



**UNIVERSITI PUTRA MALAYSIA**

**A QUALITATIVE INVESTIGATION INTO *SHARIAH* GOVERNANCE  
ATTRIBUTES, SUPERVISION PROCEDURES AND AUDITING IN SAUDI  
ISLAMIC BANKS**

**HATEM ABDULAZIZ ALAHMADI**

**GSM 2020 2**



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By

**HATEM ABDULAZIZ ALAHMADI**

**Thesis Submitted to the Putra Business School, in Fulfilment of the  
Requirements for the Degree of Doctor of Philosophy**

**January 2020**

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Abstract of thesis presented to the Senate of Universiti Putra Malaysia in fulfilment  
of the requirement for the degree of Doctor of Philosophy

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**Chairman : Ahmad Fahmi Sheikh Hassan, PhD**  
**Faculty : Putra Business School**

The primary aim of Islamic banks (IBs) is to fulfill stakeholders' needs for operational conformity to religious precepts. However, Saudi Arabia does not either issue any regulations related to Islamic banking nor special license for IBs, thereby, treating them on equal terms with the conventional banks. This is so in spite of the fact that Saudi Arabia is the largest player in the global Islamic finance sector, with total assets worth US\$ 343b in 2015 and expected to rise to US\$ 766b by 2020. At the same time most of previous research focused on customer aspects and disclosure and these studies are narrow in their approach and employed quantitative methods. Thus, this study seeks to investigate the extent to which Saudi Islamic banks and Islamic windows are complying with *Shariah* by exploring their current procedures of *Shariah* governance (SG). It employed agency theory, institutional theory and stakeholder theory in explaining governance mechanisms and factors affecting the *Shariah* compliance. In an attempt to attain the main objective of the research, this study explored the current *Shariah* governance system used by Saudi banks and the factors affecting the system. In addition, it also identified the current roles, attributes and procedures followed by SB members, identified the current attributes and functions of *Shariah* auditors, and investigated the procedures related to *Shariah* non-compliant income. Furthermore, the study followed a qualitative research approach by using semi-structured interviews with fifty selected participants related to SG in all Saudi IBs, four full-fledged Islamic banks (FFIBs) and eight Islamic windows (IWs) of conventional banks. The participants were categorized into two: internal and external participants. The internal participants include *Shariah* board (SB) members, *Shariah* department staff, internal auditors and managers whereas the external include individuals working with organizations other than the banks e.g. staff of Saudi Arabian Monetary Authority (SAMA), Islamic Economic Institute (IEI), Higher Institute of the Judiciary and Islamic Research and Training Institute (IRTI), General Authority of Zakat & Tax (GAZT) and Saudi Organization of Certified Public Accountants

(SOCPA). In addition to supplemented analysis of relevant archival evidence such as audit checklist for some products.

Result of the study indicated that there was no specific SG system used in Saudi IBs. However, the system can generally be divided into two types. First, restricted SG system which focuses on the roles and attributes of SB members but ignores *Shariah* audit, applicable in most of IWs. Second, FFIBs applied comprehensive system which focuses with the roles of SB members and *Shariah* audit. In addition, the findings explored some factors affecting the system of SG such as, the major shareholders, the market, reputation of the banks and SAMA. The results revealed that the role of SB members can be identified as advisory, supervisory, executive or the combination of all the three together. However, the role of SB was advisory and supervisory in all FFIBs except one FFIB the role combined all the three. The study found that there were four important factors related to SB attributes namely: appointment, independence, transparency and confidentiality and competence of SB. In addition, the results found that there were two important factors related to operational procedures of SB i.e. meeting and decision and the issues related to new products. The results indicated that the main attributes related to *Shariah* audit were responsibilities, effectiveness and independence of *Shariah* auditors in Saudi IB. However, the significant functions were the scope and the procedures of *Shariah* audit. The research also found that there are two types of sources for *Sariah* non-compliant income (SNCI) generated in Saudi FFIBs and IWs. Some of IWs purify and distribute unlawful income while others do not. Instead, they refer such incomes to the conventional wing of the same bank. This study contributed to the existing body of knowledge on *Shariah* governance in general and *Shariah* governance in Saudi Arabia in particular. In addition, the study introduced significant role of internal audit in assuring *Shariah* compliance regardless of the role play by SB members and *Shariah* departments. Saudi regulators are expected to find this study informative in terms of the current practices of *Shariah* governance, issues and challenges faced by the Saudi IBs. Likewise, Saudi IBs may use the findings of this study in realizing the best practices within the sector of Saudi IBs.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi keperluan untuk ijazah Doktor Falsafah

