented by the members of Shariah Committee (SC) and Shariah Department staff of BMMB Head Office for a period of two months. The findings of this study primarily revealed that the SSB members deal in accordance with regards to the Shariah compliance comprehension in association with IFI interpretation and accountability conception. This study also found that the epistemological conception of accountability emphasises on the subjection, transparency, independence, confidentiality, faith and justice which reflects the relationship between self and statutory regulations are positively influenced by Islamic business ethic. Hence, the association of accountability and level of auditing competency has a significant influence in

supporting SSB supervising the IFI accordingly. This study will definitely contribute to a practical conceptual framework of solutions to the IFI. At the same time, it may contribute a full range of knowledge and skills to the standard setter in determining the problems, designing and implementing suitable remedial measures. In addition, it will benefit the educational institutions in Malaysia especially in the development of curriculum and training modules for Shariah audit that fulfill the Shariah requirements. The educational institutions must also take up the challenge to produceable and certified Shariah auditors' graduates to cater for the future demand globally. Furthermore, the findings of this research may be used as guidelines and evaluation for future references.

Keywords: Shariah Supervisory Board, Islamic Financial Institution, Accountability, Competency, Ethnographic.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia
sebagai memenuhi keperluan untuk ijazah Master Sains

**AKAUNTABILITI DAN TAHAP KECEKAPAN AHLI LEMBAGA
PENGAWASAN SYARIAH DI BANK MUAMALAT MALAYSIA BERHAD**

Oleh

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Penubuhan perbankan dan kewangan Islam adalah berlandaskan prinsip-prinsip Syariah. Adalah penting bagi perbankan dan kewangan Islam untuk komprehensif, teguh dan mempunyai Syariah audit dan tadbir urus yang berfungsi dengan baik bagi menjamin bahawa semua produk dan perkhidmatan yang ditawarkan oleh Institusi Kewangan Islam (IKI) diakui sebagai patuh Syariah. Tujuan kajian ini adalah untuk mengkaji peranan yang dimainkan oleh Lembaga Pengawasan Syariah (LPS) di IKI dalam memastikan konsep akauntabiliti dan tahap pengauditan kecekapan selaras dengan prinsip-prinsip Syariah. Fokus kajian ini adalah kepada tiga aspek utama, iaitu: pematuhan Syariah, akauntabiliti dan tahap pengauditan kompetensi. Seiring itu, kaedah penyelidikan kualitatif telah dilaksanakan dengan menggunakan pendekatan kajian secara etnografik bagi memahami konteks sosial di antara akauntabiliti dan tahap kompetensi di kalangan LPS. Proses pengumpulan data kajian ini adalah berdasarkan tiga sumber empirikal. Pertama adalah melalui laman web Bank Muamalat Malaysia Berhad (BMMB), surat berita dan sumber internet yang lain. Kedua adalah dengan pemerhatian di lokasi: penyertaan dalam mesyuarat, sesi perancangan dan perhimpunan dalaman yang lain. Ketiga adalah melalui pemerhatian dan perbualan secara tidak formal disertai dengan temu bual separa-berstruktur dengan responden utama yang diwakili oleh ahli-ahli Jawatankuasa Syariah (JS) dan kakitangan di Jabatan Syariah BMMB Ibu Pejabat untuk tempoh dua bulan. Hasil kajian menunjukkan bahawa anggota LPS haruslah sentiasa mematuhi Syariah sejajar dengan interpretasi IKI dengan konsep akauntabiliti semasa berurusan. Kajian ini juga mendapati bahawa konsep akauntabiliti epistemologi memberi penekanan kepada subjek, ketelusan, kebebasan, kerahsiaan, keimanan dan keadilan yang menjurus kepada hubungan di antara individu dan peraturan berkanun yang positif dipengaruhi oleh etika perniagaan Islam. Malah terdapat hubungan yang positif dan signifikan di antara kebergantungan kompetensi dan akauntabiliti dalam menyokong LPS untuk menyelia IKI. Kajian ini pasti akan menyumbang kepada kerangka konsep praktikal penyelesaian kepada

IFI. Pada masa yang sama, ia juga menyumbang pelbagai pengetahuan dan kemahiran untuk penetap standard dalam menentukan masalah, mereka bentuk dan melaksanakan langkah pemulihan yang sesuai. Di samping itu, ia akan memberi manfaat kepada institusi pendidikan di Malaysia terutamanya dalam pembangunan kurikulum dan latihan modul bagi audit Syariah. Justeru, institusi pendidikan juga perlu menyahut cabaran untuk melahirkan graduan juruaudit Syariah yang berkebolehan dan diiktiraf demi memenuhi permintaan pasaran di peringkat global. Tambahan pula, hasil kajian ini boleh digunakan sebagai garis panduan dan penilaian untuk rujukan masa hadapan.

