

# Assessing the effectiveness of internal *Shari'ah* audit structure and its practices in Islamic financial institutions: a case study of Islamic banks in Yemen

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## Abstract

**Purpose** – This study aims to explore and assess the key *Shari'ah* governance factors that may have an influence on the internal *Shari'ah* audit structure and its practices in Islamic financial Institutions in Yemen, particularly in the Islamic banking sector.

**Design/methodology/approach** – To do so, the study adopts a qualitative approach employing case study analysis, and both primary and secondary data are used to formulate the appropriate interview questions and achieve the objectives of the study.

**Findings** – The authors observed that the key factors that help in assessing the internal *Shari'ah* audit structure and its practices are *Shari'ah* auditor charter, audit plan and audit manual. In addition, the authors observed that, in general, internal *Shari'ah* audit tends to be subjective in Yemeni banks because they depend on the internal *Shari'ah* auditor's qualifications and experience more than formal guidelines and regulations. This is because there are no detailed internal *Shari'ah* audit plans or detailed audit manual. Moreover, the internal *Shari'ah* auditor charter is not comprehensive in explaining the duties required of the internal *Shari'ah* auditor, and it is mixed with the *Shari'ah* Supervisory Board (SSB) duties. This means the internal *Shari'ah* auditor lacks the critical tools that enable him to achieve the desired audit manual objectives where the effectiveness of internal *Shari'ah* audit can be measured.

**Practical implications** – One of the important implications of this study is providing very important guidance about enhancing the areas where shortfalls are found within the *Shari'ah* governance process in the Yemeni banking system. This enhancement process of the internal factors of *Shari'ah* governance can be achieved by increasing the awareness of the enhancing internal *Shari'ah* audit structure as it reflects ultimately on the internal *Shari'ah* auditor's role and his practices.

**Originality/value** – Understanding the effectiveness of internal *Shari'ah* audit structure among internal auditors will improve the *Shari'ah* audit framework standards, enhance the *Shari'ah* knowledge among internal auditors and provide general guidelines to design audit programmes for *Shari'ah* governance auditing process.

**Keywords** *Shari'ah* governance factors, Internal *Shari'ah* audit structure, Islamic banking, Yemen

**Paper type** Case study



## Introduction

The internal *Shari'ah* audit was formed in Islamic financial institutions due to the disparities between *Shari'ah* governance and corporate governance. These differences in both governances led to differences in the internal audit features needed, such as orientation, objectives, scope, disclosures and reports, auditor skills and qualifications required. According to multiple studies related to internal audit, there are some issues that exist in internal audit due to some gaps such as expectation gap. One of the expectation gaps is performance gap. It is classified in two categories. The first is deficient standards gap, which is located between the existing guidelines and standards related to auditing and what society expects them to be (Porter, 1993). The second type is the expectation-performance gap and the deficient performance gap, the latter being the gap between the expected standards of performance of auditor and what is being practised in reality (Porter, 1993; Kinney, 1993). According to Kinney (1993), there are two main causes of performance expectation gap. The first is the difference between what professional standards provide and what final users may desire. The second reason is either the lack of sufficient standards that are supposed to cover all the audit practices or the existence of insufficient standards for audit responsibilities. The same thing can be faced by an Islamic bank, for example, the lack of *Shari'ah* guidelines and supervisory framework may increase the disruptions in Islamic banks Shariah Governance (SG), particularly the scope on which the internal *Shari'ah* auditor has to focus, which causes these banks to be viewed as conventional banks (Iqbal, 1998).

According to Karagiorgos *et al.* (2010), the effectiveness of internal audit in corporate governance can be determined by finding out the mutual relationship between the internal audit and key elements of corporate governance. Consequently, in order for the researcher to assess the effectiveness of internal *Shari'ah* audit, the researcher needs to evaluate the SG factors, which interact with internal *Shari'ah* audit such as existing regulations and SG organs by looking into the best practices. The corporate governance's best practices include compliance with corporate laws as well as the recommendations developed by a financial institution, international organisation and consulting companies (Bocharova, 2014). As a result, this study attempts to assess the common factors that contribute to the internal *Shari'ah* audit's effectiveness in Islamic banks in Yemen by focusing on the existing regulations and SG organs covering their practices and their attributes as well. Assessing the effectiveness of internal *Shari'ah* audit in Islamic banks has become essential as this function helps to fulfil maqasid *Shari'ah* objectives (Yaacob and Donglah, 2012; Kasim *et al.*, 2009a, b). Also, it assists in maintaining the trust and gain of stakeholders, vis-à-vis Allah's pleasure (Ridhwanullah) (Chapra and Ahmed, 2002).

In particular, in Yemen, Islamic banks observe the Islamic Banking Act No 21 of 1996 that prescribes the Islamic banking activities and specifies the importance of *Shari'ah* auditing. The internal *Shari'ah* audit is subject to different regulations and variation of practices due to the decentralised governance by the Central Bank of Yemen as we believe some of the gaps related to internal *Shari'ah* audit mentioned above may occur. Thus, this study aims to assess the effectiveness of internal *Shari'ah* audit and how it takes place in Islamic banks in Yemen. In other words, the study aims to determine the significant *Shari'ah* governance factors that affect the policies and practices of internal *Shari'ah* audit and examine their work according to best regulations and practices required.

## Literature review

This section focuses more on an overview of Islamic Banks in Yemen and the relevant institutional theory and reviews the previous studies done on internal audit effectiveness from both the Western and Islamic Perspectives. The following table shows the current number of Islamic financial institutions in Yemen and their number of branches. Furthermore,

it shows the type of ownership, and clearly the percentage of private ownership is dominant followed by foreign ownership. The only Islamic bank that is publicly owned is the Yemeni Islamic Bank for Finance and Investment with equity of 4.5% (see Table 1).

There are some limited studies that discussed the *Shari'ah* supervisory system in Islamic financial institutions (IFIs) in Yemen such as Al-Walidi (2013), who assessed this system from different viewpoints such as legal issues, fatwa methodology, SSB attributes and SSB framework and scope. Another study by Ayedh et al. (2014) found the following:

- (1) The procedures of *Shari'ah* supervisory system are not unified among IFIs in Yemen due to the self-regulated model followed.
- (2) Regarding the AAOIFI (Accounting and Auditing Organisation for Islamic Financial Institutions) standards, they are only considered as guidelines and are not compulsorily applied – the *Shari'ah* practices are not standardised in its framework.
- (3) Islamic banking law is only practised as a minimum requirement.