**KAJIAN KUALITATIF TERHADAP CIRI-CIRI TADBIR URUS SYARIAH,  
PROSEDUR PENGAWASAN DAN PENGAUDITAN DI BANK ISLAM  
ARAB SAUDI**

Oleh

**HATEM ABDULAZIZ ALAHMADI**

**Januari 2020**

**Pengerusi : Ahmad Fahmi Sheikh Hassan, PhD**  
**Fakulti : Putra Business School**

Tujuan utama perbankan Islam adalah untuk memenuhi keperluan pemegang taruh dalam memastikan pengurusan bank sesuai dengan ajaran agama. Namun, Arab Saudi tidak mewartakan apa-apa peraturan berkaitan perbankan Islam atau pun mengeluarkan lesen khas berkaitannya yang menyebabkan perbankan Islam dilayan sama seperti bank konvensional. Ironinya, Arab Saudi merupakan pemain terbesar dalam sektor kewangan Islam global dengan asset total sebanyak USD 343 bilion pada 2015 dan dijangka akan meningkat kepada USD 766 bilion pada 2020. Pada masa yang sama, kebanyakan penyelidikan terdahulu memfokuskan kepada aspek pelanggan dan produk, manakala kajian mengambil pendekatan lebih bertumpu dengan menggunakan kaedah kuantitatif. Justeru, kajian ini bertujuan mengkaji sejauh mana perbankan Islam di Arab Saudi dan kaunter perbankan Islam menepati Syariah dengan meneliti prosedur semasa bahagian pengurusan Syariah. Ini melibatkan teori agensi, teori institusi dan teori pihak pemegang taruh dalam menjelaskan mekanisme pentadbiran dan faktor-faktor yang mempengaruhi pematuhan Syariah. Bagi mencapai objektif utama, kajian ini mengkaji sistem pentadbiran Syariah yang sedang digunakan perbankan Arab Saudi dan faktor-faktor yang mempengaruhi sistem. Selain itu, kajian juga mengenalpasti peranan semasa, ciri-ciri dan prosedur yang digunakan oleh bank-bank tersebut, mengenalpasti ciri-ciri semasa dan fungsi auditor Syariah di samping mengkaji prosedur yang berkaitan pendapatan yang tidak patuh Syariah. Tambahan itu, kajian menggunakan kaedah kualitatif dengan menggunakan semi-struktur temubual bersama 50 responden terpilih yang terlibat dengan pengurusan Syariah di semua perbankan Islam Saudi, empat daripadanya bertaraf perbankan Islam penuh dan lapan yang lain merupakan kaunter atau pun jendela perbankan Islam di perbankan konvensional. Responden dibahagikan kepada dua: dalaman dan luaran. Responden dalaman terdiri daripada ahli lembaga pengarah bahagian Syariah, staf bahagian Syariah, auditor dalaman dan pengurus-pengurus, manakala responden luar meliputi individu-individu yang berkerja dengan organisasi-organisasi selain bank