Kata kunci: Lembaga Pengawasan Syariah, Institusi Kewangan Islam, Akauntabiliti, Kompetensi, Etnografik



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I certify that a Thesis Examination Committee has met on **03 June 2016** to conduct the final examination of **Mohd Hadli Shah Bin Mohamad Yunus** on his thesis entitled **Accountability And Level Of Competency Of The Shariah Supervisory Board In Bank Muamalat Malaysia Berhad** in accordance with the Universities and University Colleges Act 1971 and the Constitution of the Universiti Putra Malaysia [P.U.(A) 106] 15 March 1998. The Committee recommends that the student be awarded the Master of Science (Accounting).

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DECLARATION

Declaration by graduate student

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LIST OF ABBREVIATIONS

AAA	American Accounting Association
AAOIFI	Accounting and Auditing Organisation for Islamic Financial Institutions
AGM	Annual General Meeting
AMLA	Anti-Money Laundering
ASIFI	Auditing Standard for Islamic Financial Institutions
BAFIA	Banking and Financial Institutions Act
BBMB	Bank Bumiputra Malaysia Berhad
BCB	Bumiputra of Commerce Berhad
BIMB	Bank Islam Malaysia Berhad
BMMB	Bank Muamalat Malaysia Berhad
BNM	Bank Negara Malaysia
BOC	Bumiputra of Commerce Berhad
BOD	Board of Director
CA	Companies Act
CAR	Capital Adequacy Ratio
CBM	Central Bank of Malaysia
CEO	Chief Executive Officer
CIMB	Commerce International Merchant Bankers Berhad
CPA	Certified Public Accountant
CPD	Continuing Professional Development
DFI	Development Financial Institutions
DFIA	Development Financial Institutions Act
GSIFI	Governance Standard for Islamic Financial Institutions
GSM	Graduate School Management
IAD	Internal Audit Department
IBA	Islamic Banking Act
IBFIM	Islamic Banking and Finance Institute Malaysia
IFI	Islamic Financial Institution
IFSB	Islamic Financial Standard Board
IIFM	International Islamic Financial Market
IIRA	International Islamic Rating Agency
IIUM	International Islamic University of Malaysia
INFAD	World Fatwa Management and Research Institute
IPO	Initial Public Offerings
IT	Information Technology
ITM	Institut Teknologi MARA
LMC	Liquidity Management Centre
LRT	Light Rail Transit
MIA	Malaysian Institute of Accountants
MBS	Muamalat Banking Solutions Steering
MCCG	Malaysian Code of Corporate Governance
NGO	Non-Governmental Organisation
P.B.U.H	Peace Be Upon Him
PBS	Putra Business School
SAC	Shariah Advisory Council
SAW	Sallallahu Alaihi Wassalam
SBC	Special Board Committee

SC	Shariah Committee
SFAC	Statement of Financial Accounting Concepts
SGF	Shariah Governance Framework
SME	Small and Medium Enterprises
SSB	Shariah Supervisory Board
SSC	Shariah Supervisory Council
SWT	Subhanahu Wa Ta'ala
UiTM	Universiti Teknologi MARA
UKM	Universiti Kebangsaan Malaysia
UM	University of Malaya
UPM	Universiti Putra Malaysia
USIM	Universiti Sains Islam Malaysia
USM	Universiti Sains Malaysia





CHAPTER 1

INTRODUCTION

“The compliance with Shariah principles is an integral feature in the Islamic banking and finance. An effective and conducive Shariah framework is imperative in assuring such compliance.

It will underpin a comprehensive and wholesome development of this sector. An effective Shariah framework will harmonise the Shariah interpretations, strengthen the regulatory and supervisory oversight of the industry and will also foster and nurture a pool of competent Shariah advisers.”

(Guidelines on the Governance of Shariah Committee for the Islamic Financial Institutions by Central Bank of Malaysia, 2005)

This chapter not only provides an overview of the current study but also to describes the rationales for the study and the importance of proper recognition of the accountability conception and competence among Shariah Supervisory Boards¹ (SSBs) of the Islamic Financial Institution² (IFI). It elaborates on the problem statement, the research objective, significance of the research and the organisation of the study. The purpose of this chapter is to give a clear picture of the entire research that is carried out through the study.

This study is, thus, set into the scene of interpretive by specifically borrowing cultural thought from Geertz's interpretive anthropology. Whereby, the borrowing is not eclectic in the sense that it is anchoring this work comprehensively in Geertz's interpretive methodological framework (Rasyid, 1995). It is important to note that how the culture of the organisational participant; the SSB, argued in this study as the culture of the organisation, interplays with the accountability and competency is the enterprise of this study. Within the interpretive philosophy, there is a diverse tradition of thought; even the concept of interpretation itself has become the source of controversy (Hiley, Bohman and Sutherman, 1991). Chua (1988) discussed the diversity and reviewed the two main descendants of the tradition, that is, symbolic interactionism and ethnomethodology.

¹Shariah committee is set up by an IFI to advise and certify certain financial products and services. Also known as Shariah Auditors, Shariah Advisors, Shariah Advisory Council (SAC), Shariah Committee (SC) and Shariah Supervisory Council (SSC).