Further, the significant challenges in IFIs in Yemen are the ambiguity of accounting disclosures, regulations, IFIs belonging to families which follow their policy and not the institutional policies, lack of research, creation of new products and the CBY supervision over the IFIs is only ex-post.

*Institutional theory*

Institutional theory has been used widely in studies related to internal audits (Meyer and Rowan, 1977; DiMaggio and Powell, 1983; Arena and Azzone, 2007; Al-Twajiry et al., 2003). For example, in the Middle East, specifically in Saudi Arabia, Al-Twajiry discussed its coercive pressure and its impact on the internal audit and the role of the government in developing this function. Another study was conducted on internal audit and found that there exists a relationship between compliance with regulations and organisational goals, and this relationship may be able to explain the mechanism of an effective audit (Mihret et al., 2010; DiMaggio and Powell, 1983). Institutional theory was also adopted in research to explore the characteristics of internal audit in 364 Italian organisations to determine how they are affected by coercive pressure (Arena and Azzone, 2007; Colicchia et al., 2011). Furthermore, Arena and Azzone (2007) investigated the reasons that call for the necessity of having internal audit as a means assessing the risks and protecting the assets of a firm.

There are three important aspects studied in this theory in different fields. Such aspects are perceived to have a significant impact on firm practices and structures which are coercive pressure, mimetic pressures and normative pressure. Coercive pressure is pressure that

Name of bank	Year of establishment	No. of branches	Ownership	%
Islamic Bank Saba (IBS)	1997	14	Private	85%
Yemeni Islamic Bank for Finance and Investment (IBY)	1995	5	Foreign	15%
			Private	73%
			Foreign	22%
Tadhamon Bank	1996	20	Public	4.5%
			Private	96.7%
Shamil Bank of Yemen and Bahrain	2002	10	Foreign	3.3%
			Private	57%
Kuraimi Bank	2010	9	Foreign	43%
			Private	100%

**Table 1.**  
Overview of Islamic banks in Yemen

directly influences organisations or firms, such as legal regulations which might be both internal and external (DiMaggio and Powell, 1983). Legislative and judicial authorities help establish rules of practice and interpret laws that are necessary for starting a business (Meyer and Rowan, 1977). The third pressure is the internal normative pressure that basically has an impact on shaping the organisational structure and practices (Zucker, 1987; Mihert *et al.*, 2010). Mimetic pressure is another pressure that also affects firms which represent demand towards copying other firms to overcome uncertainty.

Institutionalisation, as defined by Dacin (1997), is “a process that firms go through to comply with socially expected outcomes, and this happens by following the law and regulations in all activities”. It is also defined as “an institution is an established order comprising rebounded and standardised social practices”, and institutionalisation as “the process whereby the practices expected in various social settings are developed and learned” (Dillar *et al.*, 2004, p. 508).

Recent literature focuses on how institutional perceptions vary and change over time due to changes in different drivers in the firm (Lawrence *et al.*, 2002). This new concept has enriched institutional theory and made it more reliable in explaining how internal audit enhances and develops through the changes of the drivers within the organisation as new internal audit takes place. Lawrence *et al.* (2002) believe that before putting these new inputs within it, this theory faces some criticism for not being able to address the process by which institutional changes come about, and as some results show, researchers have added some concepts to this theory.

The routes and speediness of spreading the practices in the firm depend on factors such as the density of communication and ties among individuals or departments and the type of structure which tends to prevail faster as long as the networks are dense and vice versa (Burt, 1982). The network is a mixture of ideologies, scripts, norms and assumptions that are shared in the firm among the individual actors which, consequently, form the goals and strategies to determine whether such practices are acceptable or not (Zukin and DiMaggio, 1990). Other factors are objectives and cultural embeddedness which are crucial in giving individual actors rational reasons for committing such practices, which ultimately help diffuse innovation (Strang and Meyer, 1994). Management support and the right position of the department are also essential elements of effective firm practice such as the case of internal audits when it was found that the hierarchical position of internal audit can assure its independence through the effective line of reporting (Arena and Azzone, 2007). On the other hand, low salary, low training activities and lack of experience and cooperation are among the main reasons behind the deterioration of the internal audit as evident in the Sudanese public sector (Brierley *et al.*, 2001).

Institutional theory has been used widely to explain the internal audit effectiveness and how some factors in management are linked to the efficiency of individual practices. The researcher concludes that effective pressures imposed on the firm will result in an ideal structure and practices needed and wanted by an organisation. Furthermore, the factors that increase the effectiveness of these processes are in compliance with the embedded culture and values, the right chosen objectives and proper training coupled with the good intention of the management support and the intention of individual actors to cooperate. This can be applied to any firm to assess the effectiveness of specific practices as the researcher noticed the multiple applications of this theory in different fields. For that reason, the researcher found this theory applicable for the proposed research to explain how the *Shari'ah* audit practices are institutionalised in Islamic banks in Yemen and investigate how much attention the authorities give to this function.

### Internal audit effectiveness from the Western perspective

Effectiveness is defined as, “the degree to which the established objectives are fulfilled and achieved” (Dittenhofer, 2001). According to Van Gansberghe (2005), the factors that can be considered to measure the internal audit effectiveness are firms and governance framework,

high competence, legislation, internal audit resources and conceptual framework. In December (2010), the International Professional Practices Framework (IPPF) of the Institute of Internal Auditor Research Foundation (IIA) was extended to the areas where internal audit effectiveness can be measured. This includes performance of auditors, auditing process enhancement, the effectiveness of meeting stakeholders' needs, the effectiveness of meeting objectives, risk management improvement and control and governance processes. Furthermore, internal audit effectiveness can be evaluated by means of the quality and sustainability of the audit plan, execution and follow-up (Dhamankar and Khandewale, 2003).

Table 2 highlights some studies which show the main factors that affect significantly the internal auditing effectiveness. The objectives of internal *Shari'ah* auditing are the same as those in the conventional financial audit; however, the differences emerge based on the Auditing Standard for Islamic Financial Institutions (ASIFI No. 1), which mentions that *Shari'ah* auditing provides assurance that transactions of Islamic banks are in accordance with *Shari'ah* principles and rules, specified by AAOIFI standards, and local and national accounting standards.

As seen in the given review of related literature, *Shari'ah* audit objectives do not exhibit a varied disparity from the traditional internal audit. This is because it is only the *Shari'ah* factor that is added which makes the scope and framework wider, and consequently new players are added to the governance such as SSB and internal *Shari'ah* auditor, including new regulations.

