

Ensuring Compliance with Islamic Financial Principles by Modern Islamic Financial Institutions (IFIs): The Role of Shari'ah Governance System

Ibrahim Muhammad Baba,¹ Muhammad Auwal Ishaq,² Nuraddeen Mohammed Lawal³
^{1,3}Yobe State University, Damaturu-Nigeria, ²Bayero University, Kano-Nigeria

Received: January 01, 2022

Last Revised: May 27, 2022

Accepted: June 15, 2022

Abstract

Unlike other religions, Islam is complete and all-encompassing. Its principles and precepts permeate all spheres of human endeavor; be it social, economic, financial or someone else. Muslims, right from the prophetic era down to the Nineteenth century, were reported to have complied with the Islamic commercial jurisprudence in undertaking most of their economic and financial dealings. Subsequently, these teachings were replaced with and dominated by western commercial laws due to the establishment of conventional financial institutions. For more than three decades, now, many jurisdictions across the globe including Nigeria, have introduced Islamic financial Institutions which try to achieve compliance with Islamic commercial jurisprudence on their products and services via Shari'ah governance system. This paper is all out to trace the history of the concept of Shari'ah governance in Islam and explain how it functions in the modern Islamic financial institutions. The research methodology adopted by the paper is purely qualitative and library based. The paper finds out that a Shari'ah governance framework that is effective and sound plays great role in making the financial institutions' products and services Shari'ah compliant. In view of the above, this research work recommends that all institutions offering Islamic financial products and services should make sure that an effective, sound and robust Shari'ah governance system is put in place in order to make their transactions conform to Shari'ah tenets and win public trust and confidence as well.

Keywords: Islamic Financial Principles, Islamic Financial Institutions, Shari'ah Governance System.

Corresponding Author: Nuraddeen Mohammed Lawal email: nuramlawal@gmail.com



1. Introduction

Compliance with Islamic financial principles which is achieved by modern Islamic financial institutions (IFIs) through a proper Shari'ah governance framework, is what differentiates between them and their conventional counterparts. A sound Shari'ah governance system is achieved through the establishment of a competent and accountable board and management as well as qualified Shari'ah committee. In addition, a strong internal Shari'ah research capacity, Shari'ah Review, Shari'ah Audit and Shari'ah Risk management process should be made available to make stronger the application of Shari'ah governance framework. This system reflects part of the efforts exerted by Muslim scholars to revive adherence to the Islamic commercial jurisprudence (*fiqh al-muamalat al-maliyyah*) practiced by Muslims right from the prophetic era down to the Nineteenth century which was Subsequently replaced with and dominated by western commercial laws resulting from the establishment of conventional financial institutions. For more than three decades, now, many jurisdictions across the globe including Nigeria, have introduced Islamic financial Institutions which try to achieve compliance with Islamic commercial jurisprudence on their products and services via this system of Shari'ah governance. Against this backdrop, this paper tries to trace the history of the concept of Shari'ah governance in Islam and explain how it is being applied by the modern Islamic financial institutions using qualitative and library-based research methodology. The paper is structured into four sections. The first section presents the introduction. The second one discusses major Islamic financial principles. The third houses detailed explanation on Shari'ah Governance System. The fourth section concludes and offers recommendations.

2. Major Islamic Financial Principles Governing IFIs

The key differentiating feature between Islamic and Conventional Finance is the compliance to the Shari'ah principles as well as norms/ethics relating to Islamic commercial jurisprudence. In other words, all business transactions, contracts, dealings, instruments, and products as well as services are non-Islamic provided they involve *Riba* (Interest), *Gharar* (Uncertainty), *Maysir* (Speculation), inequity, Exploitation, sales of prohibited items such as pork, alcohol, ammunitions, pornography and their likes. (Dogarawa, 2012; CBN, 2011; and Ayyub, 2007). In addition, Ayub (2007) has identified some ethics and norms that Islamic finance has to comply with which include the following: Justice and fair dealing, fulfilling the covenants and paying liabilities, mutual cooperation and removal of hardship, free marketing and fair Pricing and freedom from *Dharar* (Detriment). Additionally, Dogarawa (2013) identifies the following seven principles upon which Islamic banks operate: prohibition of giving and taking interest, *gambling*, avoidance of uncertainty, sanctity of contract,

promotion of socio-economic activities, compliance with moral ethical values and sound corporate governance.

3. Shari'ah Governance System:

3.1 Meaning, Objectives and Scope

Before the issuance of IFSB-10, the Shari'ah Governance System was not clearly defined as a concept. Therefore, IFSB-10 (2009) took the challenge and defined the concept as arrangements set aside by institutions or organizations through which they effectively and independently oversee Shari'ah compliance over the Issuance of relevant Shari'ah rulings , disseminating the information on these rulings to the unit or personnel who monitor their daily implementations, an internal Shari'ah audit to ensure compliance as well as an annual Shari'ah audit verify the conduct of the internal Shari'ah audit. Similar to IFSB-10 definition, Mahammad (2012), Mizushima (2014) and Kayadibi and Guclu (2021) also view the concept of Shari'ah governance as arrangements provided by Islamic financial institutions through which they mean an effective and independent Shari'ah compliance relating to dissemination of fatwa, annual Shari'ah review, issuance of fatwa, internal Shari'ah audit. From the aforementioned definitions, it can be understood that Shari'ah governance system is nothing but the arrangements made by Islamic financial institutions and organizations in relation to issuance and dissemination of *fatawa*, Internal Shari'ah audit as well as annual Shari'ah review to ensure Shari'ah compliance in all their transactions.