²IFI which are regulated under the Islamic Banking Act (IBA), Banking and Financial Institutions Act (BAFIA) and Development Financial Institutions Act (DFIA) are classified as of the "Islamic banking industry". According to Section 2 of IBA, 1983, "Islamic banking" is defined as banking business whose aims and operations are not to involve with any non-approved elements in accordance to Islam. Non-approved elements can be described as the payment and receipt of usury, gambling, hoarding and speculation in all financial transactions, it also based on culturally distinct, ethical and moral principle. In addition, cannot invest in the shares of companies that deal in alcoholic beverages, pork products, pornography and other activities which are considered unlawful from an Islamic perspective.

1.1 BACKGROUND OF THE STUDY

Over the last decade, Islamic banking, finance and accounting has grown tremendously in Malaysia especially in terms of growth of Islamic banks, *takaful*³ operations, money market and capital market operations, fund management, *zakah*⁴ institution, *waqf*⁵ institution and other financial service providers. The term “Islamic banking” indicates that the conduct of banking operations is in consonance with Islamic teachings which are based on *Shariah*⁶ principles. In view of this definition, the Islamic institutions are expected not to have the same philosophy and objective as adopted by the conventional banks (Haron and Nursofiza Wan Azmi, 2008; Devi, Hooper and Davey, 2008). As such, in Islamic accounting literature conventional accounting may create social problems and promote non-neutral values. For example, success in the conventional accounting is primarily measured in terms of material wealth based on technical, not ethical rules (Karim, 1996). However, Islamic accounting has its own values, disclosure and standardised practices compared to conventional accounting. Islam prescribes a broad accountability framework in all aspects of life comprising conduct in managing a business and this significantly has an impact on accounting practices (Baydoun and Willett, 2000; Gambling, Jones and Karim, 1993). The Islamic world view not only to measure the development of materials and services incurred but also include God's pleasure. Moreover, the success of Islamic banking and finance are closely associates with the notion of accountability and its implication to *ummah* (Islamic universal community).

As a result of appreciating this, the traditional financial capitals of the west are becoming more interested in Islamic financial products market. This is due to the reason that the Islamic market is less prone and uneasily affected by inflation and less vulnerable to speculation (Sajjad, 2010) that makes the products continue to grow (Lewis, 2000; Ariff, 1988). The relationship between market operationalisation, Islamic principles and accounting in this environment provides interesting insights on accountability in the literature.

Whilst the literature (Ahrens 1997; Dent, 1991) has identified explicit relationship between accounting and culture, Islam has profoundly been a central and vital component in accounting itself (Baydoun and Willet, 2000). Islam attaches with the entire social, political and economic factors that influence accounting (Hamid, Craig and Clarke, 1993). Syafri Harahap (2003) stated that the Islamic accounting standards intended to show its main role and contribution in developing a complete set of value added indicators, which can be used as the medium for realising value, disclosure and standardised practices.

³Islamic insurance, whereby a group of participants mutually agree among themselves to guarantee each other against a defined loss or damage that may inflict upon any of them by contributing as *tabarru'* or donation in the *takaful* funds.

⁴ Alms giving or compulsory contribution for all Muslim, a certain portion of one's wealth in support of the poor or needy or for other charitable purposes and considered as a tax.

⁵ Empowering the economy of Muslim and to achieve business jihad by spare some of their property.

⁶ Shariah, also spelled as *syariah* or *syaria'* is Islamic law of human conduct derived from the Holy Quran and the *Sunnah* (teachings of Prophet Muhammad SAW). i.e. Islamic laws and sometimes referred to as Islamic Jurisprudence, which concerns of all forms of practical action by a Muslim to show their trust and faith.

To date, Islam is one of the leading religions of the world which emphasises on submission to one God, and the followers are bound by Shariah law. In brief, Islam can be perfectly described as a way of life which teaches that life is a blessing from God and human beings live according to His command. Islam governs the moral code of conduct as guidance for human behaviour. The code also covers modern business and some basic principles that can be used in running corporate affairs. There is reason and purpose in our creation and we are accountable to God with what we do in our life on earth (Foad, 1996, p.4). The order is also clearly stated in the Holy Quran, Surah Al-Muminoon (23:115):

"Do you think that We have created you in the game (for no reason), and that you will not be returned to Us to account?"

All Muslims have to recite the *Shahada*⁷ as evidence that there is no God but Allah and Muhammad is the messenger of Allah and to perform prayers five times each day, to pay *zakah*, fasting in the month of Ramadhan, and to perform the *hajj* or pilgrimage to Mecca. The practicing Muslims are expected to respect the teachings of Holy Al-Quran which underline the foundation of Islamic law (Khan, 2002; Lewis, 2001). Islam also encompasses the essence of economic well-being and development of the Muslims at the individual, family, community, state and *ummah* level.