### **Internal *Shari'ah* audit effectiveness from an Islamic perspective**

The internal *Shari'ah* audit effectiveness can be achieved by laying out a comprehensive plan and working on it accurately (AAOIFI, 2010). This can be done by documenting all the findings, giving recommendations needed and following-up of the previous internal *Shari'ah* audit results. Some researchers define the internal *Shari'ah* audit effectiveness as "the degree to which the internal *Shari'ah* auditor was able to fulfil the established objectives" (Badara and Sadin, 2013; Ahmed *et al.*, 2009a, b; Ussahawanitchakit, 2012). Previous studies have discussed effectiveness of internal *Shari'ah* audit by professionalisation of *Shari'ah* auditor (Shahul and Yaya, 2005), duties and role of *Shari'ah* auditor (Othman and Ameer, 2015), audit framework of *Shari'ah* compliance (Shafii *et al.*, 2010) and *Shari'ah* audit framework and its scope, competency and working practices (Kasim *et al.*, 2009a, b; Yahya and Mahzan, 2012). However, to the best of our knowledge, there has been no study done to examine the factors that affect internal *Shari'ah* audit effectiveness in Islamic banks in Yemen.

Therefore, we looked into discussing the structure of internal *Shari'ah* audit in Islamic banks in Yemen, believing that effective *Shari'ah* audit mechanism starts from here as it shows how the internal *Shari'ah* audit is systemised by the bank management. Structure of internal *Shari'ah* audit is represented by *Shari'ah* audit reference profile, *Shari'ah* audit charter and audit manual. In Addition, those factors are considered normative pressures according to institutional theory discussed above. These normative pressures are intended to seek efficiency of performance efficiency increase of legitimacy by focusing on building proper structures and enhancing the practices and procedures. There is a need to assess these factors based on the fact that in Yemen, the internal *Shari'ah* audit is subject to different regulations and practices because there is no centralised governance by the Central Bank of Yemen (CBY), and therefore it becomes the banks' responsibility to draw and set up the right structures for having effective internal *Shari'ah* audit.

#### (1) Added

Binti Kasim *et al.* (2009) have suggested a model that helps assess the quality of *Shari'ah* audit. This model appears to share the same perspectives suggested by institutional theory.

Factors	Study topic	Mode of research	Year	Author(s)
(1) Internal characteristics of auditors	Internal audit effectiveness: An approach proposition to develop the theoretical framework	Quantitative studies	2013	Endaya and Hanefah
(2) Internal audit department performance				
(3) Organisation's support of members				
(4) Management support				
(1) Management support	Internal audit effectiveness: An Ethiopian public-sector case study	Quantitative study (structured questionnaire, interview and observations)	2007	Mihret and Yismaw
(2) Organisational setting				
(3) Auditee attributes				
(4) Internal audit quality				
(1) Characteristics of the internal audit team	Identify the organisational drivers of internal audit effectiveness in Italy	Quantitative study (survey of 153 Italian companies)	2007	Arena and Azzone
(2) The audit processes and activities				
(3) Organisational links				
(1) Management support	Effectiveness of internal auditing: An empirical examination of its determinants in an Israeli organisation	Quantitative study questionnaire and mail survey of 292 organisations	2010	Cohen and Sayag
(2) Internal auditors independence				
(3) Internal auditor profession				
(1) Competence of internal audit team	Factors associated with internal audit effectiveness: Evidence from Greece	Quantitative questionnaire to 240 firms	2015	George <i>et al.</i>
(2) Audit committee				
(3) Internal audit quality				
(4) Independence of internal audit				
(1) Audit committee and stakeholder support	A study on effective implementation of internal audit function to promote good governance in the public sector	Interview of 25 organisations	2007	Belay
(2) Professional audit standards				
(3) Existence of approved audit charter				
(4) Qualified auditors				
(1) Management support	The effectiveness of internal audit in Malaysian public sector	Quantitative questionnaire to 99 participants including directors of internal auditors and internal auditors	2009a, b	Ahmad <i>et al.</i>
(2) Level of auditor qualifications and training				
(3) Level of auditing acceptance by the management				

**Table 2.**  
Previous studies  
conducted to discuss  
effectiveness of  
internal auditing

This is because this model compares the normative and the coercive influences with actual performance of internal *Shari'ah* audit. If actual performance of internal *Shari'ah* audit matches the normative and the coercive influences, the result of auditing will be effective. If the result does not match, the possibility of a performance gap will be high (see [Figures 1 and 2](#)).

All in all, we can conclude that based on the literature review, the linkage between institutional theory and *Shari'ah* governance factors that impacts internal *Shari'ah* audit effectiveness can be demonstrated as follows:

### Internal *Shari'ah* audit structure and mechanism for effective internal *Shari'ah* audit

#### *Shari'ah* audit references profile

To conduct efficient and effective auditing, the internal *Shari'ah* auditor should have a *Shari'ah* audit reference profile. Al-Fazee, who is *Shari'ah* professor in Kuwait University, mentioned in his paper, "*Shari'ah* Audit Manual", presented in *Shari'ah* Audit Conference in 2009, that to implement the *Shari'ah* principles, comprehensive *Shari'ah* references should be available for auditor or reviewer to refer to when undertaking a job. This profile should include the following: the official law related to the Islamic banks such as the commercial law and Islamic banks law; the instructions and rules issued by the central bank; Islamic banks regulations and policy; the annual strategic plan; Islamic banks structure; SSB meeting minutes and SSB resolution; sample of contracts and the agreements that were endorsed by SSB; sample of contracts and the agreements that were not endorsed by SSB; previous *Shari'ah* auditor results; International Islamic Fiqh Academy *Shari'ah* standards and AAOIFI standards; Islamic banks memorandum; general firm audit manual and its application policy; *Shari'ah* audit manual; and Islamic banks *Shari'ah* policy.