seperti staf *Saudi Arabian Monetary Authority (SAMA)*, *Islamic Economic Institute (IEI)*, *Higher Institute of the Judiciary and Islamic Research and Training Institute (IRTI)*, *General Authority of Zakat & Tax (GAZT)* dan *Saudi Organization of Certified Public Accountants (SOCPA)*. Sebagai tambahan kepada analisis tambahan bagi bukti arkib berkaitan seperti senarai semak audit untuk sesetengah produk. Hasil kajian menunjukkan tiada sistem Syariah yang spesifik digunakan di perbankan Islam Arab Saudi. Bagaimanapun, sistem tersebut boleh dibahagikan secara umum kepada dua bahagian. Pertama, sistem tadbir urus Syariah yang memberi tumpuan kepada peranan dan sifat ahli lembaga pengurusan Syariah bank tetapi mengabaikan audit Syariah, ini melibatkan hampir semua perbankan Islam. Kedua, bank-bank perbankan Islam penuh menggunakan sistem komprehensif yang memberi tumpuan kepada peranan ahli lembaga pengurusan syariah dan audit Syariah. Kajian juga menjumpai beberapa faktor yang mempengaruhi sistem tadbir urus Syariah seperti pemegang saham utama, pasaran, reputasi bank dan SAMA. Hasilnya menunjukkan bahawa peranan ahli lembaga pengurusan Syariah dapat dikenalpasti sebagai penasihat, penyelia, eksekutif atau gabungan ketiga-tiganya. Walau bagaimanapun, peranan lembaga pengurusan syariah adalah penasihat dan penyelia di semua perbankan Islam penuh kecuali satu daripadanya yang menggabungkan ketiga-tiga peranan tersebut. Kajian mendapati terdapat empat faktor penting yang berkaitan dengan sifat-sifat lembaga pengurusan syariah iaitu: perlantikan, kebebasan, ketelusan dan kerahsiaan serta kecekapan mereka. Di samping itu, keputusan mendapati bahawa terdapat dua faktor penting yang berkaitan dengan prosedur operasi lembaga pengurusan syariah iaitu mesyuarat, keputusan dan isu-isu yang berkaitan dengan produk baru. Kajian menunjukkan bahawa sifat utama berkaitan audit Syariah adalah tanggungjawab, keberkesanan dan kebebasan juruaudit Syariah di perbankan Islam Arab Saudi. Walau bagaimanapun, fungsi penting adalah skop dan prosedur audit Syariah. Kajian ini juga mendapati terdapat dua jenis sumber pendapatan tidak patuh Syariah (SNCI) yang dihasilkan di perbankan Islam penuh Arab Saudi dan kaunter perbankan Islam. Sesetengah kaunter perbankan Islam membersihkan dan mengagihkan pendapatan yang menyalahi undang-undang, sementara yang lain tidak. Sebaliknya, mereka merujuk pendapatan tersebut kepada bahagian konvensional bank yang sama. Kajian ini menyumbang kepada maklumat sedia ada mengenai tadbir urus Syariah secara umum dan tadbir urus Syariah di Arab Saudi khususnya. Di samping itu, kajian ini memperkenalkan peranan penting audit dalaman dalam memastikan pematuhan Syariah selain peranan yang dimainkan oleh ahli lembaga pengurusan Syariah dan jabatan Syariah. Pihak kawal selia Arab Saudi dapat memanfaatkan kajian ini daripada segi amalan semasa tadbir urus Syariah, isu dan cabaran yang dihadapi oleh perbankan Islam Arab Saudi. Perbankan Islam Arab Saudi pula boleh menggunakan penemuan kajian ini dalam merealisasikan amalan terbaik dalam sektor perbankan Islam di Arab Saudi.

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I also would like to express my sincere gratitude and thanks to my supervisor, Dr Ahmad Fahmi. His sage advice, insightful criticisms and valued comments and suggestions have added enormous value to the quality of the study.



I certify that a Thesis Examination Committee has met on 8 January 2020 to conduct the final examination of Hatem Abdulaziz Alahmadi on his thesis entitled "A Qualitative Investigation into *Shariah* Governance Attributes, Supervision Procedures and Auditing in Saudi Islamic Banks" 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 Doctor of Philosophy.

Members of the Thesis Examination Committee were as follows:

**Muzafar Shah Habibullah, PhD**

Professor  
Putra Business School  
(Chairman)

**Fauziah Mahat, PhD**

Associate Professor  
School of Business and Economics  
Universiti Putra Malaysia  
(Internal Examiner)

**Siti Zaleha Abdul Rasid, PhD**

Associate Professor  
School of Graduate Studies  
Universiti Teknologi Malaysia  
(External Examiner)

**Mahfud Sholihin, PhD**

Professor  
Universitas Gadjah Mada  
Indonesia  
(External Examiner)

---

**PROF. Ts. Dr. M. IQBAL SARIPAN**

Deputy Vice Chancellor (Academic & International)  
Universiti Putra Malaysia

Date:

On behalf of,  
Putra Business School

This thesis was submitted to the Senate of the Universiti Putra Malaysia and has been accepted as fulfilment of the requirement for the degree of Doctor of Philosophy. The members of the Supervisory Committee were as follows:

