

**SHARIAH GOVERNANCE DISCLOSURE
BY ISLAMIC BANKS IN MALAYSIA**

By

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ABSTRACT

Shariah governance is the utmost important division of Islamic banks to differentiate with its conventional counterpart. Although Islamic banks had been in the Malaysian banking industry for more than three decades, it is still at the stage towards comprehensive and proper framework. Besides, Islamic banks have the responsibility to ensure Shariah compliance in its overall operation. Non-compliance element will damage the confidence of the stakeholders and the perception on the purity of Islamic banking system. Thus, this study intends to scrutinize the scope of latest regulations on Shariah governance in Islamic banks, then comparing it with the international standard and to analyze its practice in compliance with the stipulated guidelines. These purposes are achieved by using qualitative method of research by applying doctrinal and legal research where the latest annual report and few regulations are referred. Besides, the descriptive and comparative study was also adopted for deep understanding. All data was taken from the Islamic banks listed under BNM and analysed it using content analysis. The practice of Shariah governance was examined by using Shariah governance disclosure ratio on the items in the SC report based on referred regulations. This study found that Malaysian regulations on Shariah governance of Islamic banking are more comprehensive rather than the international standard. However, only few Islamic banks comply with the guidelines, whilst the transition period for the compliance is almost end. Thus, it is recommended for the authorities to ensure Shariah governance disclosure been fully complied by the related Islamic banks. As the result, a proper and comprehensive Shariah governance in Islamic banks in Malaysia could be achieved.

Keywords: Malaysia, Islamic banking, Shariah governance

ABSTRAK

Tadbir urus Shariah adalah komponen yang paling utama dalam sesebuah bank Islam untuk membezakannya dengan bank konvensional. Walaupun bank Islam telah beroperasi dalam industri perbankan di Malaysia lebih dari tiga dekad, ianya masih menuju ke arah kerangka yang komprehensif. Tambahan pula, bank Islam mempunyai tanggungjawab untuk memastikan pematuhan Shariah dalam setiap operasi yang terlibat. Elemen ketidak patuhan Shariah akan mengurangkan keyakinan pihak-pihak berkepentingan dan juga persepsi terhadap kesucian sistem perbankan Islam. Oleh yang demikian, kajian ini berhasrat untuk meneliti skop undang-undang berkaitan dengan pematuhan Shariah dalam bank Islam, kemudian membandingkannya dengan standard antarabangsa dan meneliti praktis bank Islam dalam pematuhan kepada undang-undang. Ianya akan dicapai dengan menggunakan penyelidikan kualitatif dengan menggunakan penyelidikan doktrinal dan undang-undang, berdasarkan laporan tahunan terbaru dan beberapa undang-undang berkaitan. Selain itu, penyelidikan deskriptif dan perbandingan juga digunakan untuk pemahaman yang lebih mendalam. Kesemua data diambil daripada bank-bank Islam yang tersenarai di bawah BNM dan analisa menggunakan analisis kandungan. Praktis pematuhan Shariah dinilai menggunakan nisbah pendedahan tadbir-urus Shariah berdasarkan perkara-perkara di dalam laporan Jawatankuasa Shariah. Hasil kajian telah menunjukkan bahawa undang-undang Malaysia lebih komprehensif dan terperinci berbanding standard antarabangsa. Walau bagaimanapun, hanya beberapa bank Islam yang mematuhi garis panduan yang telah ditetapkan walaupun tempoh peralihan untuk pematuhan semakin tamat. Oleh itu, adalah disyorkan kepada pihak berwajib untuk memastikan pendedahan kepada pematuhan Shariah oleh bank Islam dipatuhi sepenuhnya. Hasilnya, pematuhan Shariah yang komprehensif dalam bank Islam dapat dicapai.

Katakunci: Malaysia, Bank Islam, Tadbir-urus Shariah

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LIST OF ABBREVIATION

AAOIFI	Accounting and Auditing of Islamic Financial Institutions
BNM	Bank Negara Malaysia
CBA 2009	Central Bank Act of Malaysia 2009
CPIFR	Core Principles for Islamic Finance Regulation
DFIA 2002	Development Financial Institutions Act 2002
FSA 2013	Financial Services Act 2013
FSAP	Financial Sector Assessment Program Malaysia
FSMP	Financial Sector Master Plan
GP1-i 2013	Guidelines on Corporate Governance for Licensed Islamic Banks 2013
GP8-i 2012	Guidelines on Financial Reporting for Islamic Banking Institutions 2012
IFIs	Islamic Financial Institutions
IFSA 2013	Islamic Financial Services Act 2013
IFSB	Islamic Financial Services Board
OECD	Organisation for Economic Co-operation and Development
pbuh	Peace Be Upon Him
SC	Shariah Committee
SCA 1993	Securities Commission Act 1993
SGF 2011	Shariah Governance Framework 2011
SSB	Shariah Supervisory Board

CHAPTER ONE

INTRODUCTION

1.1 Background of Study

Ironically, the exclusivity of the divine values of Islamic finance based on the Quran and Hadith being the basis of the system has significantly risen the emergence of Islamic banking and finance. Consequently, the business and economics development of Islamic finance has become the new trend in the finance and banking industry (Wardhany & Arshad, 2012). Basically, the Shariah principles are the substance of Islamic banking operations. By that fact, the comprehensive system in compliance with Shariah principles distinguishes Islamic banking from the conventional banking (Shaharuddin, 2011). Agreeably, Shariah compliance is the original foundation in having a banking system that fulfills the religious requirements for Muslims, from Islamic point of view (Elias, 2014). In order to avoid Shariah non-compliance risk, a sound and robust Shariah governance framework is crucial with the excellent enforcement of laws.

According to Hasan (2010), for the purpose of Shariah compliance, the theoretical substance of Shariah governance needs an additional layer of governance in Islamic banks. The internal Shariah governance of Islamic banking institutions should be supported by their external counterparts to ensure that all involved parties do their duties as stipulated in Islamic law requirements. At this point, the regulations and its

enforcement play a vital roles being the external checks upon the processes of compliance to Shariah principles. Consequently, it is understandable that, in the Islamic banking sectors, the Shariah principles are the final arbitrator for compliance being recognized as an Islamic bank (Radzi & Muhamed, 2012).

In addition, Shariah governance had been admittedly significant in the international standard since the prominent standard setting organisation which is the Accounting and Auditing of Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB) has specific part envisages on Shariah governance. In AAOIFI, there is the Governance Standard for Islamic Financial Institutions No. 1 on Shariah Supervisory Board: Appointment, Composition and Report that was classified as governance standard. Meanwhile, IFSB has its IFSB-10 on Guiding Principles on Shariah Governance Systems for Institutions offering Islamic Financial Services, published on December 2009. These two are the only international standards that particularly states on the Shariah governance in the Islamic Financial Institutions (IFIs).

Shariah governance being the ultimate significance in the Islamic bank and due to that, it is one of essential ground of differentiation between the conventional and Islamic bank. Initially, the Shariah governance role in Islamic banks is to make sure that all the products and services are in accordance with Shariah principles and the business done by the Islamic banks is Shariah compliance. Besides, the responsible board or committee related to Shariah governance also needs to promote justice and disclosure or

transparency in the financial transactions of the banks to sustain the confidence of the stakeholders and also to develop the risk management tools on Shariah risk for Islamic banks (Lahsasna & Saba, 2014). Hence, it can be seen that Shariah governance plays a very comprehensive role for the Islamic banks.