#### *Shari'ah* auditor charter

Based on the Bank Negara Malaysia (BNM) guidelines, the *Shari'ah* auditor is important because the *Shari'ah* auditor specifies the tasks, responsibilities, purpose and authority of the internal *Shari'ah* auditor which comes as a formally written and detailed document approved

Quality of *Shari'ah* Audit and Performance Gap by Abdulbari Mashal (2017)

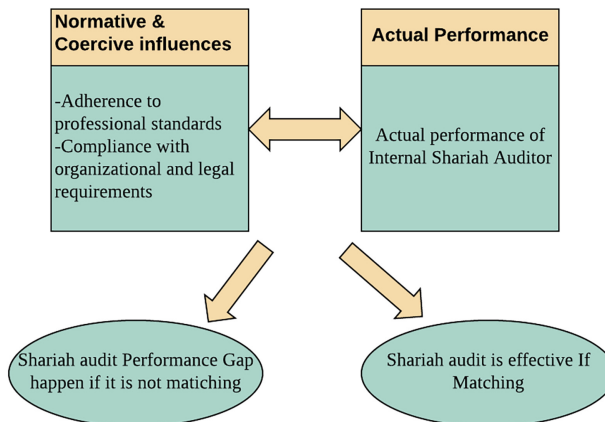
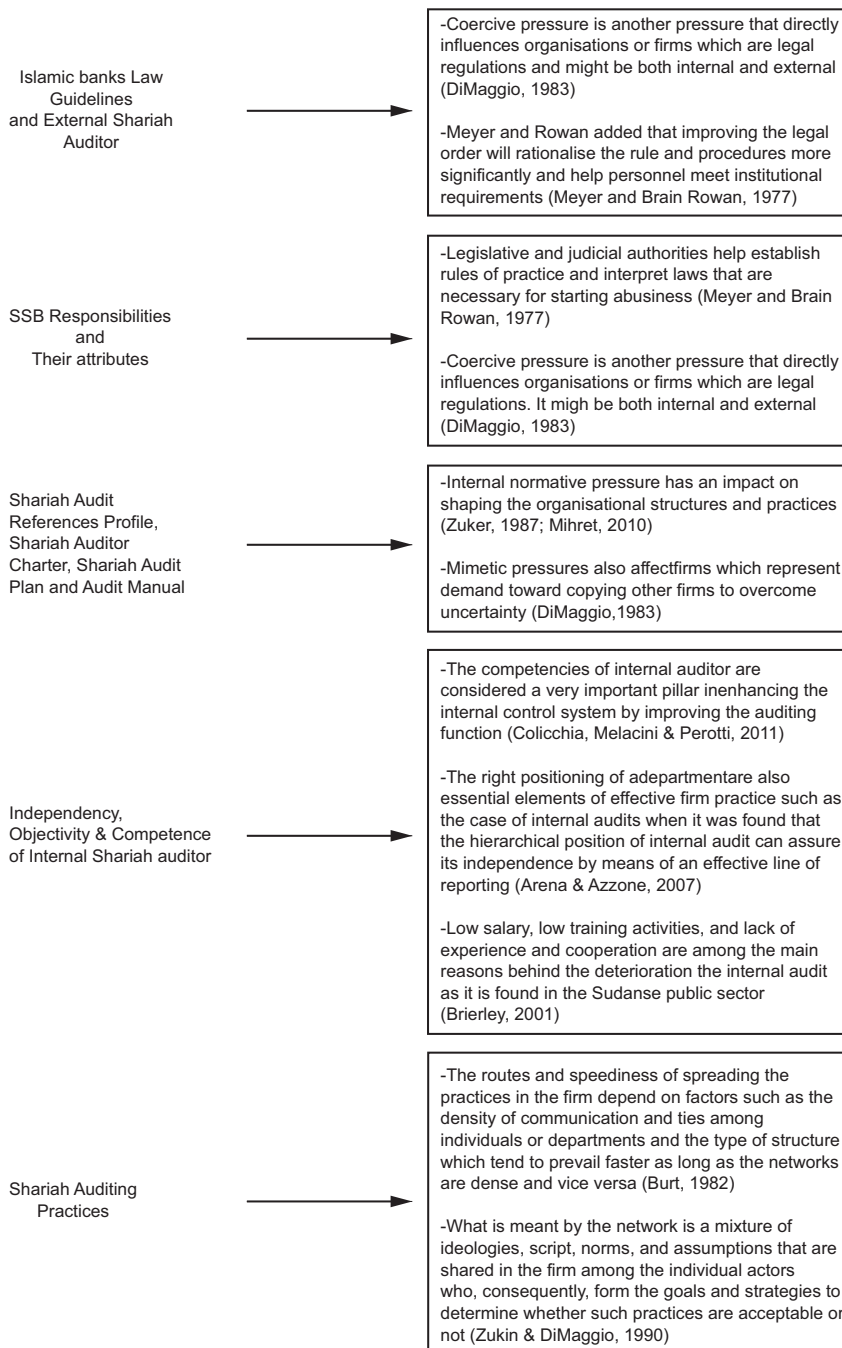


Figure 1.  
Quality of *Shari'ah* audit and performance gap (Binti Kasim *et al.*, 2009)



**Figure 2.**  
Impact of the linkage  
between institutional  
theory and *Shari'ah*  
governance factors

by the *Shari'ah* committee. The *Shari'ah* auditor charter should be endorsed by the Board of Director (BOD) so that all levels of bank management will be aware of the internal role of the *Shari'ah* auditor. According to Governance Standards for Islamic banks (GSIB) 3, Para 3, the internal *Shari'ah* audit is an integral part of the organisation's means of control, and it operates in accordance with the policies established by the institution. The internal *Shari'ah* audit shall have the *Shari'ah* auditor charter that illustrates the purposes, powers and responsibilities. The *Shari'ah* auditor charter shall be prepared by the administration in accordance with the provisions of Islamic *Shari'ah*, and it should be endorsed by the SSB of the institution and issued by the BOD. Furthermore, the *Shari'ah* auditor charter should show that the internal *Shari'ah* auditor has no authority or executive authority towards the business (GSIFs 3, Para4).

#### *Shari'ah auditor plan*

The *Shari'ah* auditor plan should be designed by the manager of the *Shari'ah* suppression department in cooperation with the other departments that are more exposed to *Shari'ah* risks. This includes assets, treasury and credit card (Abu Ghadda, 2001, p. 49, Ahmed, 2001, p. 57).

According to Fahd Bin Sulaiman Al-Attaiwi (2015), the annual *Shari'ah* audit plan should include the following:

- (1) General introduction that shows the purpose.
- (2) The scope of audit.
- (3) The audit objectives which can be summarised as all the contracts, transactions, products, service agreements that are all *Shari'ah*-compliant and endorsed by SSB.

In addition, the annual *Shari'ah* audit plan should include the scope that should be audited, timeline of each audit work and the percentage of the samplings (Aljasser, 2009). This plan should be reviewed frequently and may cover one to five years. This is also dependent of the risk factors identified in the audit plan. This risk factor is based on the size of transaction, transaction complexities or the quality of *Shari'ah* supervision (Aljasser, 2009). According to Al-Fazee (2009). The *Shari'ah* audit plan can be divided into:

- (1) Strategic *Shari'ah* audit plan: This plan usually covers a period of two to five years and gives priority to high main risks.
- (2) Annual plan: This plan is related to the internal *Shari'ah* audit for only one year.
- (3) Tactical plan: This plan describes the procedures of filed visit for internal *Shari'ah* auditor. It comprises three steps which are internal *Shari'ah* audit preparation, internal *Shari'ah* audit execution and post-execution of internal *Shari'ah* audit.