Wardhany and Arshad (2012) have stated that, for effective Shari'ah governance system to take place, there must be at least eight elements. These include (i) the board that will be overseeing all aspects related to Shari'ah compliance of the entire operations of Non-Interest financial institutions. (ii) a Shari'ah committee made up of qualified and able members who can take care of all Shari'ah-related financial issues referred to them and provide solutions. (iii) the responsibilities assigned to put in place required resources and skilful manpower should be effectively managed in order to support all functions relating to the implementation of Shari'ah governance,(iv) an internal Shari'ah audit to be carried out on regular basis (v) an annual regular Shari'ah review in order to ascertain compliance with Shari'ah over the IFIs' business operations (vi) an avenue for risk management to detect the non- Shari'ah compliance risks as well as to take necessary measures to reduce them (vii) a research team to be internally constituted to carryout research on Shari'ah matters and (viii) issuance of fatwa and its dissemination to the relevant stakeholders.

The Objective or instrumental functions of Shari'ah governance system is geared towards achieving Shari'ah compliance on the products or services developed and marketed by IFIs. Haqqi (2014). Furthermore, Hasan, (2011) identifies four fundamental objectives of Shari'ah governance of Islamic financial institution. He stated that it tries to provide legitimate products and services, promotes justice and moderation in Islamic commercial financial transactions, instils confidence and trust in stakeholders and provides an effective avenue for risk management measures peculiar to these institutions as well.

3.2 The Origin of Shari'ah Governance System

The discussion on modern concept of Shari'ah Governance is relatively new to the area of *fiqh muamalat*. However, right from the beginning of Islam, the institution of *Hisbah* has been in existence through which public morals are supervised and markets were regulated by the *Muhtasib* who oversee the affairs of the Hisbah institution. *Hisbah* is a state institution responsible for promoting what is good and proper and preventing what is evil or improper (Ishola & Said, 2012). The Glorious Quran laid down the foundation of *Hisbah* where Allah (SWT) said "let there arise out of you, a band of people inviting to all that is good, enjoining what is right and forbidding what is wrong, they are the ones to attain felicity" (Q3:104). The prophet SAW was the first *muhtasib*. After the establishment of Islamic state at Madinah, the prophet tried to lay down norms and made arrangement for the protection of these norms through viable institutions. He used to inspect markets in order to make sure that there was no cheating or any improper behavior in the market. However, the jurisdiction of *hisbah* cut across all spheres of life: be it moral, spiritual, social, civil or economic. Ibn Taymiyyah maintained that the main economic role of *hisbah* includes ensuring the supply and provision of necessities; supervision of industries, trade and other services; inspection of weight and measure and the standard of product as well as prevention of hoarding, gambling, some usurious practices and many other economic crimes (Musa & Fagge ,2012). Hasan (2011) also states that the economic functions of *hisbah* are to effectively control scales and prices, protect good measures, and ensure correct valuation of coins and prevention of fraud. The *muhtasib* must be a free Muslim, male with very good reputation and integrity, known for his good social values and deep knowledge in Shari'ah. He must also be a man of insight and the ability to ascertain right from the wrong.

It is therefore important to note that majority of the financial dealings carried out in Muslim states before nineteenth century were compatible with Shari'ah dictates. However, at the end of the nineteenth century, conventional laws began

to penetrate and take over due to the introduction of some non-Shari'ah compliant banks in Muslim states. Muslim scholars including but not limited to as Sayid Abu al'ala Maududi, Anwar Iqbal Qureshi became very much concerned about this development and they started to remind Muslims of the dangers of *riba* and the obligation of having modern Shari'ah Compliant banks (Hamid & Karim, 2015).

Interestingly, in 1963, Ahamd el-Najjar responded to this challenge and introduced the Mit Ghamr saving bank in Egypt which due to some factors was closed in 1967. During the same period, nine Islamic banks were also established and operated on profit and loss sharing basis. Moreover, the Islamic Development Bank (IDB) located in Jeddah, Saudi Arabia and Dubai Islamic Bank had also been established in 1974 and 1975 respectively. However, all these banks operated without formal Shari'ah advisory board and their activities were governed by the Shari'ah consultants from Muslim jurists whenever the need arose.

With the introduction of more contemporary Islamic banks, the stakeholders found it significant to introduce Shari'ah Advisory Board as an additional organ to the conventional corporate governance sharing in common the same objective and function of *Hisbah* institution to make the business Islamic.