**Ahmad Fahmi Sheikh Hassan, PhD**

Associate Professor  
School of Business and Economics  
Universiti Putra Malaysia  
(Chairman)

**Hairul Suhaimi Nahar, PhD**

Lecturer  
C/O School of Business and Economics  
Universiti Putra Malaysia  
(Member)

**Yusuf Karbhari, PhD**

Professor  
Cardiff Business School  
University of Cardiff  
(Member)

---

**PROF. Ts. Dr. M. IQBAL SARIPAN**  
Deputy Vice Chancellor (Academic & International)  
Universiti Putra Malaysia

Date:

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### **Chairman of Supervisory Committee**

Signature : \_\_\_\_\_  
Name : Assoc. Prof. Dr. Ahmad Fahmi Sheikh Hassan  
Faculty : School of Business and Economics, UPM

### **Members of Supervisory Committee**

Signature : \_\_\_\_\_  
Name : Dr. Hairul Suhaimi Nahar  
Faculty : C/O School of Business and Economics, UPM

Signature : \_\_\_\_\_  
Name : Prof. Dr. Yusuf Kharbhari  
Faculty : Cardiff Business School, UK

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## LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
AGC	Audit & Governance Committee
BCBS	Basel Committee on Banking Supervision
BOD	Board of Director
GAZT	General Authority of Zakat & Tax
FFIB	Full-Fledged Islamic Bank
GAZT	General Authority of Zakat & Tax
IA	Internal Audit
IIA	Institute of Internal Audit
IAF	Internal Audit Function
IB	Islamic Banking
IBs	Islamic Banks (include both full-fledged and Islamic windows)
IDB	Islamic Development Bank
IEI	Islamic Economics Institute- King Abdulaziz University
IFI	Islamic Financial Institution
IW	Islamic Window
SAR	<i>Shariah</i> Auditor
SB	<i>Shariah</i> Board
SGF	<i>Shariah</i> Governance Framework
SGS	<i>Shariah</i> Governance System
SAMA	Saudi Arabian Monetary Authority
SCCA	Saudi Center for Commercial Arbitration
SOCPA	Saudi Organization for Certified Public Accountants

# CHAPTER 1

## INTRODUCTION

### 1.1 Background and Motivation

Islamic banking emerged in the late 1970s with only a limited number of institutions and negligible amount of capital but has grown significantly over the past few decades, with total assets reaching almost USD1.72 trillion at the end of 2017<sup>1</sup>. Islamic banking has also experienced far greater growth than conventional banking since the 2008 financial crisis (Hasan & Dridi, 2011; Rahman *et al.*, 2014) and expanded operations outside the Muslim world to developed economies including Europe and the United States (Abedifar, Molyneux & Tarazi, 2013). While strong financial performance is important for stakeholders, the primary aim of Islamic banks (IBs) is to fulfill stakeholders' needs for operations to conform to religious precepts. Recent empirical studies have, indeed, confirmed that the most attractive feature for customers in IBs is *Shariah* compliance (see Abdul Rahman & Abdullah, 2013; Abedifar *et al.*, 2013; Amin, Isa, & Fontaine, 2013; Berg & Kim, 2014; Khan, Hassan, & Shahid, 2007; Bizri, 2014).

Due to its accelerated development and dynamism in the industry, there is an increasing need for regulation and governance of IBs. However, corporate governance structure in IBs need additional measures of governance for the purpose of *Shariah* compliance, known as *Shariah* governance, which is to maintain the confidence of the shareholders and other stakeholders by assuring them that all transactions, practices and activities are in compliance with the *Shariah* principles.

*Shariah* governance is now becoming more diverse and advanced, in parallel with the development of Islamic finance industry worldwide. In view of the impressive growth and increasing sophistication of the Islamic finance sector, *Shariah* governance of this rapidly evolving industry has proved challenging. Hence, each jurisdiction has adopted different approaches to developing and nurturing its *Shariah* governance framework (SGF). To illustrate this from a regulatory point of view, Malaysia represents the most regulated *Shariah* governance system, followed by Brunei, Pakistan and Sudan, respectively, whilst Gulf Cooperation Council (GCC) countries and the UK prefer less regulatory interference (Hasan, 2011a).