#### *Audit manual*

One of the important factors of the internal control system in Islamic banks is the audit manual in which it shows the procedural work to audit either the product or the transactions that are endorsed by SSB. This written audit manual includes the definition of products or transaction, the *Shari'ah* control and standards related to it as well as the contracts needed to execute it in order for the *Shari'ah* auditor to refer to it and form the right audit forms during the auditing process (Dahlawi, 2013; Al-Omrani, 2015). The audit manual is also defined as a set of methods to which the *Shari'ah* audit department refers in order to get valid information that leads to personal convinced opinion about the commitment of firms to the *Shari'ah* principles (Issa, 2002).

This written audit manual includes the definition of the product or transaction and the *Shari'ah* control and standards related to it. This also includes the contracts that need to be executed which are used as reference for the *Shari'ah* auditor to form the right audit forms during the job (Dahlawi, 2013; Al-Omrani, 2015). The *Shari'ah* supervisory department is responsible for preparing the internal *Shari'ah* audit manual, following-up on the resolutions of the *Shari'ah* committee, classifying them, preparing the required *Shari'ah* researches, developing the products and training the new employees on the basics of jurisprudence (GSIFs2). Al-Fazee (2009) has mentioned that some Islamic financial institutions have been able to automate regulatory procedures, but we do not think that they will be able to automate internal *Shari'ah* audit unless they have a written audit manual.

### Research methodology

This study adopts a qualitative approach and uses both primary and secondary data to formulate the appropriate interview questions and achieve the objectives of the study. In particular, the researchers prefer to use a case study which enables us to explore deeply to form accurate theoretical statements (Otley and Berry, 1998). The study compared and contrasted the internal *Shari'ah* auditing procedures of two Islamic banks in Yemen without specifying the best practices. Instead, we proposed recommendations on how the internal *Shari'ah* auditing practice ought to be. According to Simons (2009) and Yin (2003), a case study is useful when there is a need to explore subjects that lack the academic background and require further investigation of real-life context to explain changes such as organisational and managerial processes. Further, to make our questions reflect the reality, we analysed the primary documents related to internal *Shari'ah* auditing in some Islamic banks in Yemen. The primary documents included minutes of the meetings, internal *Shari'ah* auditing report to SSB and general managers, internal regulations, internal *Shari'ah* audit manual, as well as the forms used for auditing. Other documents were analysed, such as the annual report, Yemen's Central Bank laws and Islamic bank memorandums. All these annual reports were collected with permission from SSB and top management of the banks included in the study.

The population of the research includes two Islamic banks in Yemen, which are the Islamic Saba Bank (ISB) and Islamic Bank of Yemen (IBY). The sample taken represent total of three internal *Shari'ah* auditors and four of SSB from the two banks in the study. Furthermore, an external auditor from the Central Bank of Yemen was interviewed as well.

### Respondents of bank 1

SSB member (S1) is a member in SSB in Bank 1 and works as a *Shari'ah* supervisor in the bank. His bachelor's degree was in law, and he studied *Shari'ah* and fiqh in Azhar Alshareef and Egypt University. His work experience varies from an adviser in the fatwa department in the Justice Ministry in the UAE and as a *Shari'ah* supervisor in a Yemeni insurance company in the takaful section (according to his CV).

SSB member (S2) is a member of Bank 1. He holds a bachelor's degree in *Shari'ah* and law from Sana'a University and also has a postgraduate diploma in management. Currently, he is working as a general manager in the planning and statistics division in the Civil Service Ministry in Yemen besides being a member of the SSB in Bank 1 (as obtained from the respondent in the interview). In terms of the internal *Shari'ah* audit interview section, the same person, SSB member (S1), was interviewed as there was no internal *Shari'ah* auditor in this bank and part of his job is internal *Shari'ah* audit. Therefore, we refer to him in this section as (A1).

**Respondents of Bank 2**

SSB member (S3) is the secretary of the Consultative Council of Islah Party and a former Member of Parliament. He is a member of SSB in Bank 2 and a lecturer in comparative fiqh at Sana'a University.

SSB member (S4) is working as a *Sharī'ah* supervisor in Bank 2. Furthermore, he works as an economics lecturer at Eman University and is also working as an SSB member in the new Islamic bank, Alkarimi.

We refer to the interviewed *Sharī'ah* supervisor's assistant in this bank as internal *Sharī'ah* auditor (A2). This is because the term "Supervisor" is being used in Yemen alternatively with "internal *Sharī'ah* auditor". He has a PhD in comparative jurisprudence and a bachelor's degree in Islamic studies. Furthermore, he has some professional certificates in management and is a certified *Sharī'ah* supervisor with a certificate from the AAOIFI and Islamic Development Bank (IDB). He has published books and studies on Islamic finance and other related topics.

The internal *Sharī'ah* auditor we interviewed is (A3) who is the same person as SSB member (S4). He works as both SSB member and internal *Sharī'ah* auditor. All in all, the total number of interviewees was eight (see [Table 3](#)).

**Findings and discussion**

The study analysis indicates that one of the key factors to have effective internal *Sharī'ah* audit is by having clear and comprehensive *Sharī'ah* audit governance which includes

		SSB competence	
Requirements	SSB competence as a requirement	SSB should have at least three members who are qualified in Fiqh Muamalat and have experience in accounting and financing (Bank Governance Guidelines of Yemen, 2014, p. 34)	
Actual Practices	SSB Educational level found	<i>Bank 1</i> Bachelor (SSB members CV)	<i>Bank 2</i> PhD holder (SSB member's CV)
	SSB knowledge	Fiqh Muamalat, Awqaf, <i>Sharī'ah</i> and law, planning (SSB members' CVs)	Literature, Islamic finance (SSB members' CVs)
Requirements	Being updated with latest fatwa and standards	No ( <i>Sharī'ah</i> supervisory report, 2008)	-(Yes) Discuss fatwa book (No 2, 2009) (No 4, 2009) (No 7, 2009) (SSB report, 2007)
	SSB members' work experience	Varied (SSB members' CVs)	Varied (SSB members' CVs)
Requirements	<i>Sharī'ah</i> auditor competence as requirements	Based on the Banks Governance Guidelines of Yemen (2014) that banks should provide the internal <i>Sharī'ah</i> auditing department with qualified auditors	
Actual practices	Educational level	<i>Bank 1</i> Bachelor's (internal <i>Sharī'ah</i> auditor's CV)	<i>Bank 2</i> PhD (internal <i>Sharī'ah</i> auditor's CV)
	Knowledge	<i>Sharī'ah</i> and Fiqh (internal <i>Sharī'ah</i> auditor's CV)	Comparative jurisprudence, Islamic studies, <i>Sharī'ah</i> (internal <i>Sharī'ah</i> auditor's CV)
Experience	Varied (internal <i>Sharī'ah</i> auditor's CV)	Varied (internal <i>Sharī'ah</i> auditor's CV)	