The introduction of Shari'ah committee as part of the governing structure of Non-Interest financial institutions is somewhat new. This idea was the innovation of Sheikh Saleh Kamal during his establishment of Dallah al-Barakah Group (Hasan, 2011) cited in Abdurrahman, (2010). It follows a gradual process in the sense that the early IFIs including Mit Ghamr Savings Bank, the Nasser Social Bank in Egypt and the Dubai Islamic Bank were not apt to have any Shari'ah board, Kayadibi and Guclu (2021). However, their operations were observed to be Shari'ah compliant. Kahf, (2004) as cited in Hasan (2011) states that the formal establishment of Shari'ah board emerged first in 1976 with the setting up of the Faisal Islamic Bank of Egypt. Subsequently, the Jordan Islamic Bank and the Faisal Islamic Bank of Sudan were also established in 1978 followed by the Kuwait finance House, the Bank Islam Malaysia Berhad and the Dubai Islamic Bank in 1979, 1983 and 1999 respectively. Additionally, the International Association of Islamic Bank (IAIB) was replaced with CIBAFI in 1999 which also introduced its Shari'ah committee. The Islamic *Fiqh* Academy of the OIC, based in Jeddah, also enjoyed the authority of issuing *fatwas* on matters concerning Islamic finance and Islamic banking.

Interestingly, the majority of IFIs got it imperative to set up their individual Shari'ah boards (Hasan, 2011). Despite the above, Islamic banks started their

activities without a vivid picture of the important organs of the Shari'ah governance. This indeed resulted into having substandard Shari'ah governance practices in the then Islamic financial institutions. Responding to this above problem, various national and international regulatory bodies of Islamic finance across the globe have initiated guidelines to ensure better conduct of Shari'ah governance. These bodies include Bank Negara Malaysia, OIC *Fiqh* Academy, Accounting and Audition Organization of Islamic Financial Institutions, (AAOIFI), and Islamic Financial Services Board (IFSB) set up in 1959, 1971, 1990, and 2002 respectively. From the international level, for example, the AAOIFI and IFSB issued Standards 1-5 and IFSB-10 respectively. The standards are specifically on Shari'ah governance. Examples of some of the national regulatory bodies include Bank Negara Malaysia (BNM) that issued its guidelines (BNM/GPS1) in 2004 and Shari'ah governance framework for Islamic financial institution (IFIs) in April 2010. Locally, CBN also developed a framework for Shari'ah governance including two guidelines for the supervision of full-fledged as well as branch and window operations of the IFIs in Nigeria.

3.3 General Requirements of Shari'ah Governance System

For every Shari'ah governance framework to be effective, there are some minimum requirements to be put in place. These requirements are made very clear by some international standards setting organizations as well as central banks of some jurisdictions such as AAOIFI, IFSB and BMN respectively. According to these organizations, IFI is bound to set up an effective Shari'ah governance system that emphasizes roles where each key functionality plays an active role in the efforts geared towards active implementation of the Shari'ah governance framework. A sound and effective Shari'ah governance framework must comprise a responsible board and management, an independent, competent and accountable Shari'ah advisory committee, an active internal Shari'ah research capacity, active Shari'ah audit, annual Shari'ah review as well as Shari'ah risk management process, (Alam, Rahman, Mustafa, Shah, Hossain, 2019).

The Board of directors of IFIs is burdened with the responsibility of overseeing the Shari'ah governance structure and Shari'ah compliance while the management is to take good care of the of business operations in line with Shari'ah principles and give any support that the Shari'ah Committee may require as well. COMCEC (2020). The above stated items are further explained in the following pages:

3.3.1 Shari'ah Supervisory Boards (SSB) and their Functions

Although the formation of Shari'ah Supervisory Board is undoubtedly an additional cost on the part of IFIs, it is however considered necessary in view of

its crucial roles in ensuring that all the products and services of these institutions are in total compliance with the Islamic precepts. The board has different nomenclature applicable to various jurisdictions which include among other things the Shari'ah Advisory Board (SAB), Shari'ah Supervisory Board (SSB), Shari'ah Advisory council (SAC), Shari'ah Board (SB) and Shari'ah committee (SC). The CBN required Jaiz Bank Plc Nigeria to establish SSB with the name: "Advisory committee of experts" (ACE).

Like Governance standard no. 1 of AAOIFI on Shari'ah supervisory board; appointment, composition and report, CBN has also defined Advisory committee of experts as "an independent body of Jurists who specialize in *Fiqh al-Muamalat* or Islamic commercial jurisprudence. This body has shared some responsibilities including but not limited to reviewing the entire activities, practices, products, instruments and operations of the Islamic financial institutions in line with Shari'ah precepts. (Gulf African Bank, 2010). Nevertheless, this Board may comprise some members other than specialists in *Fiqh al-Muamalat* such as lawyers and bank practitioners as long as they are conversant with the area of Islamic finance and *Fiqh Muamalat* (Lahsasna, 2010).

In other words, the board is mandated to direct, review, and supervise the activities of NIFIs to ascertain its compatibility with Islamic principles. The resolutions or *fatwas* of SSB of certain IFIs shall keep binding them. (Lahsasna, 2011); Hassan, et, al. 2010), cited in Dawud, 2002).

However, different scholars identified different roles of Shari'ah Supervisory Board (SSB). For instance, Hassan et, al. (2010) citing Antonio (2001) stressed that the roles of Shari'ah board include among other things the supervision of the operations of Islamic financial institutions making periodic statement on matters concerning achieving Shari'ah compliance on the products and services of given Bank as well as making review of and recommendations on any newly introduced products or services of the institution. Another function includes ensuring Shari'ah compliance to maintain public confidence, issuing *fatwas* and scrutinizing entire institution's activities to ensure that all *fatwas* and rules are implemented; advising the institution before any new contract is carried out as well as organizing meetings to examine whether Shari'ah compliance is being achieved, educating the officers of the bank as well as the public concerning the rulings of Islamic commercial law, organizing conferences *visa-viz* seminars to brainstorm on challenges being faced by Islamic financial institutions as well as publishing books and papers (Hassan et, al. 2010). In addition, the SSB should be innovative enough in such a way that it develops new products for their institutions to competitively cater for the various financial needs of their customers.