The structure of Shariah governance may be seen in the annual report of every Islamic bank. However, looking at every Islamic bank's annual report randomly, there are different structure and style of Shariah governance in diverse legal environments upon various banking system globally. Thus, it is worth to scrutinize the regulatory framework of the Shariah governance system, particularly in Malaysia as the regulators have established our own Shariah governance framework and system in order to monitor the Shariah governance structures, process and arrangements of the local Islamic banks (Shaharuddin, 2011). Besides, the disclosure items also differ for each bank due to the awareness by the management of the Islamic banks and the demand by the regulations upon the compliance with the Shariah principles.

1.2 Problem Statement

Ideally, Islamic banks have provided a practical prospect to its stakeholders and investors who have tendency with the exclusive Islamic banking system of the religious and philosophical stance. The Shariah governance had been accepted as the essence of comprehensive regulatory and supervisory infrastructure within the Islamic banking and finance system (Hassan et. al., 2013). Furthermore, the establishment of a proper Shariah

governance framework is upon demand (Hasan, 2007) since Islamic banking system become internationally acknowledged and it is assumed to grow significantly with the steep growth in Islamic banking system (Akhtar, 2006).

In addition, Shariah governance is undeniably an important component that is peculiarly exclusive to Islamic banks only. Contrary to the conventional banking institutions, Islamic banking has the responsibility to ensure the compliance with the Shariah principles in all its operations, products, management, instruments, practices and those that need the attention from the view of Islamic law, either comply with Shariah or not (Hasan, 2007). Therefore, there are few stipulated regulatory frameworks that emphasizes on the criteria of Shariah compliance of the Islamic banks.

The most stands out international standard is the IFSB, where Principle 3.1 of the IFSB Guiding Principles on Corporate Governance, it states that, ‘an appropriate mechanism must be created to ensure the compliance with the Shariah principles’. Similarly under Principle 7.1 of the IFSB Guiding Principles on Risk Management states that ‘IFIs shall have in place adequate systems and controls, including Shariah Board/Advisor to ensure compliance with the Shariah rules and principles’. Both stated principles shows that a mechanism or a system of control must be enforce in order to ensure the compliance with Shariah principles.

Respectively, the Malaysian regulations also give attention on Shariah compliance for Islamic banking institutions. The BNM has listed the applicable law and guidelines that made compulsory for each banks in Malaysia to adhere. Noticeably, the principal regulatory objective of the recognizable Islamic Financial Services Act (IFSA) 2013 is having end-to-end Shariah compliance by IFIs. Particularly, in Division 1 of Part IV of IFSA 2013, it specifies on Shariah compliance. Where section 28 of IFSA 2013 states on duty of institution to ensure compliance with Shariah rules and principles, section 29 states on power of BNM to specify standards on Shariah matters. The other regulations applicable for Islamic banks are the Shariah Governance Framework (SGF) 2011 and specifically the Guidelines on Corporate Governance for Licensed Islamic Banks (GP1-i) 2013 and the Guidelines on Financial Reporting for Islamic Banking Institutions (GP8-i) 2012 for the purpose of this study.

In addition, according to Hasan (2007), Shariah compliance is the backbone of Islamic banking and finance sector, as it increases the confidence of the shareholders and the public if all the practices of the banks are in compliance with the Shariah principles from the beginning until the end. Grassa (2013) contended that, with various implementation of Shariah governance in Islamic banking institutions all over the world, a higher standard of Shariah governance are definitely needed. The reason is that, the non-Shariah compliant component existed would not just affect the confidence of the stakeholders and the public towards the perception on Islamic banking system, but also exposing Islamic banks to risks of the banking system. For example, the fiduciary risk, reputational risks and most importantly, Shariah-compliance risks. Thus, the evaluation of Shariah

governance is important as it is not only demanded by the customers, but also other stakeholders, including institutional investors and Muslim society who are directly and indirectly involve with the institutions.

Fortunately, one of the effective methods in evaluating the Shariah governance compliance by Islamic banks is based on the disclose items in the annual reports of the respective Islamic banks (Ramli, Majid, Muhamed & Yaakub, 2014). Besides, the disclosures in annual reports shows that the institution having effort to secure the level of confidence and trust of its stakeholders (Sulaiman, Majid & Ariffin, 2011). Consequently, compliance with Shariah principles will be achieved by having a proper Shariah governance framework that the summary of it founded in that particular Islamic bank's annual report (Hasan, 2007).

Therefore, by conducting this study, the implementation of Shariah principles in the Shariah governance by the Islamic banks in compliance with the related Shariah regulatory frameworks for Islamic banks will be able to be recognised. The comparison with the international requirements could also be seen upon comparing with the local regulations given by the BNM. By that, the practice of the Malaysian Islamic banks would be evaluated based on the relevant regulations. Hence, the suggestions and recommendations will be able to be deliberated in rectifying Islamic banks that does not comply with the requirements of the laws. Significantly, the trust and confidence from

the stakeholders especially among Muslims could be regained along with the respect that the Islamic banks should achieve.

1.3 Research Questions

Based on the previous problem statement, this research comes out with three research questions:

- i. To what extent the disclosure of Shariah governance of Islamic banking institutions in Malaysia is required by the existing legislations?
- ii. Whether the Malaysian legislations on Shariah governance disclosure are more comprehensive compared to the legislations issued by the international bodies for Islamic banking and finance?
- iii. To what extent the Islamic banking in Malaysia comply with the requirement of the law pertaining to Shariah disclosure?

1.4 Research Objectives

By research questions, this study aims at achieving the following specific objectives:

- i. To scrutinize the scope of Shariah governance disclosure of Islamic banking institutions in Malaysia as required by the existing legislations.

- ii. To compare the Malaysian legislations on Shariah governance disclosure with the legislations issued by the international bodies for Islamic banking and finance.
- iii. To analyse the practice of Islamic banks in Malaysia on the compliance with the requirement of the law on the Shariah governance disclosure.

1.5 Significance of Study

This study particularly focuses on the extent of Shariah governance disclosure in Islamic banks in Malaysia based on the latest annual report released by the banks annually. There are scarce of literature that study the Shariah governance disclosure based on annual report. Therefore, it is needed as there are still loopholes with regard to the compliance with Shariah requirements on Shariah governance by Islamic banks in Malaysia.

Furthermore, this study will be a very useful information for relevant stakeholders of Islamic banks such as the regulatory authorities, the financial institutions as well as Islamic finance players with regard to the appropriate Shariah governance framework and its practices. It is a great interest for the stakeholders due to lack researches and analyses on the compliance of Shariah governance specifically on regulatory framework of Islamic banking in Malaysia, which is IFSA 2013.

Moreover, this study will have a great impact towards regulators, legal practitioners, bankers, students and public in general, especially among Muslims, in enhancing their knowledge and in realizing the reality on the compliance with the regulatory framework of Shariah governance based on the disclosure of the selected Islamic banks annual reports. Thus, it is crucial for regulators to know the feedback of the public upon the released regulations in order to improve for better regulations in the future.