**Table 3.**  
SSB competence

*Shari'ah* auditor charter, audit plan and audit manual. AAOIFI standards were found to be recognised by both banks, as it was confirmed by the respondent. The interviewees for the following sections are the four internal *Shari'ah* auditors in both Islamic banks. One internal *Shari'ah* supervisor is from Bank 1 (as he is the only one who conducts the internal *Shari'ah* audit) and three are from Bank 2.

AAOIFI standards are compulsory for us, and we guide the management to stick to it as a reference for all Islamic banks. (A1, Bank 1)

AAOIFI standards are compulsory. However, Bank 2 mentioned that these are considered as one of the references we depend on but it is compulsory to us as much as the SSB fatwas and their instructions. (A1, Bank 1)

AAIOFI is considered as one of the references for SSB, and the management depends on it even if it is not stated in the memorandum. Furthermore, it is considered as part of our internal *Shari'ah* audit training. Basically, this bank is a member of AAOIFI, and we apply all that we need from these standards; however, as internal *Shari'ah* auditor neither exists in internal *Shari'ah* auditor profile nor it is compulsory to us as much as the SSB fatwas and their instructions. (A2, Bank 2)

AAIOFI standards are recognised by the bank in general, and we depend on them somehow regarding internal *Shari'ah* audit. (A2, Bank 2)

Since the AAOIFI standards are recognised by the CBY and the management of Islamic banks, it becomes necessary to know how far these standards are applied in terms of internal *Shari'ah* mechanism and its structure.

#### *Internal Shari'ah auditor charter*

The internal *Shari'ah* auditor charter must show the role and the responsibilities of the internal *Shari'ah* auditor, the scope of auditing, as well as the composition of the department. It was found that both internal *Shari'ah* supervisor and internal *Shari'ah* auditor terms are being used in Islamic banks in Yemen. As a result, we mentioned here the exact term as it is stated in the internal document in each Islamic bank.

We noticed the term "internal *Shari'ah* auditor" is mentioned in the career description in Bank 1. In Bank 2, used the term "internal *Shari'ah* supervisor". However, there is no specified description for the internal *Shari'ah* auditor, and all the responsibilities listed are mixed with SSB responsibilities. When we asked about this issue, the internal *Shari'ah* supervisor confirmed that this is a part of his job. "Yes, as internal *Shari'ah* supervisor, we do issue fatwas; answer any questions related to *Shari'ah* compliance as well as do the internal *Shari'ah* supervision. We believe that issuing fatwas should be done by one of the internal *Shari'ah* supervisors who should be qualified in law and *Shari'ah* perspective and has the skills to solve any related issues that might be faced by the bank" (A1, Bank 1)

Therefore, there is a need for more information about how the internal *Shari'ah* auditors view their job and what it means to them.

For Bank 1, A1, who is working as an SSB member and an internal *Shari'ah* supervisor, stated that: "The internal *Shari'ah* auditor or internal *Shari'ah* supervisor, which am now, means to be responsible for preparing the contracts, conduct research, solve any issues and do ex-post *Shari'ah* supervision in order not to leave any gaps that can be misused by some of the Islamic bank haters". (A1, Bank1)

The answers from Bank 2 were: "It is control and check-up process for all the activities that adhere to the SSB fatwas, which we consider as promoting virtue and preventing vice. This is because the responsibilities of Halal and Haram come under both SSB and internal *Shari'ah* auditor duties and any negligence in this part will cause the Islamic bank to be not Islamic". (A2, Bank 2)

Internal *Shari'ah* audit is very essential to Islamic banks to protect its activity from *Shari'ah* violations during the practices. In other words, it is the only guarantee to check if the bank is adhering to fatwas issued by SSB as well as work based on contracts and guidelines endorsed by the SSB. (A3, Bank 2)

In Bank 2, the respondents believed that the internal *Shari'ah* audit is more a protection and checking process for the Islamic bank's activities to ensure they are not against *Shari'ah* principles. Regarding Bank 1, the internal *Shari'ah* auditor's duty is broad if not mixed with the duty of the SSB. Preparing the contracts and solving any related issues are part of the internal *Shari'ah* supervisor's responsibilities.

We found through internal regulations for both banks (Bank 1 and Bank 2) that the internal *Shari'ah* auditing scope in the charter does not cover *Zakat* and financial statement.

The answers we got were almost the same, namely, that all the internal *Shari'ah* auditor charter is not comprehensive enough, and in reality, *Zakat* and financial statement are audited.

We do *Zakat* and financial statement auditing; the scope described is not accurate. I am internal *Shari'ah* supervisor and not internal *Shari'ah* auditor which means internal *Shari'ah* supervisor's tasks are broader than the tasks of the internal *Shari'ah* auditor whose job is focused on technical things only. However, the internal *Shari'ah* supervisor goes beyond economic and legal matters. (A1, Bank 1)

Initially, the internal *Shari'ah* auditor charter is not comprehensive enough. Furthermore, in reality, *Zakat* and financial statement are being audited by the internal *Shari'ah* supervisor and not by internal *Shari'ah* auditor. (A2, Bank 2).

*Shari'ah* auditor charter is not comprehensive, and practically *Zakat* and the financial statement are being audited by him. (A3, Bank 2)

### *Observations and findings*

- (1) In some banks, the one who is doing the internal *Shari'ah* audit is the internal *Shari'ah* supervisor, and there is no internal *Shari'ah* auditor.
- (2) Some banks do not have a full description of the internal *Shari'ah* auditor that explains the auditor's purpose, authority, responsibility and position within the organisation. This might lead to having a gap between what ought to be done by him and what he is doing especially for those who are newly employed.
- (3) Some banks mix the description of the internal *Shari'ah* auditor with the concept of the SSB duty, and this is because the one who performs the internal *Shari'ah* auditing is a member and at the same time in SSB too. This becomes obvious when we know the perception of the internal *Shari'ah* auditor from some respondents as they believe some of their duties are preparing the contracts, conducting research and solving issues. This raises questions about the quality of the internal *Shari'ah* audit as to how this member can manage to cover all the transactions in the bank and its branches while he is an SSB member at the same time.
- (4) No full department of the internal *Shari'ah* audit is found in one of the banks selected. This will put a heavy load on the internal *Shari'ah* auditor and decrease the quality of the internal *Shari'ah* audit, especially if the bank has multiple branches.