However, the functions of Shari'ah board is seen from various levels which include international, macro and micro levels. The Shari'ah Boards of AAOIFI, IDB and International *Fiqh* Academy (IFA) play their roles internationally. The roles include, among other things, developing Shari'ah approved instrument, issuing and reviewing of governance standards to ensure Shari'ah compliance. In addition, these bodies are also involved in encouraging and providing harmonization and standardization of *fatwas*, practices and applications amongst the Shari'ah boards of various IFIs to eradicate or mitigate any element of inconsistency in *fatwa* issuance and application. However, the functions of these boards are mainly advisory to the IFIs. From the level of central bank or macro level, there exist such Shari'ah boards. For example. Malaysia Indonesia, Brunei, Pakistan, Sudan and Nigeria have all established Shari'ah board at their central bank levels (Hassan, 2011, CBN, 2011). Their main roles are to establish Shari'ah governance framework, standardize and harmonize *fatwas* as well as assume the role of highest authority for NIFIs. Finally, the Shari'ah boards at the institutional or micro level are charged with duty of advising and monitoring the activities of the concerned institutions with sole aim of making them Shari'ah compliant. In the nutshell, their activities can be seen in three main functions namely issuing *fatwas* through collective *ijtihad* (independent judgment of Shari'ah scholars), supervising the activities of the institutions (*raqabah*) as well as reviewing the operations (*mutaba'ah*) (Hasan, 2011). In view of the above, it is discernible that the Shari'ah Advisory Board function involves guiding and supervising the Shari'ah related issues of IFIs through providing the needed oversight on Shari'ah related matters as well as making efforts to adequately attend to all issues of concern by getting full support from internal and external Shari'ah Audit personnel.

a) Qualifications and Composition of the Shari'ah Supervisory Board Members

The members of this Board must be individuals. In other words, a company, institution or a body should not be considered as a member. They are required to obtain academic qualifications or be knowledgeable and expert in the sciences of Shari'ah specifically in the field of Islamic commercial jurisprudence (Lahasasna, 2011) In addition, the proposed members are required to be experienced and exposed in the areas of Science of Islamic Jurisprudence or *Usul al-Fiqh*. They should equally be able to read, write and speak in both Arabic and English languages. Alaro (2009) maintained that, a member of SSB should attain the qualification of full *Mujtahid*. It is also part of his requirements to be trained by an experienced supervisor. As part of the ethical qualifications, the member of the SSB should possess the qualities of trustworthiness, integrity and justice (Hassan et, al. 2010).

Varying opinions exist as regards to the composition of SSB, The AAOIFI Governance standard (1) required that SSB should be at a minimum consist of three members with one of them as a chairman. Unlike AAOIF, the Shari'ah Governance in Indonesia required that SSB should not be less than two members and not more than half of the entire number of members of the Board of directors (BOD) of the IFIs. (Hasan, 2011). More so, Ayub (2007) stated that there must be at least one Shari'ah scholar to advise the NIFI in so that Shari'ah contravention can be averted in its operations. However, nowadays, many jurisdictions including Malaysia, Bahrain as well as united Arab Emirate (UAE) are adopting AAOIFI model. Besides, the services of consultants such as economists, accountants, business managers, Bankers, lawyers, Consumers etc may be engaged so as to assist in making the products and services of IFIs Shari'ah compliant (Bakkar, 2002). Nevertheless, the consultants cannot enjoy voting rights or take part in issuing a *fatwa* or verdict by the SSB.

b) Guiding Principles and Rules Governing SSB

The Shari'ah governance can be well practiced if the principles of Independence, Competency, Confidentiality, Consistency as well as Disclosure and Transparency must be observed (IFSB 2009; CBN, 2011 and Karim and Hamid, 2015). These principles are meant to regulate and govern the relationship between the SSB and the IFIs. These principles are explained as follows:

c) Independence of the SSB Members

This concept of Independence has been defined by AAOIFI Governance standard no. 5 as “an attitude of mind which does not allow the viewpoints and conclusions of its possessor to become reliant on or subordinate to the influences and pressures of conflicting interests. It is achieved through organizational status and objectivity”.

This principle suggests that the management or board of the IFIs should not in any way influence the Shari'ah decision of SSB. In other words, SSB shall be left alone to perform its duties and exercise independent judgment to genuinely serve the interest of the institutions. The NIFI's management is therefore required to give the SSB comprehensive, correct, sufficient and timely information so that it can fulfill its assigned responsibilities. This principle also requires that the SSB should be given unrestricted access to the internal Shari'ah review unit of Islamic Financial institution to crosscheck whether compliance and internal control have been achieved properly. (Ishaq, 2015).