1.6 Scope of the Study

This study is intended to focus on the Shariah Governance disclosure in Islamic banks in Malaysia as the governance framework is the vital component of every bank. Apparently, only the legal framework guiding Islamic banks in Malaysia will be highlighted since compliance to the regulation would render a bank to be legally operates. This will be measured by the Shariah Governance disclosure ratio that will be developed based on reliable sources such as journals, articles etc.

The study will be conducted by referring to the Malaysian regulatory framework that is related with Shariah governance and its practice by Islamic banks in Malaysia. In addition, this study adopts legal research and using primary data as sources of data. Thus, the content analysis technique based on documents reachable are used, such as the Islamic banks' annual reports of the latest year listed by BNM together with the previous studies regarding Shariah governance and disclosure of Shariah governance.

1.7 Structure of the Study

This study is structured into five chapters. Chapter one is the introduction chapter discussed on the background of the study to give an overview of Shariah governance in Malaysia and the regulatory frameworks related to the study. Secondly, continue with the problem statement, research questions and research objectives derived from the problem statement. Then, continues with the significance of study, the scope of study, the structure of the study and lastly, the conclusion remarks.

The remaining chapters of this study are organized as follows. Chapter two basically reviews the concept of Shariah governance, the regulations and its practice by Islamic banks in Malaysia. In detail, firstly, on the concept of corporate governance, the concept of good governance in accordance with Islamic perspective, the concept of Shariah governance which includes Shariah compliance and full disclosure in Islamic perspective. Then, reviews on Shariah governance in Islamic banking institutions in Malaysia with few legislations, and then compare with the international standards of Islamic banking institutions. Last but not least, the brief enlightenment on Shariah Governance disclosure ratio that will be used in chapter four.

Chapter three is the research methodology section that arranges the method of study used in the research. As the research applied the qualitative method, thus the study is descriptive, analytical and critical as it presents document analysis method and content

analysis technique. These are used to interpret the data of Shariah governance in Islamic banks. Research designs and method sampling are also explained in this chapter. And lastly, the section on data analysis in analyzing the data used in this study.

Chapter four elaborates and answers all the research questions in this study. Firstly, explains on the existing regulations on Shariah governance of Islamic banking institutions in Malaysia. Secondly, reviews on the comparison of practice of Shariah governance in IFIs internationally and in Malaysia. Lastly, the analysis of actual implementations of Shariah governance disclosure in the selected Islamic banks listed under BNM. Thus, this section will review the disclosure of Shariah governance, especially in the Shariah committee report of the banks, by using the Shariah Governance disclosure ratio.

Finally, chapter five concludes the study, by summarizing the study come together with the penalty for non-compliance with Shariah governance disclosure. Then, the solutions and recommendations are stated based upon the non-compliance of the Shariah principles and the Shariah governance disclosure by Islamic banks in Malaysia. Last but not least, the limitation of the study is stipulated for the future study and also the concluding remarks.

1.8 Conclusion

Briefly, Shariah governance nowadays has become a very significant basis of every Islamic bank in order to preserve Islamic orientation in every single practising Muslims. The disclosure is needed as it would preserves the confidence upon Islamic banks, especially in Malaysia that had been recognized as the active player of Islamic banking and finance. Nevertheless, there must be standardization and regulation in order to avoid confusion among stakeholders of the Islamic banks. Thus, the legal framework would be the best mechanism in ensuring the perseverance of Islamic teaching among Muslims in Malaysia dealing in banking sectors and the enforcement of the law will make the involved institutions adhere with the regulations.

Thus, by having the comprehensive regulations on Shariah governance, with responsible regulators, the involved Islamic banks will be able to fulfill the objective of being a truly Islamic banking institutions, especially Islamic banks listed under the BNM. They will also gain confidence and trust from their stakeholders, including the investors and especially the Muslims society at large.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter will review the concept of Shariah governance and the related points. Firstly, the concept of corporate governance and then the basis of Shariah governance as a good governance in Islamic perspective will be discussed based on past studies. The concept of Shariah governance will also be emphasized, with a brief relation with the concept of Shariah compliance and the concept of full disclosure in Islamic perspective by referring to a few verses of al-Quran. The core of this study will be review, which is the concept of Shariah governance in IFIs briefly to get the idea of its practice. Lastly the references of few studies that review the Shariah governance disclosure index will be featured in order to build and strengthen the analysis of this study. The past studies and researches may give the right conceptual analytical insight to the study.

2.2 The Concept of Corporate Governance

In the conventional outlooks, the corporate governance is actually derives from Anglo-Saxon model. It is formulated based on the agency theory to represents the shareholder value system. The first code on corporate governance was made by Sir Adrian Cadbury (or known as the Cadbury Report) in 1992 in United Kingdom. The Cadbury Report had

two main objectives, firstly, to ensure the accountability of the board of directors by using an effective mechanism, and secondly, to prevent corruption in the companies. The reason is that, at that time, corruption was widely practiced by many companies in United Kingdom. The report was initially used as a guideline to have comprehensive corporate governance (Hassan, 2014).

2.2.1 Definition of Corporate Governance

The word “governance” usually means “corporate governance” to conventional finance player (Mizushima, 2014). Hasan (2008) divides the definition in two senses, where firstly the narrower sense defined corporate governance as a formal system of accountability of senior management to the shareholder. Secondly, in a bigger picture, corporate governance includes the entire network of formal and informal relations involving the corporate sector and their consequences for society in general.

Besides, the Organisation for Economic Co-operation and Development (OECD) had defined corporate governance as procedures and processes in an organization as it is directed and controlled, where it is claimed to be the best known concept of corporate governance in Western countries by Mizushima (2014). While Shanmugam and Perumal (2005) defines corporate governance as the method where a corporation is directed, administered or controlled (Abu, Jasin, Razak & Sharif, 2014), as well as the laws and practices that affects the direction of the institution. Hence, corporate governance has

direct link with the legal and organizational structures that govern the internal integrity of a corporation (Choudhury & Hoque, 2006).

Under IFSB's Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services, 'corporate governance' had been defined as "A defined set of relationship between a company's management, its Board of Directors, its shareholders and other stakeholders which provides the structures through which: i) the objectives of the company are set; and ii) the means of attaining those objectives and monitoring performance are determined". While the Securities Commission in the Malaysian Code on Corporate Governance 2012 define corporate governance as "The process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long-term stakeholder value, whilst taking into account the interest of other stakeholder". This definition is in line with the definition given by Muneeza & Hassan (2011).

However, despite of many definitions given, Rusni Hassan (2014) claimed that there is no global or static definition of corporate governance as its goals and objectives differ from a jurisdiction to another jurisdiction. It is the duty and responsibility of the respective organizations to formulate their own definitions to suit their own interest. Moreover, in consistent with Hassan et. al. (2014), there is no uniform or precise definition of corporate governance as it is a multi-disciplinary subject made subsequence

to the consciousness of the need to taking care of the rights of all stakeholders within the institutions.

2.2.2 Elements of Corporate Governance

Conversely, the corporate governance arrangement had caught attention of the regulators after the financial crisis in 1997 to 1998 and the highlighted main issue was to strengthen the governance framework. The financial crisis shows that, although the governance and risk management framework were in its place, it had failed in avoiding a crisis before it exploded. Besides, the OECD reported in 2009 that the financial crisis had attributed to failures and weaknesses in corporate governance arrangements (Aziz, 2013).