Most IBs in Malaysia allocate funds and necessary training for their *SB* members; however, a small number of IBs in GCC countries and none in the UK have initiated the same thing (Hasan, 2011a). Moreover, the Malaysian SGF, which took effect June 2011, offers clarity on the accountability and responsibility of these parties, imposes new regulations on the appointment of *SB* members, and requires IFIs to establish

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<sup>1</sup> Global Islamic Finance Markets Report 2019.

*Shariah* compliance and *Shariah* research function; on the other hand, no mandatory SGF exists for either GCC or the UK (Hasan, 2011; Nomran, & Haron, 2019). As a result, Malaysian system of *Shariah* supervision seems to be more efficient and effective in achieving the *Shariah* compliant purpose than that of GCC or the UK system (Grassa, 2013; Hasan, 2011).

IBs in GCC countries, namely countries in the Arabian Gulf, including Saudi Arabia, Kuwait, Bahrain, Qatar and the UAE and Oman, have their own framework of *Shariah* governance. In Saudi Arabia, there are twelve Islamic banks, four of which are full-fledged Islamic banks (FFIBs) and the remaining eight are Islamic windows (IWs) of conventional banks. However, Saudi Arabia treats FFIBs and IWs as equal to conventional banks and therefore allows the market to develop its own *Shariah* governance system (Hasan, 2011a).

With regard to IBs, the corporate governance consists of *Shariah* governance mechanisms that make sure that Islamic *Shariah* principles are adhered to in their business operations. Among the apparent *Shariah* governance mechanisms in IBs is SB, which is believed to ensure the credibility of IBs by making sure that there is *Shariah* compliance in a given bank's operations (Almutairi & Quttainah, 2017; Banaga, Tomkins, & Ray, 1994; Briston, 1986; Ginena, 2014; Bougatef, 2015; Karim, 1990; Rammal, 2006). Therefore, in order to make *Shariah* governance mechanism in the Islamic banking operation much stronger, several countries have established a centralized SB at the national level such as Malaysia, Brunei and Indonesia in Southeast Asia (Grassa, 2013b), Bahrain and Oman in GCC countries (Mubeen, Kulkarni, & Al Hussaini, 2014). However, the opposite remains the case in Saudi Arabia where it is left to the bank to establish its one. Another *Shariah* governance mechanism is *Shariah* audit, which can be simply defined as a form of audit to ensure *Shariah* compliance. This is pivotal as it involves participation of individual *Shariah* members and internal auditors. Despite its importance, IBs are still struggling to establish an effective *Shariah* auditing framework (Kasim *et al.*, 2013; Yaacob *et al.*, 2014; Yahya & Mahzan, 2012) which is partly attributed to the lack of qualified and experienced auditors equipped with specialized *Shariah* knowledge, particularly in commercial jurisprudence. In addition, although the audit scope in IBs is similar to that of conventional banks, it remains a moot point that the scope of audit in IBs should be much wider given the more rigorous *Shariah* requirements (Kasim & Ibrahim, 2009; Sarea *et al.*, 2013; Yahya & Mahzan, 2012). Despite the fact that IBs tend to strive in order to develop their products, activities, and operations based on *Shariah* principles, Saudi banks still faces various challenges such as the rules and regulations, corporate governance and inefficient accounting and auditing standards (Alrehaili, 2014). This absence of rules, regulations and governance has somehow led to the inability of labeling certain IBs' transactions *Shariah* based (Usmani, 2002). Thus, there are still cases of *Shariah* non-compliance events that to some extent lead to financial impact that are *Shariah* non-compliant. However, any non-compliant income earned by IBs could not be used for the benefit of the banks and must be subjected to purification process.

The literature review revealed that the practices of *Shariah* governance and SB in Saudi Arabia are still weak compared to other countries such as Malaysia. We should mention here however, the majority of these studies found in literature were not expletory in nature, they were either quantitative or concentrated on a secondary data. This study is important because it attempts to bridge this gap in literature by using qualitative methods with the purpose of exploring current SGS practiced in Saudi Arabia. Moreover, unlike previous studies, including only some of the Saudi IBs, this study attempts to explore the current SGS in all the twelve IBs exist in the kingdom, both types, FFIBs and IWs.