### *Shari'ah audit plan*

The following [Table 4](#) shows a summary of our findings for the internal *Shari'ah* audit plan analysis. We focused on this analysis of the availability of this plan and scope that should be

	Bank 1	Bank 2	
<i>Annual plan</i>	Found ( <i>Shari'ah</i> plan 2013, 2012)	Found	
		(1) Not detailed plan ( <i>Shari'ah</i> supervisor's annual plan 2004)	
		(2) Detailed plan ( <i>Shari'ah</i> supervisor's annual plan 2015)	
Annual plan scope	Murabahah and investment transactions ( <i>Shari'ah</i> plan 2013, 2012)	(1) Not detailed scope ( <i>Shari'ah</i> supervisor's annual plan 2004).	
		(2) Detailed scope ( <i>Shari'ah</i> supervisor's annual plan 2015)	
Annual plan objectives	Not found ( <i>Shari'ah</i> audit plan 2013, 2012)	Found	
		(1) Not detailed objectives ( <i>Shari'ah</i> supervisor's annual plan 2004)	
		(2) Detailed objectives ( <i>Shari'ah</i> supervisor's annual plan 2015)	
Frequency of audit	Not found	(1) Twice a year ( <i>Shari'ah</i> supervisor's annual plan 2004)	
		(2) Varied ( <i>Shari'ah</i> supervisor's annual plan 2015)	
Resources required	Not found ( <i>Shari'ah</i> plan 2013, 2012)	Not found	
		(1) ( <i>Shari'ah</i> supervisor's annual plan 2004)	
		(2) ( <i>Shari'ah</i> supervisor's annual plan 2015)	

**Table 4.**  
Review of internal  
*Shari'ah* audit plan for  
the selected  
Islamic banks

covered. Furthermore, we see if objectives that must be fulfilled by the internal *Shari'ah* auditor are mentioned as well as the frequency of the internal *Shari'ah* audit and the resources to which the internal *Shari'ah* audit should refer during his job.

First, you will have to use the term “internal *Shari'ah* supervisor” instead of the “internal *Shari'ah* auditor” as it is more precise to my position. Moreover, regarding the plan mentioned, we do not care that much about it whether the bank has it or not as we work base on our vision. (A1, Bank 2)

Internal *Shari'ah* auditor has a tactical plan that is more detailed. (A2, Bank 2)

*Shari'ah* auditors are highly qualified to determine the scope of auditing by themselves. (A3, Bank 2)

### Observations and findings

- (1) The Islamic banks do not have a detailed internal *Shari'ah* audit plan for the internal *Shari'ah* audit where the scope that should be covered or the objectives that should be fulfilled are not mentioned. This is because they believed that they do not need it as they work based on their vision, which is derived from *Shari'ah* principles.
- (2) Whether it is the internal *Shari'ah* auditor or the internal *Shari'ah* supervisor depends on the job and their knowledge and experience in determining the scope needed, and this sometimes can be through tactical plan drawn up by the internal *Shari'ah* auditor.
- (3) There are no concerns regarding the internal *Shari'ah* auditor's qualifications. However, depending on the personal opinion with regard to conducting the internal

*Shari'ah* auditing job makes it subjective more than objective, and the level of auditing will not be systemised as it will be based on what they believe should be audited.

#### *Internal Shari'ah audit manual*

The audit manual is a set of written procedures describing how to prepare and conduct *Shari'ah* auditing. In Bank 1, there are general procedures of *Shari'ah* audit. However, the audit manual for each transaction is not found, and it comes only as forms. We attribute this to the absence of an audit manual in Bank 1, as there is only one internal *Shari'ah* supervisor who is performing the *Shari'ah* audit function and he conducts these studies.

This general procedure of the internal *Shari'ah* audit as stated in the internal regulations of the *Shari'ah* supervisor comprises four points, which are:

- (1) Specify the ways and methods that help in checking the bank's commitment to the SSB resolutions and recommendations.
- (2) Raise all the methods and the ways that have been chosen in the steps mentioned above to the SSB.
- (3) Ways to increase and enhance the sense of self-supervision in the bank's workers.
- (4) Ways to correct *Shari'ah* violations.

We asked the internal *Shari'ah* auditor in Bank 1 whether the internal *Shari'ah* auditor was observing these steps in the bank. His answer was:

You know that we do not have an internal *Shari'ah* auditor and all that have mentioned are steps for the internal *Shari'ah* auditor. We did not do any of these as we have our procedures as internal *Shari'ah* supervisor. We know our job well, and we do not need guidelines. (A1, Bank 1)

Bank 2 has written procedures on how the internal *Shari'ah* auditor can check and audit each transaction. We still need to know if they have an internal audit manual that is detailed and covers all the transactions.

This internal *Shari'ah* audit manual comprises five to six pages and has some details about the internal *Shari'ah* audit steps and its requirements. (A2, Bank 2)

The audit manual of the internal *Shari'ah* audit is not in detail. However, the internal auditor knows his job well. (A3, Bank 2)

#### *Observations and findings*

- (1) There is a *Shari'ah* audit manual in these Islamic banks. However, it is not detailed, and it does not cover all the transactions. This might lead to not being able to check the quality of the internal *Shari'ah* audit and result in work duplication between the internal *Shari'ah* auditor and the internal audit.
- (2) The internal *Shari'ah* auditors and the internal *Shari'ah* supervisors seem to depend on themselves to determine the bank's transactions compliance with *Shari'ah* and do not need this *Shari'ah* audit manual. Therefore, the internal *Shari'ah* audit tends to be subjective more than objective.
- (3) Internal *Shari'ah* audit manual brings to the attention of users the major items that should be considered when planning, conducting and reporting the internal *Shari'ah* audit results or when managing the internal *Shari'ah* activities in general. As a result,

it might lead to not inability to check the quality and the professionalism of the internal *Shari'ah* audit and make the work more centralised. This makes the internal *Shari'ah* audit inadequate as it makes it difficult to carry out duties at short notice.