d) Competence of the SSB Members

Competence can be said to be the quality or state of being able or suitable for a general role or function. This implies that the Members of the SSB are

supposed to be competent in order to discharge their duties effectively. It is required that the SSB should understand the technical requirements of the business. They should also understand the risks peculiar to the business as well as take into cognizance the interest of all stakeholders in carrying out their activities. On the other hand, the IFIs are shouldered with the responsibilities of enhancing the professional development of SSB members as well as the institution's internal Shari'ah auditor. Furthermore, The NIFI should put measures through which they can conduct formal assessment of the effectiveness and the contribution of each SSB member. Gap should also be identified in order to create a room for the SSB members' training, (CBN, 2011).

e) Confidentiality of SSB Decisions

This principle requires the SSB members to always keep confidential any information they are able to generate internally in the process of fulfilling their duties. However, the SSB reserves the right to report the information in good faith to the SSB at national level for corrective actions in case of violation of any Shari'ah principles by the institutions or their board of directors.

f) Consistency of SSB Decisions

The consistency principle should be maintained. The principle suggests that the IFIs should ensure that the process of revising, modifying and substituting any Shari'ah rulings by the SSB be specified. In case of any substitute or amendment made by SSB on Shari'ah pronouncements, all the stakeholders and / or the public should be duly informed in good time. (CBN, 2011). The IFIs are responsible for ensuring that the consistency and quality in Shari'ah decision making of SSB as well as proper documentation and disclosure of these decisions are maintained.

g) Disclosure and Transparency

The Quran has adequately taken care of the importance of disclosure and transparency in relation to the practice of Islamic finance where Allah, The Almighty says *"if ye are on a journey, and cannot find a scribe, a pledge with another, let the trustee (faithfully) discharge his trust and let him fear his lord. Conceal not evidence for whoever conceals it, his heart is tainted with sin and Allah is knoweth all that ye do"* (Quran, 2:283). In addition, IFSB (2006) emphasized that all Non-Interest financial institutions' operations must comply with the Shari'ah and be consistent with international accounting codes as well. Grais and Pelligrini (2006) as cited by Hasan (2011) have identified the weakness of the current practice of information disclosure particularly, the Shari'ah report, as the big challenge being faced by Islamic financial

institutions. To worsen the situation, some Non-interest financial institutions do neglect the pertinent nature of the Shari'ah report even though it is considered to be a validation of their Shari'ah compliance. (Hasan, 2011).

h) Shari'ah Compliance Report of the SSB Members

The Provision of Shari'ah compliance report by SSB is very crucial. In Quran chapter 2, verse 282 generally emphasizes the importance of recording all business transactions carried out by the individuals or organizations. However, when applied to the Shari'ah governance, the verse provides that a Shari'ah compliance report must be issued by the SSB on either periodic or annual basis (Hasan, 2011). This report must be produced to the BOD of their respective Financial Institutions relating to their activities, Shari'ah pronouncement and declaration of Shari'ah compliance. (Hasan, 2011). This is necessary for them to create, build and conserve the trust and confidence of public and shareholders alike on the entire transactions of the NIFI under their supervision.

3.3.2. Shari'ah Review

AAOIFI has defined Shari'ah Review as scrutiny of the extent of Shari'ah compliance of relating to all practices of Islamic financial institutions. The Shari'ah governance Guidelines for non- interest financial institutions in Nigeria (2011), issued by Central Bank of Nigeria, stated that all IFIs are required to establish an independent internal unit in charge of Shari'ah review. This can be a separate department or part of the internal audit division of the institution which will operate within the purview of the policies of the institutions. The department will consist of qualified and experienced officers in the Islamic and conventional finance. This unit should be referred to for all matters concerning Shari'ah compliance. It works hand in hand with the SSB in the sense that it will assess the level of compliance with the Shari'ah rules, guidelines as well as the *fatwas* issued by the SSB. In addition, it may be taken as the secretariat to the SSB. (Lahsasna, 2010).

The management as well as the board of directors of the institutions are obliged to give the unit, the required support for proper operations. This is by allowing full access to all documents, reports and other materials that may be needed in the course of carrying out their duties. The reviewers should always plan their review assignment taking into consideration some related points such as obtaining all the vital information related to the activities of the review including locations, branches, division, products and services as well as outline the objectives as well as the scope of their work. It is also pertinent to the officers of this unit to obtain the guidelines, instructions of the SSB as well as prior internal and external Shari'ah reviews.

Identification of the necessary resources and keeping in touch with all the stakeholders of IFIs that need to know about the workings of internal Shari'ah review is also crucial. Documentation of review programs and determination on how and when the results of the review would be out shall be communicated. And finally, the work plan of the reviewers should be approved by the concerned authorities including the SSB of that institution.

3.3.3. Shari'ah Audit

Shari'ah Governance framework (SGF-BNM 2010) issued by Bank Negara Malaysia has defined Shari'ah audit as an assessment conducted periodically aimed at adding value and improving the degree of compliance of the business operations of given IFI. This is in order to achieve sound and effective internal control system for Shari'ah compliance. This function is carried out by either internal or external auditor (s) who possess adequate Shari'ah knowledge, expertise or experience. They auditors here may request the help of Shari'ah officers in discharging their function. Shari'ah audit function should at least be conducted yearly taking into consideration the IFI's risk profile. (Algabry et al, 2020).