The Islamic view of life of a Muslim and the place of the economic activities within the framework of such a view can be summarised in Figure 1.1. Islam has three essential elements namely, *Aqidah*, which concerns all forms of faith and belief, Shariah which concerns all forms or practical actions by a Muslim manifesting his faith and belief and *Akhlaq* which concerns behaviour, work ethics and attitudes that underlies practical actions of Muslims. Shariah being the practical aspect of Muslim's daily life is then divided into two namely *Ibadat*⁸, which concerns the practicalities of worshiping Allah or known as man-to-Allah relationship and *Muamalat* which concerns the practicalities of Muslim mundane daily life or known as man-to-man relationship. A significant segment of *Muamalat* is the conduct of a Muslim's economic activities and this includes the banking and financial activities. Thus, in the Islamic scheme of life and Shariah framework, a Muslim's banking and financial activities contain social and civil affairs, transactions and regulations whereby its sequence can be traced to his economic activities to *Muamalat*, to Shariah, to Islam, and finally to Allah. This is the root of Islamic banking and finance that is followed by Muslim scholars (Noordin, 2000, p.144).

Within the Islamic scheme of life and Shariah framework, Islam imposes its laws or in modern terminology sometimes referred to as norms or values. These laws or values are not man-made; instead they are ordained by Allah and derived from the sources of Shariah. The two primary sources are the holy

⁷The Muslim profession of faith ('there is no god but Allah, and Muhammad is the messenger of Allah'), the first of the Five Pillars of Islam.

⁸ The ritual of his worship to Allah SWT, in the context of man-to-Allah SWT relationship.

Al-Quran and *Al-Sunnah*⁹. Apart from the two primary sources of Shariah, another additional sources also known as secondary sources of Shariah such as the *Ijmak*¹⁰, the *Ijtihad*¹¹, the *Qiyas*¹², the *Mursalat Mursalih*¹³, the *Istihsan*¹⁴, the *Istishab*¹⁵, the *Sadd Zarah*¹⁶, the *Urf*¹⁷, the *Maqasid Shariyyah*¹⁸, the *Ta'wil*¹⁹, the *Istiqra*²⁰, and the *Siyasah Shariyyah*²¹ (Billah, 2003; Noordin, 2000; Hamid et al., 1993). In the process of *Ijtihad*, the Shariah regulatory councils must refer to the Quran as the primary source for the solution of a particular issue. If the rule exists in the Quran, it has to be adopted; otherwise one has to refer to the *Sunnah*. If no ruling is found in the *Sunnah*, then the regulatory councils referred to the *Ijmak*. Nevertheless, if there is no Shariah ruling found or stated anywhere in Holy Quran, *Ijtihad* is then used based on *Qiyas* or other secondary sources of Shariah.

Furthermore, the essential feature of Islamic banking is interest-free or forbid any charges of interest but it does not mean that capital is costless in an Islamic system (Ariff, 1988). Islam recognises capital as a factor of production but it does not allow the factor becoming a prerequisite or predetermined claim on the productive surplus in the form of interest. As interest bearing securities are prohibited, Islamic system allows profit calculations which preserve equity between stakeholders thus become an important component in Islamic accounting.

Conducting activities in accordance with Shariah principles entails that the institution pledges not to engage in interest-based debt transactions, not to conduct pure financial transactions disconnected from real economic activity, not to participate in transactions where there is exploitation of any party, and not to participate in activities regarded as harmful to society (Grais and Pellegrini, 2006). The prohibition of *riba'* (usury or interest), in the Holy Quran has been repeatedly condemned and prohibited (Al-Ajmi, Abo Hussain, and Al-Saleh, 2009; Chong and Liu, 2009; Olson and Zoubi, 2008; Sole, 2007;

⁹ It is a collection of the Prophet's sayings and deeds, including his opinions about matters, as well as the practices of his companions. The *Sunnah* occupies a place second to the Qur'an.

¹⁰ Muslim jurisprudence, "consensus" or "agreement" related to interpretation of the Shariah over issues pertaining to people's life. Unanimous agreement among Muslim jurists on any Shariah ruling in a particular period after the demise of the Prophet Muhammad SAW.

¹¹ Shariah decision making. Refers to the endeavour of a qualified jurist to derive or formulate a rule of law to determine the true ruling of the divine law in a matter on which the revelation is not explicit or certain, on the basis of *Nass* or evidence found in the Holy Qur'an and the *Sunnah*.

¹² Likening a new case in question without textual evidence to an original ruling which is supported by explicit legal text which shares the same effective cause.

¹³ Deciding a ruling based on the principle of general public interest in issues which do not have clear and specific ruling from legal text of either Quran or *Sunnah*.

¹⁴ Setting aside an established ruling backed by *dalil* (evidence) on a matter in favour of an alternative ruling which is stronger and more convincing than the first ruling, based on the support by *dalil*.

¹⁵ Presumption of continuity of the original ruling as long as there is no other *dalil* to establish the contrary.

¹⁶ An approach used to prevent any means to evil in order to avoid forbidden acts.

¹⁷ Established customs or conventions in accordance with the Shariah.

¹⁸ Objectives which are being sought to be realised by the Shariah when deciding on a ruling aimed at protecting the human being's interest.

¹⁹ An effort to delineate the Shariah principles based on *dalil* without being restricted by its literal meaning.