### *Auditing profile*

The *Shari'ah* audit references profile should include the official law related to the Islamic banks such as the commercial law and Islamic banks law, the instructions and rules issued by the Central Bank, Islamic banks regulations and policy, the annual strategic plan, Islamic banks meeting structures, SSB resolution, sample of contracts and the agreements that were endorsed by SSB, sample of contracts and the agreements not endorsed by SSB, previous *Shari'ah* auditor's results, International Islamic Fiqh Academy Shariah standards and AACIFI standards, memorandum of Islamic banks, general firm audit manual and its application policy, *Shari'ah* audit manual, Islamic banks *Shari'ah* policy (Al-Fazee, 2009).

Through our analysis of two Islamic banks' documents in Yemen, we could not find any tactical plan which the internal *Shari'ah* auditor should start with or have auditing profile as a reference for the internal *Shari'ah* auditors to refer to before performing his duty.

We asked the interviewees if the internal *Shari'ah* audit had a profile of auditing. All the respondents admitted that they did not have it, and some of them referred this to the qualifications that make them do their job correctly.

Still, all these are formalities, and we do not need them, simply because we are doing all our best on our own and our job is based on *Shari'ah*. Furthermore, we do not violate the CBY instructions, and our objective is the same. (A1, Bank 1)

We do not have. (A2, A3, Bank 2)

### *Observations and findings*

- (1) Neither tactical plan nor audit profile is found in both Islamic banks as one of them considers this as a mere formality, and they depend more on their qualifications. Another bank gave the reason that because they do comprehensive auditing for all the financial transactions only and that is why they do not need this audit plan.
- (2) The profile of the internal *Shari'ah* auditor does not exist in both banks, which may make its process very slow and not accurate, as this profile helps the auditor to easily refer to fatwa resolutions on which he depends to do his job.

The following [Table 5](#) summarises the findings gained from both documents review and interview analysis for the two banks selected.

### **Conclusion**

This study was conducted to explore and assess the key audit *Shari'ah* governance factors that may have a significant impact on the internal *Shari'ah* audit, the structure and its practices in Islamic financial Institutions in Yemen particularly in the Islamic banking sector. The study utilised a qualitative approach by conducting a case study analysis, which enabled the researchers to explore deeply the factors and form accurate theoretical statements in internal *Shari'ah* auditing procedures. Further, the study compared and contrasted the internal *Shari'ah* auditing procedures of two Islamic banks in Yemen without specifying the best practices.

We found that the effectiveness of the internal *Shari'ah* audit can be determined by finding the mutual relationship between the internal audit and key elements of *Shari'ah*

**Table 5.**  
Summary of findings

Findings from documents review	Findings from interview analysis
(1) No tactical plan, no tactical objectives and no auditing profile are found	(1) Internal <i>Shari'ah</i> auditor depends on his knowledge and qualifications to do his job, and the objectives are already known (Bank 1, Bank 2)
(2) Internal <i>Shari'ah</i> audit rules description is not clear and mixed with responsibilities of SSB (Bank 1)	(2) Internal <i>Shari'ah</i> supervisor is the one who does the internal <i>Shari'ah</i> audit in all branches in (Bank 1)
(3) No internal <i>Shari'ah</i> audit department (Bank 1)	(3) Internal <i>Shari'ah</i> auditor depends on his vision which is derived from <i>Shari'ah</i> principles more than plan
(4) No detailed internal <i>Shari'ah</i> audit plan found	
(5) Scope found in <i>Shari'ah</i> audit plan is very general	
(6) <i>Shari'ah</i> audit manual is found in both banks. However, it is not in detail, and it does not cover all the transactions	
(7) No audit forms used in Bank 1; however, it is found in Bank 2	

governance. The findings of both the documents analysis and interviews revealed that the level of *Shari'ah* audit governance practised is varied at those selected Islamic banks due to the variation level of the two banks' commitment to fulfil the requirements needed by AAOIFI standards in terms of internal *Shari'ah* audit structure. This is because there is neither a detailed internal *Shari'ah* audit plan nor a detailed audit manual. As a result, the internal *Shari'ah* audit tends to be subjective because it depends more on the qualifications and experience of the personnel than formal guidelines and regulations. Moreover, the internal *Shari'ah* auditor charter, it is not comprehensive in explaining the duties required of the internal *Shari'ah* auditor, and it is mixed with the SSB duties. In other words, according to institutional theory, normative pressures formed do not meet the requirements of coercive pressures. The reason is the confusion over how the internal *Shari'ah* is perceived by both regulators and practitioners as they mix it up with the concept of some other related terms to *Shari'ah* governance system such as internal *Shari'ah* reviewer and *Shari'ah* supervisor. All this reflects on the Islamic banks' policy as well as the terms of *Shari'ah* audit and leads to its ineffectiveness at the level of internal *Shari'ah* audit practices. As a result, the *Shari'ah* practitioners are unable to respond to *Maqasid Shari'ah* despite their obvious willingness.

Therefore, the study suggested that the enhancement process of the internal factors of *Shari'ah* governance can be achieved by increasing the awareness of improving internal *Shari'ah* audit structure as it is reflected ultimately in the internal *Shari'ah* auditor's role and his practices. Furthermore, it ensures uniformity and standardisation in the decisions by the *Shari'ah* advisory bodies of the various Islamic banks; however, it is preferred to have a *Shari'ah* Advisory Council which advises the Central Bank to lead, as it has the ultimate authority on Islamic banking system and financial market as a whole. In which case, a centralised *Shari'ah* governance system seems to be beneficial to the industry in terms of effectiveness and credibility of the Islamic banks in Yemen.

According to our results and findings and based on what we have gone through during our interview process, we may add one more reason that contributes to effectiveness in performance besides the pressures mentioned in institutional theory, which is the need to perceive the functions of the subject matter that is intended to be assessed for its effectiveness, otherwise the whole system of organisational factors will work in another direction from the desired objective. In other words, if the internal *Shari'ah* audit is not viewed based on related well-known standards, the factors or players within the *Shari'ah* governance will not interact with each other to fulfil the requirements needed and leave a gap between what should be practised and what is being practised. This finding was observed

during the interviews when we found that there was confusion and misunderstanding regarding the role of internal *Shari'ah* audit and mixing it up with the role of internal *Shari'ah* supervisors. Therefore, if the concept of this function is not properly recognised by the regulators or practitioners, it will not result in effectiveness in internal *Shari'ah* audit no matter how well the pressures are set.

Finally, the results obtained in this study should be interpreted in light of certain limitations. Although we were able to collect almost all the documents needed – either primary or secondary from two selected Islamic banks – and interview respondents, it would be much better if we increased the number of Islamic banks in future studies to ensure a fair representation of the various interested groups. This might give a fully transparent and comprehensive result that can be generalised on the subject matter for all Islamic banks in Yemen.

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