Meanwhile, the roles of corporate governance are to promote corporate fairness, transparency and accountability and to protect the rights and interests of all stakeholders (Hasan, 2011), the Shariah governance also has the same objective, but the viewpoint and the approach is different as it considers Shariah principles in addition to the interest of the directors and the stakeholders of the institution (Muneeza & Hassan, 2011).

Thus, by looking into the elements of the corporate governance, it can be said that the conventional approach is the vital stand point in the emerging of Shariah governance. This does not mean that the Shariah principles are not complete, however, to be accepted

by the conventional practice, corporate governance become the basis with the additional and correction by Shariah principles.

2.3 The Concept of Islamic Corporate Governance

There is a huge distinction between corporate governance and Islamic corporate governance. Noted that the origin of corporate governance is the conventional facet, the Islamic corporate governance distinguished it by few elements by including Islamic principles. Furthermore, little has been written on the governance structure of Islamic banking (Alnasser & Muhammed, 2012) despite with the growth of Islamic banking institutions, the domestic support of every particular country is increasingly required to promote the operations of the institutions (Choudhury & Hoque, 2006).

2.3.1 Definition of Islamic Corporate Governance

Islamic corporate governance does not differ much with the conventional definition as it refers to a system by which institutions are directed and controlled, with the intention to meet the objective of the institutions by protecting all the stakeholders' interest and right. Uniquely, with the Islamic features, it refers to the special decision making theory premised on the divine religions of Islam (Hassan, 2008).

Choudhury and Hoque (2006) includes Shuras of groups of participants as the board or committees within Islamic corporate governance in order to stimulate the social wellbeing function for common wellbeing rather than to only maximize shareholder's wealth, driven by mutual interest. One of the most important requirements is the existence of Shariah board having responsibilities in ensuring all transactions are in accordance with Shariah principles (Alnasser & Muhammed, 2012).

Hasan (2008) contended that, little is written or discussed on the Tawhid methodology to the term of corporate governance although all the Islamic economists and Muslim jurists agree on the concept of Tawhid in Islamic corporate governance. The most outstanding literature on the concept of Tawhid are Choudhury and Hoque, 2006, Hasan 2008, 2009.

Figure 2.1 shows the Tawhid and Shura based approach.

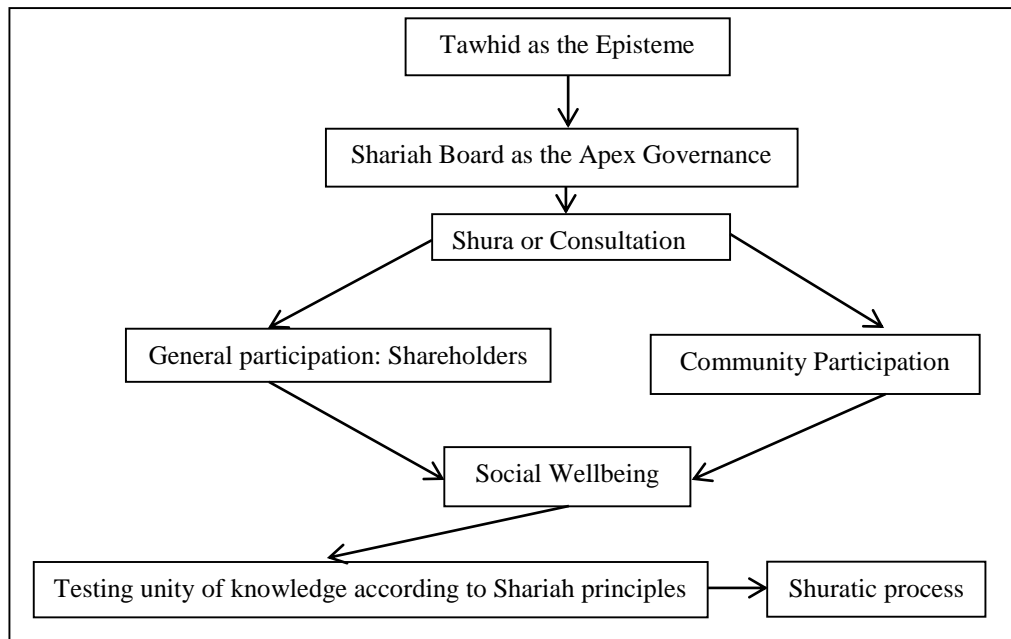


Figure 2.1

Islamic corporate governance

Source: Choudhury & Hoque, 2006., Hasan 2008, 2011., and Thajudeen, 2013.

2.3.2 Elements of Islamic Corporate Governance

Since the trust upon Islamic banks is the most needed factor in preserving the stakeholders' confidence, the elements of the prevalence of transparency, business disclosure, healthy competition and sustainable productive performance that come with social benefits will enhance the trust factor. However, the most critical elements of Islamic corporate governance is the systematically guidance towards the formation of behavioral preferences of Tawhid based on the meaning of unity of knowledge in Islam (Choudhury & Hoque, 2006). As in Figure 2.1 at the previous page, Tawhid is the episteme which is the knowledge used as guidance for the Shariah board in governing the Islamic banks.

Furthermore, Choudhury & Hoque (2006) also envisages that, in Islamic corporate governance, the conflict is overcome by the participatory nature of the Shuratic process. It is the element of social wellbeing that replaces the element of maximization of shareholders wealth in the conventional corporate governance as the differentiation element (Hasan, 2008, 2011:, Thajudeen, 2013). Besides, Alnasser and Muhammed (2012) differentiate governance structure in Islam from the normal corporate governance in the standardization of rules, which must obey the Shariah principles stated in the al-Quran where the governance structure must meet the expectations of every Muslim by providing Islamic acceptable financing mode.

To have a clear vision, Abu-tapanjeh (2009) had attempted with comparative list of common principles or elements in Islamic corporate governance with the revised principles of OECD as in Table 2.1 below:

Table 2.1
Corporate Governance from Islamic Perspective

OECD principles and annotation	Islamic principles
The right of shareholders and key ownership functions.	Property as trust from Shariah rules.
Promotion of transparent and efficient markets with rule of law and division of responsibility.	Sole authority is Shariah principles.
Basic shareholder rights.	Society as stakeholder.
Participation of decision making at the general meeting.	Accountability not only to stakeholders but also to Allah, the ultimate owner.
Structure and arrangement for corporate control.	Just and fairness of value.
Ownership rights by all shareholder, including institutional shareholders.	Equitable distribution of wealth to all stakeholders and disadvantage members.
Consultative process between shareholders and institutional shareholders.	In the form of Zakat and Sadaqah.
The equitable treatment of shareholders.	Social and individual welfare with both spiritual and moral obligation.
Protection to minority and foreign shareholders.	Sensation of equality.
The role of stakeholder in the corporate governance.	Islamic accountability to Falah and social welfare orientation.
Creating wealth, jobs and sustainability of financially sound enterprise.	Haram or Halal transaction.