The Shari'ah audit scope shall be comprehensive enough to cover the entire business operations consisting of financial statements' audit and compliance audit on the structure, people, process and information technology application systems of the organization; and review of the Shari'ah governance process adequacy. The auditors are asked to always get and refer to related sources which include the rulings and *fatwas* issued by SSB, guidelines, results of Shari'ah audit already conducted and the Shari'ah checklist prepared internally by the institution so as to make their duty effective. After performing their duty, they are obliged to communicate their findings to the Board Audit Committee as well as the Shari'ah Committee. They are also required to propose rectification measures where they detected Shari'ah non-compliance and monitor their implementation by the given NIFI as well.

3.3.4. Shari'ah Risk Management

Shari'ah risk management can be seen as a function that focuses on a systematic identification, measurement, monitoring and controlling of Shari'ah non-compliance risks aimed at mitigation of any possible occurrence of non-compliance events (SGF-BNM, 2010). This function shall be part and parcel of the integrated risk management framework of NIFIs. Taking into cognizance the technicalities and complexities involved in managing the Shari'ah noncompliance risk, the function shall be undertaken by duly qualified and/or

experienced officers in risk management. In line with the standard practice, the officers are expected to identify, measure, control as well as monitor Shari'ah non-compliance risks that occur in the operations where NIFIs are paying more attention especially to the existing effective controls' measures and the possible impact of such risks to the NIFIs. This usually leads to non-recognition of income earned because of of the transactions that do not comply with the Shari'ah.

As part of this function, the officers shall formulate and recommend appropriate Shari'ah non-compliance risk management policies and guidelines and develop and implement processes for Shari'ah non-compliance awareness as well. At the end of the day, the officers are expected to submit report to the board risk management committee. Syazwani el, all (2018).

3.3.5 Shari'ah Research

Shari'ah research means an act of carrying out rigorous research and studies on Shari'ah issues which include issuing Shari'ah advice and guidance on daily bases to the officers concerned including the institution's product developers. As it applies to all other functions, this work shall be discharged by qualified and competent Shari'ah officers.

However, to achieve this function professionals such as accountants, lawyers among others related aspects may form part of the presentation to the Shari'ah supervisory committee. For instance, a deep research may be required to look into new products and business developments. The officers under this unit and that of secretariat shall ensure that proper deliberation and dissemination of Shari'ah related matters took place

4. Conclusion and Recommendations

Shari'ah governance system or framework, as we have seen, is the comprehensive process through which Islamic financial principles are observed by IFIs and hence making their products and services. This paper has attempted to trace the history of Shari'ah governance system by examining and explaining the requirements of every robust, sound and effective Shari'ah governance framework. Every financial institution that fails to put in place those requirements on ground; they expose themselves to the risk of non-Shari'ah compliance which will have its attendant negative effective on its business operations. Consequently, this paper finds out that an effective and sound Shari'ah governance framework plays great role in making the financial institutions' products and services Shari'ah compliant. The Islamic financial institutions are, therefore, as matter of necessity urged to put in place an

effective, sound and robust Shari'ah governance system in order to make their transactions conform to *Shari'ah* tenets and win public trust and confidence as well.

Reference

- AAOIFI. (2005). *Governance Standard for IFIs, No. 1 Shari'ah Supervisory Board (SSB): Appointment, Composition and Report*. Bahrain: AAOIFI.
- AAOIFI. (2005a). *Governance Standard for IFIs, No. 2, Shari'ah Review*. Bahrain: AAOIFI.
- AAOIFI. (2005b). *Governance Standard for IFIs, No. 3, Internal Shari'ah Review*. Bahrain: AAOIFI.
- AAOIFI. (2005c). *Governance Standard for IFIs, No. 4, Audit and Governance for Islamic Financial Institutions*. Bahrain: AAOIFI.
- AAOIFI. (2005d). *Governance Standard for IFIs, No. 5, Independence of Shari'ah Supervisory Board*. Bahrain: AAOIFI.
- Ahmad, J.S. (2010). Corporate Governance in Islamic Banks. Hawkamah, the Institute for Corporate Governance. DIFC, the Gate Level 14
- Ahmed, M. and Khatun, M. (2013). The Compliance with Shari'ah Governance System of AAOIFI: A Study on Islamic Banks Bangladesh. *The Journal of Islamic Economics, Banking and Finance*, Vol. (9) No.1783 July - Sep 2013.
- Alaro, A.A. (2009). Shari'ah Supervision as a Challenge for Islamic Banking in Nigeria in: Oloyede I.O. (ed.), *Al-Adl (The Just): Essays on Islam, Islamic Law and Jurisprudence*, Ibadan, Nigeria, 2009, pp. 53-72.
- Alam, M. K., et-all, (2019). Sharaih Governance Framework of Isalamic Banks in Bangladesh, Practices, Problems and Recommendations. *Asian Economics and Financial Review*, 2019, 9 (1): 118-132.
- Algabry et all, (2020) Conceptual Framework of Internal Shari'ah Audit Effectiveness Factors in Islamic Banks. *ISRA International Journal of Islamic Finance*, Volume 12 Issue 2.
- Al-Shammari, B. (2005). Compliance with International Accounting Standards by listed companies in Gulf Cooperation Council Member States: An empirical Study. A Thesis presented to UWA Business School, University of Western Australia for the award of Doctor of Philosophy, Accounting.
- Asri, M. and Fahmi, M. (2014). Contribution of Islamic Worldview to the Corporate Governance. International Islamic University Malaysia (IIUM) M.Sc. Accounting Semester 2
- Ayub, M. (2007). *Understanding Islamic Finance*. John Wiley & Sons Ltd. The Atrium, Southern Gate, Chichester, West Sussex PO19 8SQ, England