Most of the previous studies were narrow in their approach, using only quantitative methods to generate data. These methods were not able to have in-depth analysis of the phenomenon. This study considered the lack of qualitative studies to be a gap in the literature. This study therefore used a qualitative method, in interview-based research with participates from inside and outside Saudi FFIBs and IWs. Hence, this study investigated the current *Shariah* governance system in all Saudi IBs, both FFIBs and IWs. Likewise, the study explored the attributes, roles and procedures of SG mechanisms, including SB members, *Shariah* auditors and internal auditors. Finally, the study examined all the procedures related to *Shariah* non-compliant income in Saudi IBs.

## 1.2 Problem Statement

The primary aim of IBs is to fulfil stakeholders' needs for alternative form of financing that conforms to religious precepts. However, one of the most critical challenges faced by Islamic banking is full compliance of *Shariah* rules, regulations and principles in all their activities to make it more transparent and disciplined. Thus, Islamic banking system needs to have a good governance guidelines for *Shariah* supervision and auditing to ensure that all activities, operations and products are in compliance with Islamic law. All these challenges and problems also plague the Saudi IB system where the Saudi Arabian Monetary Authority (SAMA) does not issue any specific regulation related to *Shariah* compliance in IBs<sup>2</sup> as well as standard and regulations regarding disclosures and transparency in these IBs<sup>3</sup>. Although the Saudi Islamic banking assets account for more than 50 percent of total banking assets, SAMA is gradually managing this sensitive issue (Mansour & Bhatti, 2018).

Based on the Islamic financial services industry stability report 2018, Saudi Arabia is the second largest player in Islamic finance globally after Iran. Furthermore, Al Rajhi Bank is the largest Islamic bank in Saudi Arabia, and also the largest Islamic bank internationally with assets of US\$ 87bn at end-2015 (Fitch Ratings' Report, 2016). However, the regulatory framework in Saudi banks is passive, when compared to other countries such as Malaysia, given the fact that there is no specific regulation for all

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<sup>2</sup> <http://www.sama.gov.sa/en-US/Laws/Pages/BankingRulesAndRegulations.aspx>

<sup>3</sup> <https://socpa.org.sa/Socpa/Technical-Resources/Accounting-Standards.aspx>



Saudi banks (Hasan, 2011a; Shaharuddin, 2011). Furthermore, the regulations relating to the SB, which is supposed to promote credibility and trust in relation to the compliance with *Shariah*, are not duly developed in Saudi banks (Safieddine, 2009). In addition, there is no specific legal framework for IBs in Saudi Arabia and IBs are subject to the same regulatory framework as conventional banks (Grassa, 2013). This is because Saudi Arabian Monetary Authority (SAMA) has not granted individual Islamic banking licenses for Islamic banking operations (Al Sayari, 2004; Ramady, 2015). This implies that there is no specific legislation from SAMA that regulates the operations of IBs in Saudi Arabia (Mansour & Bhatti, 2018). It has also been revealed that IBs in Saudi Arabia had poor disclosure practices for banks that claim to be operating on *Shariah* principles (Azid & Alnodel, 2019; Zubairu, Sakariyau & Dauda et al., 2011).

SB and *Shariah* audit are considered the main governance mechanism that provides the assurances for *Shariah* compliance in Islamic banking operations. In the case of Saudi Arabia, which has twelve Islamic banks divided into four FFIBs and eight IWs, there is only one level of SB formed and operating within the banks. However, these banks have different policy regarding *Shariah* compliance and its procedures. The second mechanism of *Shariah* compliance is *Shariah* audit. However, IBs found it tedious to establish an effective *Shariah* audit framework (Nawal Kasim *et al.*, 2013; Rahman, Kasim, & Osman, 2019; Yaacob et al., 2014; Yahya & Mahzan, 2012). In the same vein, there is no distinction between the audit scope of IBs and that of the conventional banks. Hitherto, scholars have lamented that IBs should take more rigorous and religiously inclined approach towards audit in the Islamic banking system (Kasim & Ibrahim, 2009; Rahman *et al.*, 2019; Sarea *et al.*, 2013; Yahya & Mahzan, 2012). The status quo currently means that each IB in Saudi Arabia uses its own auditing guideline or a modified conventional internal audit framework. Similar to *Shariah* audit practice, identifying and purifying *Shariah* non-compliant income (SNCI) does not have any specific standard or guideline issued by Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) or Islamic Financial Services Board (IFSB). In the absence of standards or criteria of the procedures with respect to SNCI and income purification, each full-fledged Islamic bank (FFIB) or Islamic window (IW) uses its own processes and procedures in addressing SNCI and purifying that income.