Source: Abu-tapanjeh (2009)

The listed elements or principles had clearly shows the distinguished pattern of the conventional corporate governance and the Islamic corporate governance. Moreover, to ensure the transactions are according to Islamic principles, it is the main role of Shariah board in Islamic corporate governance, where in case of the transaction is not according

to Shariah rules, the bank might lose confidence of the majority of the people (Alnasser & Muhammed, 2012).

2.4 Good Governance in Islamic Perspective

To compare with good governance in Islamic perspective, good conventional corporate governance must be protected against any kind of negative implications that may affect an institution. In short, having good corporate governance is all about having a better organization, a responsible society and a better economic system (Hassan et. al., 2014). However, being a Muslim, the Islamic principles must also be counted in to be accepted as a good governance.

2.4.1 Definition of Good Governance in Islamic Perspective

The conventional good corporate governance comprises three major criteria, which are transparency, disclosure and accountability that need to be successfully implemented relatively (Muneeza & Hassan, 2011). However, in Islamic corporate governance, the word '*Tadbir*' is Arabic term which means administration, management, or governance. The comprehensive clarification of '*tadbir*' signifies by al-Jurjani in his book entitled *al-Ta'rifat* as, "the act of putting matters into effect in accordance with the knowledge of what will follow in the end" (Ismail & Badron, 2012). By all means, Shariah governance would render an act followed by the perfect flow as stipulated in Islam.

The Quranic verse that relates with governance is the word ‘*tadbir*’, which have the same meaning as management or arrangement, is in surah as-Sajadah, verse 5 to 7:

“He arranges [each] matter from the heaven to the earth; then it will ascend to Him in a Day, the extent of which is a thousand years of those which you count. That is the Knower of the unseen and the witnessed, the Exalted in Might, the Merciful. Who perfected everything which He created and began the creation of man from clay.”

(as-Sajadah, 32: 5-7)

These verses enunciate few features of divine governance covering the affairs from heaven to earth. The basis is the knowledge (‘*Alim al-ghayb wa al-shahadah*), power (*al-Aziz*) and love (*ar-Rahim*) that generate excellence in ‘*ihsan*’ as Allah creates and administer everything perfectly (*ahsana*). Human are the creation that are in charge of having skills of good governance in order to accomplish the entrusted mission as ‘*Khalifah*’ (caliph) guided by Islamic teaching (YPIEM, 2005).

Precisely, according to Mujahid (2012), caliphate is a well-known system of governance in Islam in contrast with the Western paradigm. In the Hadith:

“The Prophet (pbuh) said: ‘The Prophets ruled over the children of Israel; whenever a prophet died, another prophet succeeded him, but there will be no more prophets after me. There will soon be *khulafah* and they will number many. Fulfill the *bayyinah* [i.e. pledge of allegiance] to them one after another and give them their dues for Allah will verily account them about what He entrusted them with’ ”

(Imam Nawawi, *Riyadh us-Salihin*, Hadith no. 657)

It is clear that Khalifah is the successor of the Prophet after the last Prophet of Muhammad (pbuh). Upon being Khalifah as people's guardian, he must ensure Shariah law implemented accordingly prevailing justice. Allah said in Surah al-Maidah, verse 42, upon judging, justice is the prevailing objective:

“(They are) listeners of a lie, devourers of what is forbidden; therefore if they come to you, judge between them or turn aside from them, and if you turn aside from them, they shall not harm you in any way; and if you judge, judge between them with equity; surely Allah loves those who judge equitably.”

(al-Maidah, 5:42)

It was further argued that a good governance will surely have some salient characteristics, firstly, proper recognition and acknowledgement of not only the theoretical and the practical components of governance but also the diverse elements contained in each component; secondly, proper recognition and acknowledgement of the different kinds and grades of goals and ends; and thirdly, proper recognition and acknowledgement of the various governance with special attention being paid to their individual root (Ismail & Badron, 2012).

However, Ismail and Badron (2012) had already study to provide an alternative interpretation for the concept of “Good Governance” which is basis in the religious, intellectual and scientific tradition of Islam. The interpretation involves elaboration on the concept and meanings of ethics in Islam, that embrace the basis and framework for

good governance with in-depth study on the term '*tadbir*' then further explore the numerous theoretical and practical implications of good governance.

2.4.2 Elements of Good Governance

Ahmad (2010) had envisages five elements of good corporate governance. Firstly, having a good board practices and this element can only be achieved if the roles and authorities of the members are clearly defined and understood with a well-structured and composition of procedures in place. Secondly, the disclosure and transparency of financial and non-financial information in a high quality published annual report. Thirdly, able to control the environment and processes of the institutions with an independent audit committee, a good risk management framework, a well functioned of internal audit and independent external audit. Fourthly, the shareholders right is fulfilled with a well-organized general assembly formalized the minority shareholders right and clearly defined an explicit dividend policy. Lastly, giving commitment by creating the corporate governance committee with the future improvement plan in place, for example, committed the appropriate resources, formalized the institutions policies and procedures, and lastly developed code or guidelines for the committee.

Disclosure, transparency and accountability are three major fundamentals which embrace a good corporate governance practice (Hassan et. al., 2014). Besides, Mizushima (2014) resisted that good corporate governance must provide incentives for the management of

the institutions in order to achieve the objectives of the institutions and its related shareholders. Where good corporate governance is basically on the transparency, participatory and accountability, these elements are actually deep-rooted in Islam. Thus, it is the fundamental part of the governance framework of Islamic banks (Ismail & Badron, 2012).

Therefore, it can be understood that good governance in Islam is closely related with faith towards Allah with the guidance brought by the Prophet (pbuh). In fact, the awareness of *adab* in *tadbir* is to govern within the limitations of truth and justice. By that, the *adab*-oriented *tadbir* as similar to “good governance” is “the intellectual and practical process, within the coverage of a true and just system, to obtain good results.” Needless to say, the concept of *tadbir* being defined as ‘governance’ relates with ethics (*adab* and *akhlaq*) and integrity (*sidq*) (Ismail & Badron, 2012) are to be said as the root of good governance being a caliph in this Earth. Thus, the same would be applied towards the concept of good governance in governing the Islamic banking institutions nowadays in order to ensure the effectiveness of Shariah governance.

2.5 The Concept of Shariah Governance

According to Muneeza and Hassan (2011), Shariah governance is a vital mechanism for effective running of Islamic banking institutions in Malaysia. It concerned with the religious aspects of the activities and conducts of Islamic banks (Grassa, 2013). An

appropriate governance framework for effective governance becomes particularly significant to overcome human demand (Aziz, 2005). By looking at the practice, corporate governance in Islamic banks was definitely covered by Shariah that governs human in controlling their spiritual, mental and physical behavior. Whilst it is understandable that Islamic corporate governance is always refers to Shariah governance, a strong foundation of it are the essential components for the development of a sound Islamic banking industry.

Shariah governance also refers to a system based on Shariah principles and managed by the effective SC in guaranteeing that the activities by Islamic banking institutions are in accordance with the Shariah principles. The efficient Shariah governance had gave additional values to the existed corporate governance framework with the essential values of faith and *akhlaq* (Grassa, 2013). In short, Shariah governance is closely linked with the Islamic teaching and implements it in the religious board of Islamic banks.