- Bakkar, M. P. (2002). International Shari'ah Supervisory Board. Bakkar Advocates & Legal Consultants, Beirut.
- Banaga, A., Ray, G. and Tomkins, C. (1994). "External Audit and Corporate Governance in Islamic Banks: A Joint Practitioner-Academic Research Study. Aldershot: Avebury.
- Bank and Other Financial Institutions Decree (BOFIA) 1991
- Barde, I.M, (2010). An Evaluation of Accounting Information Disclosure in the Nigerian oil Marketing Industry. A Thesis submitted to the Department of Accounting, Bayero University Kano, for the award of Doctor of Philosophy, Accounting.
- Boyatis, R.E. (1998). Transforming Qualitative information: Thematic Analysis and Code Development.
- CBN (2007). Central Bank of Nigeria Act. The Federal Government printer, Lagos Nigeria FGP 95/62007/1,000(OL58).
- CBN (2011a). Framework for the Regulation and Supervision of Institutions offering Non-interest Financial Services in Nigeria. FPR/DIR/CIR/GEN/01/010
- CBN (2011b). Guidelines in Non-interest Window and Branch Operations of Conventional Banks and Other Financial Institutions" Financial Policy and Regulation Department Central Bank of Nigeria, Abuja, December 13, 2010. As amended in June 2011
- CBN (2015a). Guidelines on the Governance of Advisory Committees of Experts for Noninterest (Islamic) Financial Institutions in Nigeria (ACE). Central Bank of Nigeria.
- CBN (2015b). Guidelines on the Governance of Financial Regulation Advisory Council of Experts for Non- interest (Islamic) Financial Institutions in Nigeria (FRACE). Central Bank of Nigeria.
- CBN (2011) c. Guidelines on Shari'ah Governance for Non-interest Financial Institutions in Nigeria" Financial Policy and Regulation Department Central Bank of Nigeria, Abuja, December 13, 2010. As amended in June 2011.
- Chik, M.N. (2012). Shari'ah Governance. *Islamic Finance News, the word leading Islamic Finance News Provider.*
- COMCEC (2020) *Standing Committee for Economic and Commercial Cooperation of the organization of Islamic Cooperation. Proceedings of the 14th Meeting of the Concec financial Cooperation Working Group on Improving Shari'ah Governance Framework (SGF) in Islamic Finance. September 15th 2020, Virtual Meeting.*

- DeLorenzo, Y. T. (nd). Shari'ah Supervision in Modern Islamic Finance.
- Dogarawa, A. B. (2012). *Historical Development of Islamic Banking and the Nigerian Experience*. In S. A. Karwai, A. G. Habib and B. T. Jibril (eds), *Islamic Economics: A Book of Readings*. Dee Young Printing Press, Kaduna. International Institute of Islamic Thought Nigeria Office (IIIT). Pp.122-134
- Gulf African Bank (2010). *The Role of the Shari'ah Supervisory Boards and Shari'ah Coordinators*. The 2nd East and Central African Islamic Finance Conference; 3rd - 4th May 2010
- Haqqi, A.R.A. (2014). *Shari'ah Governance in Islamic Financial Institutions: An Appraisal*. 114 *Us –China law review* Vol. 11: 112. Pp. 112-133
- Hasan, Z. *Regulatory Framework of Shari'ah Governance System in Malaysia, GCC Countries and the UK*. *Kyoto Bulletin of Islamic Area Studies*, 3-2 (March 2010), pp. 82–115
- Hassan, R., Ibrahim, U., Abdullahi, N.I., Abd Aziz, A. and Sawari, M.F. (2010). *Analyses of the Role and Competency of the Shari'ah Committees (SCs) of the Islamic Banks and Financial service providers*. Research paper (no. 18/2010) International Shari'ah Research Academy for Islamic Finance (ISRA).
- Hassan, R., Ariffin, M., Othman, A. A., Napiyah, M. D. M., Omar, M. N., Yusoff, A., Khatimin, N. and Zaharim, A. (2011). *Survey on the Implementation of Internal Shari'ah Compliance Function in Malaysian Islamic Banks and Takaful Companies*. *Recent Advances Management, Marketing and Finances*. Pp. 101-107
- Idris, M. and Lawal, R. (2013). *Evolution of Islamic Banking System*. In S.U.R. Aliyu, N.A. Ahmad, B. Tijjani and M. Kamba (eds), *Readings in Islamic Banking and Finance*. Benchmark Publishers Limited. International Institute of Islamic Banking and Finance. BUK Pp. 49-59
- IFSB. (2005). *Guiding Principles of Risk Management for Institutions (other than Insurance) Offering only Islamic Financial Services* Kuala Lumpur: IFSB.
- IFSB. (2006). *Guiding Principles on Corporate Governance for Institutions Offering only Islamic Financial Services (excluding Islamic insurance (Takaful) institutions and Islamic mutual funds*. Kuala Lumpur: IFSB.
- IFSB (2009). *Guiding Principles on Shari'ah Governance Systems for Institutions offering Islamic Financial Services*. Kuala Lumpur: IFSB.