A small number of researchers have attempted to study various aspects of Sharia governance in several countries including Saudi Arabia see for example (Azid & Alnodel, 2019; Grassa, 2013b; Hasan, 2011a; Khokhar & Bukhari, 2014). In spite of all these commendable efforts, these studies focused on customer's aspect, disclosure, and most of the studies are also narrow and quantitative in their approaches, whereas a few relied on secondary sources of data. Conclusively, none of these studies look at the problem using a qualitative source of data that enables an in-depth analysis of the phenomenon.

As mentioned above, that most of the previous studies focused on the various aspects related to *Shariah* compliance and only a few studied some of the Saudi banks. Also, since these studies were quantitative they tend to emphasize on what the banks have been disclosing in an annual report which is not enough to identify the actual practice pertaining to *Shariah* compliance in those banks due to the lack of a mandatory regulation regarding *Shariah* governance disclosure. However, none of these previous studies investigate how Saudi banks comply with the *Shariah* in their products and activities particularly in the absence of any mandatory or even central regulations from SAMA or standards from Saudi Organization of Certified Public Accountants (SOCPA).

Thus, this study investigates deeply in Saudi banks regarding what is the current *Shariah* governance systems in these banks. What are the pressures that motivate these banks to follow *Shariah* law. The fact that Saudi Arabia has only one level of SB that belongs to the bank means that these banks have different policies and procedures regarding SB. The study is an attempt to investigate the role and attributes of SB members in Saudi banks. In addition, the study investigates the current role and scope of *Shariah* audit in these banks as well as the independence of those auditors and the level of participation with internal audit. Finally, the study will investigate the procedures related to the identification, purification and distribution of *Shariah* non-compliance income, which is a good indicator of the level of *Shariah* compliance in those banks.

### **1.3 Research Objectives**

The principal aim of this study is to identify the *Shariah* compliance and the motivations of this compliance in Saudi banks. The following specific objectives have been identified:

1. To explore the current *Shariah* governance system used by Saudi banks and the factors affecting this governance system.
2. To identify the current roles, attributes and procedures followed by SB members in Saudi banks
3. To identify the current attributes and functions of *Shariah* Audit in Saudi banks
4. To investigate the procedures adopted by Saudi IBs in identifying and purifying the *Shariah* non-compliant income.

### **1.4 Research Questions**

Against the above research objectives, the following research questions have been formulated:

RQ1: What is the current *Shariah* governance system used by Saudi banks and the factors affecting it?

RQ2: What are the current roles, attributes and procedures followed by SB members in Saudi banks?

RQ3: What are the current attributes and functions of *Shariah* Audit in Saudi banks?

RQ4: What are the procedures adopted by Saudi banks to identify and purify the *Shariah* non-compliant income?

## 1.5 Significance of the Study

The rationale for undertaking this study is the fact that there has been very little extensive and in-depth research in the area of *Shariah* governance and *Shariah* audit practice in Saudi banks. This is so in spite of its importance in ensuring IBs compliance with *Shariah*. Previous studies tend to agree about the unclear *Shariah* governance system of IBs in Saudi Arabia and the absence of an effective *Shariah* auditing framework in IBs (Kasim *et al.*, 2013; Yaacob *et al.*, 2014; Yahya & Mahzan, 2012). Furthermore, that SAMA has not issued any specific regulations about *Shariah* governance, *Shariah* audit or even the disclosure of any information relating to the procedures of *Shariah* non-compliant income or even *Shariah* compliance in these banks. However, previous studies were focusing more on the aspect of customers and disclosures. Moreover, most of the previous studies included only part of the total Saudi IBs which will not give a complete picture of *Shariah* governance framework in Saudi Arabia. In addition, for studies that focused on disclosure, their findings can only be used in part, since the disclosure practice of *Shariah* governance is considered as optional (Azid & Alnodel, 2019). To the best knowledge of the researcher this study is the first study that employed three theories in studying *Shariah* governance in the Saudi context. Agency theory is employed to explain the role of *Shariah* governance mechanisms in mitigating the managerial opportunism with regard to *Shariah* compliance. Institutional theory to explain what types of isomorphism factors (coercive, normative and mimetic) affecting the mechanisms of SG as well as *Shariah* compliance. Stakeholder theory to explain the role provided by SB members to the stakeholders.