²⁰ Comprehensive examination of a matter before a definite ruling is made on the issue.

²¹ A discipline of Islamic jurisprudence that discusses the rulings related to policies and approaches taken in managing the national administrative structure and its people consistent with the spirit of Shariah.

Rammal, 2006; Grais and Pellegrini, 2006; Ghannadian and Goswami, 2004; Lewis, 2001; Visser and MacIntosh, 1998; Pomeranz, 1997; Hamid et al., 1993; Karim, 1990; Ahmed, 1989; Bashir, 1983) and the application of trading and commerce are the cornerstones of Islamic accounting, banking, finance and so forth. Likewise, this has been clearly stated in the Holy Quran, Surah Al-Baqarah (2: 275):

“Allah SWT²² permitted sale (trading) and prohibited riba (usury)”

Apart from that, Islamic banking also looks at accountability concept which is differs from other religions, whereby accountability to God for one's actions is the key principle in Islam. Any lawful act done with the intention to please God is considered worship. Every Muslim is accountable to God for his or her life, youth, wealth and knowledge.

In line with the concept of Islam as “*Addeen*” (a way of life), every *ibadah*²³ is commanded by Allah SWT embraces all facets of his mundane activities in this world and in the world hereafter, both faith and way of life (Rosly and Bakar, 2003). According to Lewis (2001), Islam commands authority over totality of a Muslim's being, not accepting any distinction between the sacred and the secular. In each aspect of economies, politics, religious and social affairs, even accounting, all fall under the jurisdiction of the divine law of Islam. Hence the interpretation of accountability to God and the community for all activities is paramount to a Muslims faith.

Accountability requires every Muslim to ensure that every word and deed is subject to Shariah which derived from Al-Quran and *Sunnah* (Abu-Tapanjeh, 2009). Islam also emphasises on the issue of responsibility and accountability of human beings whereby each individuals are responsible for his or her own actions. We are of course free in our actions however; we are responsible and accountable for them. God only provides guidance for us to know what is good and what is bad. He said in the Holy Quran, Surah Al-Insaan (76:3):

"We created man of water drops ... Yes We guided him to the right way – now whether he (follows it and) be grateful or (goes astray and) be subject to ingrate he is."

Therefore, a Muslim business person is required to have high morals and dignity to be competence; cannot deceive, cheat or exploit others (Lewis, 2006). Muslim should not concentrate on gaining profit only in their business. Instead, they have to strive and hardworking, be more productive and diminish any element of indolence. Most of the Islamic banks appoint their own Shariah committees who act as advisers on religious issues whereby their role is different from the external independent auditors' roles (Karim, 1990). Thus, all Islamic banks are required under the Islamic Banking Act (IBA) 1983 to establish a Shariah body known as SSB being one of the most important governance mechanisms to ensure compliance with Shariah rulings (Karim, 1995). According to Rammal (2006) in order to fulfil the criteria of each

²² Acronym for *Subhahu Wa Ta'ala* means “The most glorified, the most high.”

²³ *Ibadah* is concerned with the practicalities of worship to Allah. In the context of man-to-Allah relationship.

products and services as being *halal* (permissible under Islamic law) the SSB, which normally consists of *fiqh* scholars, practitioners and academicians, has a duty to advise IFI on Shariah compliance in every aspect of its operations. There is no limitation on the number of the SSB members; arguably the ideal number would be three to five members.

In principle, the role of the SSB covers five main areas such as: firstly, certifying permissible financial instruments through *fatwas*²⁴ (ex-ante Shariah audit), secondly, verifying that transactions complied with *fatwas* issued (ex-post audit), thirdly, calculating and paying *zakah*, fourthly, disposing any non-Shariah compliant earnings (any earnings which are non-compliance with Shariah is a significant and substantial risk for IFIs whereby compliance with the Shariah is the *raison d'être*. This means that if a product is found to be non-compliant, it must be withdrawn from the market and any profit obtained from it must be channelled to charity). Lastly, the role of the SSB is to advise on the distribution of income and expenses among shareholders and investment account holders (Grais and Pellegrini, 2006).

Among the duties and responsibilities of the SSB are also include advising the Board of Directors (BOD) on Shariah matters on bank's business operations and to ensure the conduct of its affairs are in compliance with Shariah principles at all times (Nathan and Ribiere, 2007; Grais and Pellegrini, 2006). SSB has to endorse the Shariah Compliance Manuals, and also validate relevant documentations. Among other duties and responsibilities of the SSB is to ensure that proper record is kept for easy reference, and they are required to provide written Shariah opinions or decisions.

In addition, their functions also govern five main issues of corporate governance namely independence, confidentiality, competence, consistency, and disclosure (Grais and Pellegrini, 2006) which will be discussed in detail in Chapter 2. Furthermore, SSB plays an important role in sense that they help to ensure that IFIs strictly adhere to the principles of Shariah while offering a constructive and creative recommendations and solutions to ensure Islamic banking and finance systems are able to cope with all the challenges of working in a sophisticated and ever-changing financial environment.