Shariah governance comes as the Islamic version of the conventional corporate governance. The conventional corporate governance only focused on the directors and the stakeholders interest, meanwhile Shariah governance goes further with the addition of Islamic principles (Muneeza & Hassan, 2011) and provides the accepted Islamic financing modes that meets the expectations of Muslim necessity.

Currently, in the presentation on Shariah Framework & Governance in Islamic Finance on 10th of September 2014, among current issues in corporate governance of Islamic banking institutions is on the Shariah Committee (SC). SC is a specific organ of governance where it should be concerned with monitoring Shariah compliance and not just issuing fatwas. Since SC members may lack monitoring skills, auditors and audit committee should act in concert to assist SC. Therefore, fit and thorough set of corporate governance in IFIs is the most significant part to ensure the trustworthy of the stakeholders are fulfilled.

The Shariah governance being the active role of Shariah board and compliance with Islamic principles is a strong fundamental for Islamic banks (Hamza, 2013). Tan Sri Dato' Dr Zeti Akhtar Aziz, in her speech on 'Effective Corporate Governance in Islamic Financial Institutions', had considered four main ingredients that is important to the governance framework for Islamic banking institutions. Firstly, to ensure the backbone of the institutions are consistently with Shariah principles. For example, the value of honesty and truthfulness as the governance framework in the Islamic transaction. Secondly, for the governance framework to accept the multi-roles of Islamic banking institutions, since there is various levels of stakeholders to practice justice in Islam. Thirdly, to separate the Shariah governance framework as a distinct body to assure public confidence towards Islamic banks, where SC are functioned to manage the Islamic banks complying with Shariah principles. Lastly, the Shariah governance framework must uphold higher level of disclosure and transparency in revealing the information of one to another stakeholders (Aziz, 2005).

By these considerations, without doubt, Islam had promotes a very positive governance system. Furthermore, it can be seen that the consideration also comprises all aspects of Islamic finance and banking, which are from the compliance to Islamic principles, to the element of justice in Islam, until transparency of information for the stakeholders.

Nowadays, Malaysia desires to transform into becoming Islamic banking and finance hub and one of the efforts is through strengthening the Shariah governance in the Islamic banking sector (Hasan, 2008). However, in a Malaysian system that Islamic banking is not the exclusive mode of system, Shariah compliance is nevertheless given absolute importance. Which means, Malaysia is still struggling to practice Islamic banking whereas the Malaysian banking system were derived from conventional system, therefore the effort to develop fully Shariah compliance in banking institution are vital to be emphasize.

Consequently, developing Shariah standard is important because of the following reasons. Firstly, Shariah standard would solve the general confusion created by the outrageous interpretations thus results inconsistencies in of Islamic banks financial report. Secondly, it is a little step towards the harmonisation of products in Islamic banking sector where Shariah standards for Islamic financial contracts will be able to restructure the Islamic products. Lastly, the Shariah standard would serve as a guide for product development along with the Shariah reviewers and Shariah auditors upon the review and audit the operations of Islamic banking institutions (Laldin, 2014).

Corresponding to the increasing global development of Islamic banking and finance, the Shariah governance has received great attention presently (Grassa, 2013). Thus, the differences upon having Shariah governance can be seen in the practice of Islamic banking institutions internationally and domestically. However, the concept of Shariah compliance and full disclosure must be emphasized in order to grab the basis of Shariah governance.

2.5.1 The Concept of Shariah Compliance

For Muslims, Shariah compliance in business is the spiritually necessities in order to purify wealth. To have a non-compliance transactions would have bad impact on revenue of the institution since it earned from unlawful sources, thus the revenue must be given away as charity. Originally, Shariah compliance reflects the purity of the transactions where non-compliance of it may leads to prohibitions to fulfill their religious obligations (Kasim, 2012). Hence, according to Alhabshi (2014), by being completely compliant to the procedures, it will increase the total Shariah compliant assets thus acceptable within Muslim society.

Therefore, Islamic banks have the important duty to ensure the activities and practices compliance with Shariah principles in all aspects. For example, in the products,

instruments, operations and management, where these will be achieved by the formation of a proper Shariah governance framework. (Miskam & Nasrul, 2013). Since complying with the Shariah rules and principles becoming the primary objective of Islamic banking operations, there are two issues that need to be fulfilled, firstly, on the enforcement of a proper system to ensure Shariah compliance, and secondly, in increasing the awareness and enhance public confidence in the Islamic banking institutions. Therefore, the outcome of truly Shariah governance practice is definitely the compliance of Islamic banks with Shariah principles and further, producing report which can benefits the institutions as well as a wider range of stakeholders (Obid & Naysary, 2014).

The regulatory framework in Malaysia has been developed with the objective to promote financial stability and to ensure Shariah compliance in the Islamic banking activities (Lahsasna, 2014). Usually, the disclosure of Shariah compliance in the annual report reflects the level of Shariah compliance by the institutions (Puad, 2014). Therefore, being non-compliance with Shariah principles would render a negative perception towards the purity of the institution having Islamic transactions.

2.5.2 The Concept of Full Disclosure in Islamic Perspective

The Islamic banking practices must adhere with the concept of full disclosure towards the stakeholders. Full disclosure in Islam is understandable as disclosing everything that is related in serving as a practicing Muslim. This definition reflects the purposes of Islamic banking system as to serve the public interest and also to reflect the Islamic values. The

Islamic concept of corporate governance also must focus on three main areas, namely accountability, transparency and trustworthiness (Shanmugam & Perumal, 2005).

Being accountable, the element of transparency for full disclosure was pictured in surah al-Baqarah, verse 282:

“O you who believe! When you contract a debt for a fixed period, write it down. Let a scribe write it down in justice between you. You should not become weary to write your contract down, whether large or small, for its fixed term, that is more just with Allah, more solid as evidence and more convenient to prevent doubts among yourselves...Take witness whenever you enter into a commercial contract..”

(al-Baqarah, 2: 282)

This verse envisages about the need to properly record every transaction in order to avoid injustice and to avoid concealing any details that might lead to further injustice (Shanmugam & Perumal, 2005), where the practice of recording transaction and financial obligation is not quite foreign in Islam based on the stipulated verse of al-Quran (Ismail & Latiff, 2001).

The ownership of Allah SWT had been clearly stipulated in surah Taha, verse 6, where Allah owns everything in the heaven, earth and what in between:

“To Allah belongs what is in the heavens and on earth and all between them, and all beneath the soil.”

(Taha, 20: 6)

Therefore, every individual are accountable for their actions during their lives as every little things are subordinated to Allah SWT. Furthermore, sovereignty belongs to the Islamic law or Shariah, not the people. It is the Khalifah who implements the Shariah in the lands of Islam. Specifically, being the trusteeship of mankind, every Muslims are considered as ‘*Khalif*’ or vicegerent of this world, as stated in verse 30 of Surah al-Baqarah:

“And when your Lord said to the angles; I am going to place in the earth a vicegerent, they said: What! Wilt Thou place in it such as shall make mischief in it and shed blood, and we celebrate Thy praise and glorify Thy holiness? He said: Surely I know what you do not know.”