Thus, the findings of this study provided useful information to the literature regarding *Shariah* governance in general and *Shariah* governance in Saudi Arabia in particular. In addition, the study contributed to the body of knowledge with regard of agency, institutional and stakeholder theories in studying *Shariah* governance. Moreover, since currently there were no specific regulation regarding *Shariah* governance in Saudi Arabia, regulators will find this study informative about the current practices of *Shariah* governance, issues and challenges faced by the Saudi IBs.

## 1.6 The Scope and the Structure of the Thesis

The aim of this study was to understand the current system of SG applied by these banks and the factors affecting this system. In addition, to the role, attributes and operational procedures played by SB members and *Shariah* auditors as a mechanism of SG. This study also explored the SG attributes, supervision procedures and auditing in Saudi IBs; in addition to identifying the current procedures applied by Saudi IBs regarding *Shariah* non-compliant income. This study covered all Saudi IBs which are four FFIBs and eight IWs, where ten of these banks are located in the capital city (Riyadh) and two in Jeddah. Fifty participants were selected for interviews among whom were staff working within the banks and those working with related organisations. Major interviewees were SB members, *Shariah* auditors, *Shariah* department staff, internal auditors and managers. The interview also included academics and practitioners from organizations that are related to SG in Saudi IBs. In addition, the study analysed annual reports with regard to SG for the years 2016 to 2018. This study also employed agency theory, institutional theory and stakeholder theory in explaining governance mechanisms, factors affecting the *Shariah* compliance, as well as the role provided by SB to the stakeholder with regard to *Shariah* compliance.

The structure of this study is as follows: first chapter presents an outline of why such research is undertaken, along with discussing the research motivations. The aims of the research and the key objectives, questions and significance of the study are addressed. The second chapter reviews existing studies that covers the introduction of *Shariah* governance and the governance system of AAOIFI. In addition, the chapter covers *Shariah* audit functions in general, *Shariah* audit scope and particularly income purification. Then the chapter presents the literature on IA function and SB as the two main governance mechanisms in IBs. The third chapter highlights the contextual background related to banking sector in which this study is carried out (Saudi Arabia). In addition, the chapter also presents background of the regulators related to IBs in Saudi Arabia. The fourth chapter highlights the theories used in the current research as the theoretical framework for the study. In addition, this chapter presents the theoretical framework for this study. The fifth chapter discusses the methodological approach and design of this research in order to achieve its objectives and answer its questions. It highlights the rationale behind choosing the selected methods. The sixth chapter presents the findings of the study based on the themes of the study, which is linked to the objectives of the study. In addition, the chapter also linked the findings with the AAOIFI standard as an index as well as the discussion. The seventh chapter is the concluding chapter that discusses the conclusion of the study, contribution to knowledge and practice, with the presentation of a proposed conceptual framework developed from the themes identified in the data and recommendations for further studies on the subject matter.

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## BIODATA OF STUDENT

Hatem Alahmadi was born on July 8<sup>th</sup>, 1974 in Madinah, Saudi Arabia. In 1997, he got his bachelor on Mathematics from King Abdulaziz University. In 2003, he started his master in Accounting in King Saud University, in Riyadh. He graduated in 2007 and worked as a lecturer in College of Technology in Madinah. In 2010, he converted to Taibah University in the same city. In 2018, he attained his Certified Shari'a Adviser and Auditor (CSAA) from AAOIFI. In 2020, he got his PhD in Accounting from Putra Business Scholl in Malaysia. He is married and blessed with three boys and two girls.





## LIST OF PUBLICATIONS

Alahmadi, H. A., Hassan, A. F., Karbhari, Y., & Nahar, H. S. (2017). Unravelling Shariah Audit Practice in Saudi Islamic Banks. *International Journal of Economic Research*, 14(15), 255-269.

Alahmadi, H. A., Hassan, A. F., & Karbhari, Y. (2020). Shariah Non-Compliance Income: Sources, processing, Purification and Distribution in Saudi Islamic Banks. *Global Business Review*. (Submitted).





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