- Ishola, M. H. and Said, A. M. (2012). Resource Allocation in Islam: The Role and Limitation of Markets. In S. A. Karwai, A. G. Habib and B. T. Jibril (eds), *Islamic Economics: A Book of Readings*. Dee Young Printing Press, Kaduna. International Institute of Islamic Thought Nigeria Office (IIIT). Pp.49-62
- Jaiz Bank Nigeria Plc (2013). Annual report and Accounts.
- Jaiz Bank Nigeria Plc (2012). Advisory Committee of Experts (ACE) Report on Shari'ah. Compliance
- Jaiz Bank Nigeria Plc (2013). Advisory Committee of Experts (ACE) Report on Shari'ah. Compliance
- Jaiz Bank Plc (2014). Shari'ah Audit Report, April 2014.
- Kantudu, A. S. (2006): An analysis of the impact of pension reform Act in Nigeria. PhD Thesis. Department of Accounting, Ahmadu Bello University Zaria, Nigeria.
- Karim, G. and Hamid, A. (2015). "Foundations of Shari'ah Governance of Islamic Bank. Wiley.
- Kasim, N. Nuhtay, S.N. and Salman, S.A. (2013). Comparative Analysis on AAOIFI, IFSB and BNM Shari'ah Governance Guidelines. *The International Journal of Business and Social Science*. Vol.(4) no.15 special issue- November 2013
- Krippendorff, K. (1980). Content Analysis: An Introduction to its Methodology. SAGE Publications, International Education and Professional Publisher, thousand Oaks London New Delhi. Second Edition.
- Kayadibi, S. and Guclu, F. (2021). Shari'ah Governance for Islamic Financial Institutions in the context of Malaysia. In S. Karabulut (Ed.), *Theoretical and Empirical Perspective on Economic and financial issues* (pp629-649). Geza Kitabevi.
- Lahsasna, A. (2010). Fatwa, Shari'ah Supervision and Governance in Islamic Finance. CERT Publications Sdn. Bhd. 277, Jalan Bandar Metro Melawati 53100 Kuala Lumpur, Malaysia. Second print, February, 2011
- Lawal, R. (2014) "Corporate Financial Reporting in the Nigerian Banking Industry: Comparative Study of Islamic and Conventional Banks" Being a Dissertation Submitted to the International Institute of Islamic Banking and finance, Bayero University, Kano- Nigeria, In Partial Fulfillment of the Requirements for the Award of Master of Science (M.Sc.) in Islamic Banking and Finance

- Mamman, S. (2006). Accounting for Leasing in Nigeria. Being a PhD Thesis summated to the Department of Accounting, Ahmadu Bello University Zaria, Nigeria for the award of Doctor of Philosophy in Accounting
- Musa, M. and Fagge, (2012). The Economic System of Islam. In S. A. Karwai, A. G. Habib and B. T. Jibril (eds), Islamic Economics: A Book of Readings. Dee Young Printing Press, Kaduna. International Institute of Islamic Thought Nigeria Office (IIIT). Pp.16-30
- Orisankoko, A.S. (2010). The Propagation of Non-Interest Banking in Nigeria: An Appraisal of the Ideological Risk. *Journal of Islamic Economics, Banking and Finance*. Vol-7 No-2 Apr-June 2011. Pp. 72-84
- Ramli, N.M., A.S. Abdul Majid, N.A. Muhamed and N. A. Yaakub, (2014). The Shari'ah Governance Disclosure Index and Institutional Ownership of Islamic Financial Institutions in Malaysia. *Proceedings of 5th Asia-Pacific Business Research Conference* 17-18 February, 2014 Kuala Lumpur, Malaysia. Pp. 1-14
- Rammal, H. and Perker, L. (2010). Audit and Governance in Islamic Banks: Selection and Training of Shari'ah Board Research: A review article. *British Accounting Review*. 23: 195-210.
- Sadiq, N. (2012). An Assessment of the Level of Compliance with Statement of Accounting Standard 4 in Nigeria Cement Industry: The Case Study of Ashaka Cement PLC." A Research Project Submitted to the Department of Accounting, Bayero University, Kano in partial fulfillment of the requirements for the award of Bachelor of Science Degree in Accounting.
- Shaukat, M. (2009). General Perception of *Fatwa* and its Role in Islamic Finance. INCEIF the Global University in Islamic Finance Kuala Lumpur, Malaysia under its MIF/PhD Program '*Fatwa, Islamic Jurisprudence and Legal Maxims* CODE: FQ 6113/5113'
- Suleman, N.S. (2011). "Shari'ah Audit Issues and Considerations" *IFN 2011 Issuers and Investors Asia Forum*, October, 2011.
- Syazwani el, all (2018). Shari'ah Risk: Its Origion, Definition, and Application in Islamic Finance. SAGE Journals.
- Wardhany,N, and Arshad, S. (2012), Role of Shari'ah Board in Islamic Corporate Banks: A Case Study of Malaysia, Indonesia and Brunei Darussalam. *Second ISRA Colloquium with a title 'Islamic Finance in a Challenging Economy: Moving forward'* conducted at Sasana Kilang, Bank Negara Malaysia, 27th November, 2012.

Zaidi, J.A. (nd). Shari'ah Harmonization, Regulation and Supervision. *AAOIFI-World Bank Islamic Banking and Finance Conference* 10-11 November, Manama, Bahrain.