Unfortunately, the collapse of one of the Big Five²⁵ audit firms, Arthur Andersen due to malpractices and accounting irregularities at the Houston Office has damaged public trust on financial reporting. Indeed, the main objective of having auditors or accountants in financial reporting is to render a credible financial reports and statements as it is capable of influence investors, creditors and other stakeholders of the financial statements in their decision making. They have to perform the duties as the gate keeper of the financial truth to provide credible and fair-view information (Gin Chong, 1992). A particular confidence feature in respect of Islamic financial services is the requirement of

²⁴ The religious edict or proclamation that is a legal opinion issued by qualified Muslim scholar on matters of religious belief and practice.

²⁵ The Big Five became the Big Four after the demise of Arthur Andersen in 2002, following its involvement in the Enron scandal.

conveying to stakeholders that their financial business is conducted in conformity with their religious beliefs.

This research focuses on the relationship between accountability conception and competency of the members of SSB which is primarily directed to the moral and socio-moral aspects. It intends to identify the interpretation of accountability conception among SSB members responsible and competence to assist IFI to adhere to the Islamic concept and ensure all its financial transactions are accordance with Shariah principles (Karim, 1990). Based on the articles of association of financial institution or those fixed by national regulators, the tasks of an SSB's may vary in practice. The approach of the IFI is to uphold its transparency in terms of operations towards public (Besar, Sukor, Muthalib, and Gunawa, 2009). Hence, accounting element and audit operations in Islamic financial products and services have to be in accordance with Shariah principles. Accounting professions especially the auditor must constantly preserve maintain and increase level of public trust in doing audit and professional services through integrity and objectivity.

This study attempts to evaluate the association of accountability and level of competency among SSB in IFI, thus Bank Muamalat Malaysia Berhad (BMMB) has been chosen among others Islamic bank in Malaysia as the case study. According to Stake (1978) case studies are useful in the study of human affairs because they are down-to-earth and attention-holding but that they are not a suitable basis for generalisation. The interesting fact about BMMB, it was established as a second full-fledged Islamic bank in Malaysia and the history of its establishment was the effect of the spin-off following the merger of Bank Bumiputra Malaysia Berhad (BBMB),²⁶ Bank of Commerce Berhad (BOC) and BBMB Kewangan. Under the merger arrangement, with combined assets and liabilities brought over from those banks, two banks were formed, which had been an Islamic bank, BMMB, and a conventional bank, which was Bumiputra of Commerce Berhad (BCB). Furthermore, in terms of shareholding, DRB Hicom²⁷ holds 70% shares in the BMMB, while Khazanah Nasional Berhad²⁸ holds the remaining shares of 30%.

²⁶ BBMB was created to promote the economic development of the indigenous population in Malaysia. It was incorporated in 1965 in line with government initiatives to increase Bumiputra participation in the Malaysian economy. It was the largest bank in Malaysia in the 1980s. In October 1999, BBMB merged with Bank of Commerce Berhad (BOC) and formed Bumiputra-Commerce Bank (BCB), resulting in the biggest merger in Malaysia's banking history. CIMB (Commerce International Merchant Bankers Berhad) acquired Bumiputra-Commerce Group in June 2005 and renamed Bumiputra-Commerce Holdings Bhd. The new CIMB Group was launched in September 2006, signifying the culmination of the 3-way merger of CIMB, BCB and Southern Bank Berhad to form a regional universal banking group.

²⁷ One of Malaysia's the biggest conglomerates involved in the automotive manufacturing, assembly and distribution industry. The company also focuses in the services and property and infrastructure sectors.

²⁸ The strategic investment fund of the Government of Malaysia.