(al-Baqarah, 2:30)

Being in the Islamic banking institutions, the representatives that control the Shariah supervision of the institutions would be the Shariah Supervisory Board (SSB) or SC. These special people have a big responsibility in ensuring the practices of the institutions are in compliance with Shariah principles and one of it is to disclose the information on the institutions’ annual performance to gain public confidence. This leads to another verse, in Surah al-Inshiqaq, verses 7- 12 on the needs of recording and auditing:

“Then who is given his record in his right hand, soon will he shall be reckon with by an easy reckoning, and he shall go back to his people joyful. And as to him who is given his book behind his back, He shall call for perdition, and enter into burning fire”.

(al-Inshiqaq, 84: 7- 12)

Therefore, this would be the responsibility of SSB or SC to report their roles in the particular Islamic banking institutions. This is to ensure the transparencies of the works done.

Responsibility, like accountability, is being responsible between every human being and also in performing duty as human. This duty is given as an *amanah* (Trust) from Allah SWT (Shanmugam & Perumal, 2005). In highlighting trustworthiness, the Quran states in surah al-Anfal, verse 27, it is prohibited to misappropriate in things that had been entrusted:

“O you that believe! Betray not the trust of Allah and the Apostle, nor misappropriate knowingly things entrusted to you.”

(al-Anfal, 8: 27)

In any case, to tell lies, would mean going against the faith of Islam as Allah states in surah al-Ahzab, verse 70 to stay trustworthy:

“O you who believe! Fear Allah, and (always) say a word directed to the right.”

(al-Ahzab, 33:70)

As the financial reporting is primarily about disclosing the financial position truthfully, it is definitely an act of religious fulfillment (Ismail & Latiff, 2001), thus in line with Islamic teaching.

Consequently, by having absolute submission to Allah, known as *tauhid*, in all aspects of life, it is the first fundamental and the highest principle of Islam (Rahman & Bukair, 2013). In other words, the concept of being trustworthiness, transparency and responsibility in all transactions, given as full disclosure, will preserve the harmony of Shariah governance in Islamic banking practices.

2.6 Shariah Governance in Islamic Banking Institution

The governance that based on Shariah principles covers all the features of the corporate governance. In addition, it focuses on the interest of all stakeholders in adherence with Islamic principles (Muhamad, Sori & Shah, 2015). Needless to say, Islamic banks have the responsibility to assure a proper framework and the compliance with Shariah principles in the operation, products, management and others. The compliance on Shariah principles is not only demanded by the customers but also the stakeholders, including shareholders, investors and the society at large, especially the Muslims. According to Shanmugam and Perumal (2005), Islamic banks do pay attention to the AAOIFI and IFSB as these two pronouncements govern Islamic banks in international level.

El-Tiby (2011), claimed that the regulations on Islamic finance are still in the early stage, therefore a constant improvement, and clarity is needed to enhance the framework. The IFSB has issued guiding principles on Shariah-compliant governance systems to complement the existing governance control and compliance function within the IIFS.

Thus, under Principle 1.2 of the Core Principles for Islamic Finance Regulation (CPIFR), the IFSB envisages that the recent CPIFR that was introduced in April 2015 will be used by jurisdictions as a benchmark for assessing the quality of their regulatory and supervisory systems and for identifying future work to achieve a baseline level of sound regulations and practices for Islamic finance. The CPIFR will promote further integration of Islamic finance with the international architecture for financial stability, while simultaneously providing incentives for improving the prudential framework across jurisdictions so that it is harmonized and consistently implemented across the globe. Needless to say, the latest CPIFR would help IFSB in order to promote standard Shariah guidelines for Islamic banking institutions.

According to Aziz (2005), the government and the regulator has a significant role in positioning atmosphere in supporting the development of a strong governance structure. The Malaysian Shariah governance has the guidelines that had been issued on the governance structure of the SC in the Islamic banks. Further, to promote a greater financial disclosure, Islamic banks are obliged to provide disclosure of the banks' annual activities as had been required by the BNM in the annual report.

2.6.1 Shariah Governance in Islamic Banking Institution in Malaysia

The Islamic banking and finance industry in Malaysia is a very unique system since it operates both conventional and Islamic banking on a parallel basis. Malaysia was

reported to be the first country in the world to implement the dual banking systems of Islamic banking system and the conventional banking system (Hassan, 2014).

Further, it had been claimed that Malaysia established three kinds of IFIs as provided under its laws and regulations. The first is the Islamic banks licensed under IFSA 2013, second, the conventional bank offering Islamic banking business, known as 'Islamic windows' and third is the bank coming under the regulation of the Development Financial Institutions Act (DFIA) 2002 or development financial institutions like Bank Rakyat. However, it is to be noted that prior approval from the BNM must be obtained for these institutions to operate Islamic banking business (Hassan, 2014).

The main feature of the Islamic banking and finance industry in Malaysia is the centralized Shariah rulings at the regulatory and individual financial institutions levels which are the BNM (Radzi & Muhamed, 2012). The centralized Shariah governance authority refers to countries that have their own central body to govern the Islamic banks and financial institutions (Hamza, 2013., Hassan et. al., 2013., Miskam & Nasrul, 2013) and it requires institutions to ensure Shariah compliance but the government still control by establishing Shariah advisory at the central level (Wardhany & Arshad, 2012). According to Dusuki (2011), centralized Shariah governance structures comprise Shariah advisory at the regulator's level, centralized fatwa, issue guidelines on the governance of SC for the Islamic financial institutions, conduct Shariah compliance review and centralized appointment of SC in the Islamic banking institutions.

Based on the study by Hamza (2013), the reinforcement of the Shariah board role in the Islamic banks is necessary and allows strengthening of the Shariah decision-making process. The author emphasized that in Malaysia, basically, the centralized approach knows advances in term of fatwa and review and seems to give harmonization to the industry. BNM has tightened Shariah rules for Islamic banks by requiring them to set up Shariah review, audit and risk management functions to reinforce compliance (Hamza, 2013). So far, the centralized model of Shariah governance, as practiced in Malaysia is considered as the best model in order to preserve the dignity of Shariah in the Islamic banking sector.

A well-established Shariah governance framework is important for a comprehensive regulatory and supervisory management. Islamic banks needs to adhere to the framework for guidance on the compliancy of their practices, hence making it vital for the future of Islamic banking. The significance of Shariah governance is highlighted by the fact that an inadequate infrastructure on the compliance of Islamic banking to Islamic laws can be challenged (Wardhany & Arshad, 2012).

In reality, the existing frameworks of Islamic banking and finance in various jurisdictions demonstrate a diverse practice of Shariah governance system. Some jurisdictions prefer greater involvement of regulatory authorities and on the other hand, some countries prefer otherwise (Hasan, 2010). These different approaches are adopted mainly due to

diverse legal environment, where Malaysia has strong faith in “regulatory-based approach” (Hasan, 2010.; Shahrudin, 2011) in strengthening Shariah governance.

2.6.1.1 Islamic Financial Services Act (IFSA) 2013

The idea to enact IFSA 2013 in order to strengthen the regulatory platform for Islamic banking was proposed way back in 2001 in the Financial Sector Master Plan (FSMP) where the intention is to create a separate and viable effective platform for Islamic banking in parallel with conventional banking. Further, the regulatory and Shariah framework of Islamic banking will be strengthened by reviewing the existing laws and guidelines, governing the industry. Besides, IFSA 2013 is also one of the recommendations from the Financial Sector Assessment Program (FSAP) Malaysia (Thajudeen, 2014).