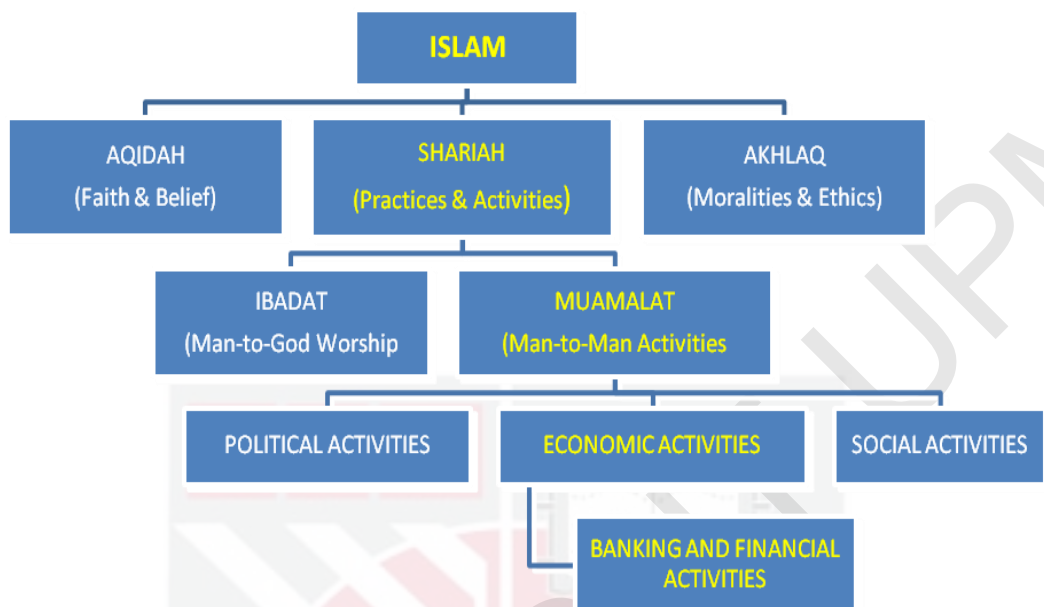


Figure 1.1. The Islamic Scheme of Life and Shariah Framework
(Source: Noordin, 2000, p.144 with amendments)

1.2 PROBLEM STATEMENT

IFIs are required to carry out their activities in accordance with Shariah principles. In this regard, it is important to have a comprehensive, robust and well-functioning Shariah audit and governance to guarantee that all products and services approved and provided by the IFIs are widely acknowledged as being Shariah compliant, not only at the point of ratification, but also in terms of continuing operations. In order to achieve its objectives, Islamic banks are compulsory to adhere to the Shariah principles in their dealings and transactions, and therefore adherence to the Shariah principles in its activities and operations of Islamic banks is crucial (Zamil, 2014).

The significance of Shariah audit and governance is recognised by conveying them as part of improving corporate governance in the Malaysian business has been delineated specifically in the Shariah Governance Framework (SGF) as issued by the BNM and became effective as at 1 January 2011 (Shafii, Ali, and Kasim, 2014). According to Yahya and Mahzan, (2012), Shariah audit has been defined as an audit attestation for Shariah compliance. Before SGF introduced in 2011 by the BNM, the Shariah governance of the IFIs is bestowed upon the Shariah committee to oversee any Shariah compliant matters. They may also have to perform both Shariah review as well as Shariah audit. The credibility of IFI in order to ensure the sustainability of the Islamic banking and finance system can be explained by the legitimacy of its compliance to Shariah and the accountability and competency level of its SSB.

This study is going to explore the role played by SSB of an IFI in ensuring the accountability conception and the level of competency is consistent with the Shariah principles. Moreover, because of the failure of the accountants, auditors or other practitioners (a few cases occurred locally, such as: SKFZ, Transmile Mile Group Berhad, Megan Media Holding Berhad, NasionCom Holdings Berhad and Wimens Corporation Berhad – due to falsifying of the financial statement and accounting irregularities; and internationally, such as: the collapse of Enron, Satyam and others which relates to corporate scandals, fraud and misuse of resources) would pose as a constant threat to the regulatory structure and public trust and confidence (Doost and Fishman, 2004). According to Healy and Wahlen (1999), “earnings management” occurs when managers use judgment in financial reporting and structuring transactions to alter financial reports either to mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that are dependent on reported accounting numbers.

This is lead to the pertinent issues of the current problem in the Islamic bank industry, where it is faced with various Shariah non-compliance cases, raised the matter of accountability and auditing competency of SSBs. According to Zamil (2014), non-compliance will result in unfulfilled objectives of Shariah and the goal of the operations to protect the welfare of the society would not be achieved. This will also result in an unsustainable banking system and lead to a failure to achieve fairness for the stakeholders. Furthermore, this study viewed the importance of morality and ethics, or *akhlaq*, which should be instilled in accordance with Shariah, and demonstrated in SSBs’ behaviours and conducts. The significant concern to the SSBs is accountable on their actions and above all it can effectively shape the Islamic finance system. So far in the case of SSB, there is neither code of ethics nor code of misconduct. In this regard, they lead to the ethical accountability issues in banking sector as accountability presents personal credibility to individual SSB members and ensures Islamic ethical principles are preserved.

According to Khorshid (2012), Muslims are accountable not only to Allah, but also to their communities, which may be based on oath. In the accounting industry and all of the business community are accountable for business ethics. This privilege comes with responsibility: misconduct comes with a punishment; good conduct will come with rewards. Islamic banking and finance is based on ethics, fairness, and justice to all people as taught by the Holy Qur’an. In Islamic banking and finance, there seem to be no codes of ethics or accountability. Above all, board members do not obey any regulations and are not responsible to regulators to ensure that Islamic banking and finance is a credible system, compatible with the conventional finance system (Zamil, 2014).

Shafii, Salleh, Hanefah, and Jusoff (2013) stated that auditing competency entails knowledge, skill and attitude in order to guarantee accurate Shariah audit conducted and that the overall operations of IFIs are Shariah compliant. SSBs must not only have the auditing skills but also require to have an additional qualification which is Shariah knowledge specifically in *Fiqh’ Muamalat*. The effectiveness of internal audit depends substantially on the

quality, training and experience of its staff. The aim should be to appoint staff with the appropriate accounting and Shariah background as well as having personal qualities and potential to be trained as a Shariah auditor.

IFIs face problems and challenges in accountability and competency of their SSB aspects in the bank's operations. In studying the problems and challenges facing IFIs in Malaysia, the author has chosen BMMB as the case study and this research focused on three issues: Shariah compliance, accountability and level of competency. Thus, accountability theory and competence issue had framed the research that influenced IFIs and the theory were explored and associated to IFIs in order to provide a more meaningful result and understanding regarding the relationship between these issues. Appreciating this, accountability and competency issues can lead to the problem of ethics in banking sectors if SSB less capability to develop adequate positive values that influence Islamic business such as *iqtisad* (moderation), *adl* (justice), *ihsan* (kindness par excellence), *amanah* (honesty), *infaq* (spending to meet social obligations), *sabr* (patience) and *istislah* (public interest which is accountability on the job in accordance with Shariah requirements) (Lewis, 2001).

1.3 RESEARCH QUESTION

The aim of this research is to examine aspects of problems and challenges facing by IFIs in Malaysia. The focus of the study is on aspects of three issues, which are: Shariah compliance, accountability and level of competency. Based on the issues at hand, the main questions of this study are to investigate whether accountability and level of competency for Shariah compliance is considered and embraced in the governance structure of the company as mechanisms of accountability in Islamic banks. Based on the problem statements as highlighted earlier the present study attempts to resolve the following questions:-

- 1.3.1 Is the interpretation of accountability from IFI consistent with Shariah principles?
- 1.3.2 What is the SSB's conception of accountability in relation to God, human and environment?
- 1.3.3 To what extent does the auditing competency of SSB members in Shariah-based principles regarding accountability?

1.4 OBJECTIVES OF THE STUDY

The objectives of the study are:-

- 1.4.1 To examine IFI interpretation on accountability of SSB and evaluate if it is in accordance with Shariah principles.
- 1.4.2 To position the epistemological conception of accountability amongst SSB members in the IFI.

- 1.4.3 To examine the association between the level of auditing competency and accountability of SSB.

1.5 SIGNIFICANCE OF THE STUDY

Firstly, this research can make a significant contribution to the literature as there was no similar study has yet been conducted in Malaysia. As far as the practice is concern, the IFI industry is notably remain in its infancy stage in our country. Therefore, any rigid, rule-based approach adopted in haste aiming at strengthening the governance of the industry may jeopardise and hinder its potential and healthy growth.

Secondly, it is expected to give significant and practical contribution to the banking institution and government in providing full range of knowledge and skills to determine the problems or issues pertaining to the concept of accountability among SSB. However, the current problem in the IFI, where it is faced with various Shariah non-compliance cases, raised the matter of trust in the accountability and competency of SSBs. Thus, this study viewed the importance of morality and ethics, or *akhlaq*, which should be instilled in accordance with Shariah, and must further be demonstrated in SSB' behaviours and conducts. Results of the study could be used to improve existing services and formulate strategic decisions in order to achieve competitive advantage. In addition, it could be useful to the authorities in designing and implementing suitable remedial measures.

Finally, the findings of this research could be useful to the Malaysian educational institutions especially in the development of curriculum and training modules for Shariah audit that fulfill the Shariah requirements. The educational institutions must also take up the challenge to produce able and certified Shariah auditors' graduates to cater for the future demand globally. Furthermore, the findings of this research could also be used as guidelines and evaluation for future references.

1.6 ORGANISATION OF THE THESIS

This thesis contains six chapters. The first chapter gives an overview of the study. It briefly outlined the background of the study, the problem statement, the research question, the research objectives and the significance of the study.

The second chapter provides a literature review related to the study. It describes a comprehensive review of the works of SSB in relation to accounting, including definitions, functions and issues encounter by SSB. Elements of Islamic auditing and accountability in auditing, conceptual framework of this study are also precisely discussed.

The third chapter offers in-depth discussion on the methodology adopted in the study. It elaborates the ethnographic study and the techniques employed. It

also explains the method used in data collection and analysis. Qualitative techniques are used for both data collection and data analysis stages of this study. This chapter also discusses on the array of techniques used including focus group, individual depth interviews, ethnography and observation.

The fourth chapter introduces BMMB as the primary subject of the study. Basically it will divulge the history of Malaysia being one of the earliest pioneers in Islamic banking industry in Southeast Asian region. It will also give an overview of BMMB.

In fifth chapter it will elucidate the outcome of the result, analysis and discussion based on findings delivered from the descriptive analysis.

Lastly, in the sixth chapters, it will conclude results of the study and provide suggestions and solutions for better future research.

1.7 CONCLUSION

In summary, this chapter highlights the structure of the study. It discusses about the background of the study which briefly highlighted the Islamic banking and finance, Islamic scheme of life and Shariah framework, accountability, competency, SSB and the current issues on accounting and auditing. It also reviews the main objectives of the study concerning the IFI consistency of interpretation of accountability in accordance with the Shariah principles, the epistemological conception of accountability amongst SSB and the association of the level of competency and accountability of SSB. At the same time, it also discussed the significance of the study which would provide valuable feedback to others. At the outset, this is important as it provides overview the structure of the study.

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