The enactment of the IFSA 2013 which was approved by Parliament in December 2012 had marked another essential revolution in Malaysia’s Islamic banking and finance laws. This new law is the result of more than six years of effort, and involved a wide-ranging review of the various laws for the regulation and supervision of the financial sector. The implementation of IFSA 2013 will be landmark law and give a major impact upon the growth of the Islamic financial system in Malaysia (Hassan, 2014).

Whilst being the mechanism of this change; IFSA had combined several separate laws into a single legislative framework and repealed the Islamic Banking Act 1983 and the Takaful Act 1984. It also respectively comprise with the Payment Systems Act 2003 and Exchange Control Act 2013. According to Hassan (2014), IFSA 2013 is intended to be an omnibus legislation for the regulation and supervision of key Islamic banking institutions.

The main objective of IFSA 2013 is to promote financial stability in compliance with the Shariah principles (Chik, 2014). Lahsasna, (2014) states that, under the key features of Shariah compliance, it aims, firstly, IFSA 2013 and the SGF being the representative in promoting Shariah governance and Shariah compliance in Malaysia. Secondly, promoting the financial stability and Shariah compliance in all the banking activities. Thirdly, strengthening the foundations for the entire business banking model by having end-to end with Shariah governance and compliance. Fourthly, supporting the Shariah compliance contracts in the Islamic financial products and services. Fifthly, giving strong caution before giving penalties upon failure to comply with Shariah principles. Then, arranging legal and regulatory principles with Shariah precepts. Besides, emphasizing the significant role of the BNM as the main regulator. Next, embedded the Shariah principles and the Shariah advisory-council rulings in the Islamic banking and finance industry. In addition, enforcing Shariah compliance status on the market and drive the Islamic banking institution toward more Shariah compliance activities by monitoring and imposing penalties. Afterwards, effectively manage the Shariah non-compliance risk. Lastly, imposing strict and severe offences and penalties upon failure to comply with Shariah principles.

The other objectives are to strengthen regulation of IFIs. IFSA 2013 had provided more cohesive and integrated legal framework, thus minimising the prospect for regulatory gaps. Post IFSA 2013, the Islamic banking model had become accepted by Islamic banks in terms of its business model (Chik, 2014).

Particularly, the latest sections that relates to Shariah governance are provided under section 30 until section 36 of IFSA 2013, and it highlights the duty of the institutions to enforce more strict Shariah compliance by imposing detail punishments for the infringes Islamic banks (IFSA, 2013, Miskam & Nasrul, 2013).

2.6.1.2 The Shariah Governance Framework (SGF) 2011

The BNM had provided requirement to establish Shariah advisors for Islamic banks, which is the SGF in 2010 (Hassan, 2014). All Islamic banking institutions in Malaysia have to comply with this framework. The primary objective of the issuance of the SGF is to enhance the role of the SC and the management on Shariah matters, enhancing the relevant bodies that have the responsibility to execute the Shariah compliance and attaining the Shariah-based operating environment.

The SGF had been full enforcement on 1st of July 2011 and its objectives are as follows: firstly, to set out the guideline on the Shariah governance structures, processes and

arrangements of the IFIs in order to ensure that all the operations and business activities are in compliance with the Shariah. Secondly, to provide a comprehensive guidance on the board, SC and management of the Islamic financial institutions in discharging their duties in matters relating to the Shariah. Lastly, to outline the functions in relation to Shariah review, Shariah audit, Shariah risk management and Shariah research.

The SGF provides the structure for Shariah governance to be adopted by IFIs in Malaysia including Islamic banking institutions. This model structure is illustrated in the following figure:

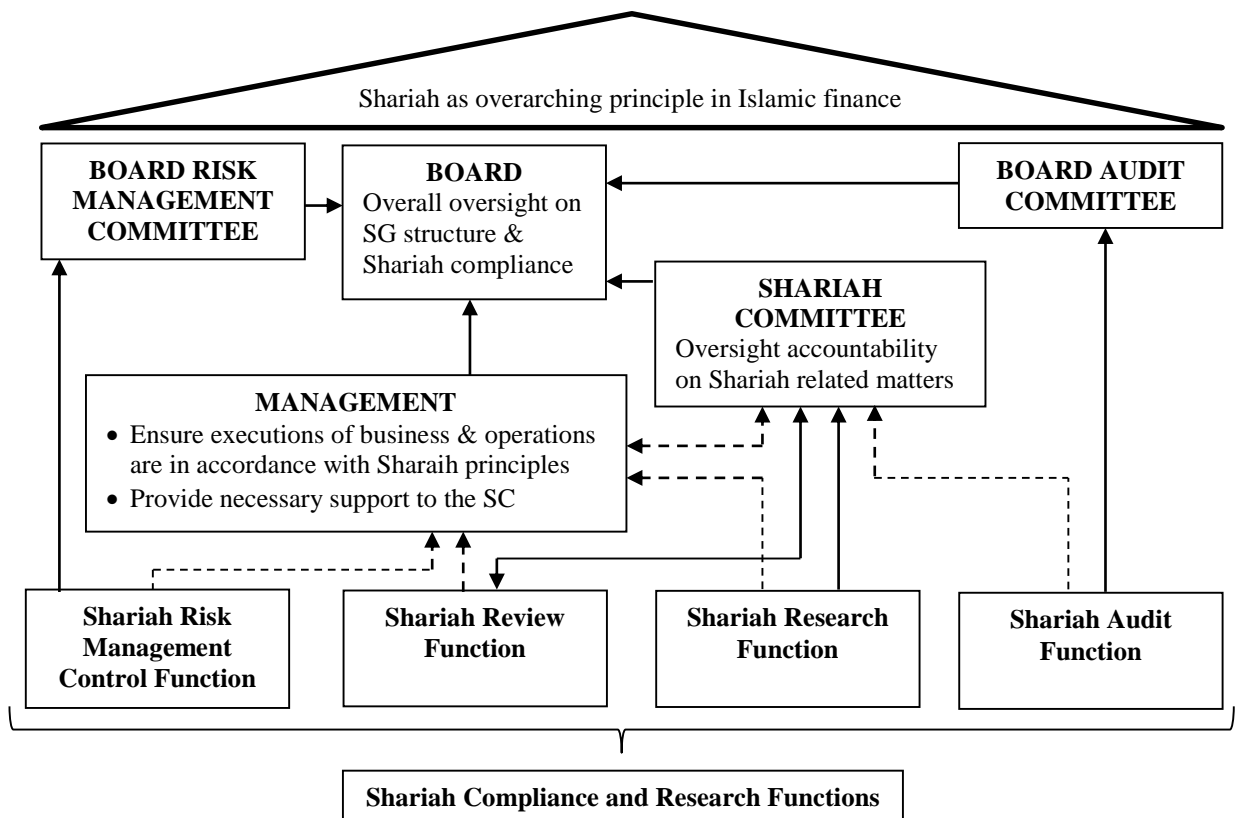


Figure 2.2
Shariah Governance Framework Model for IFIs
 Source: SGF, 2011

Based on the figure above, the SC has the huge responsibility in the IFIs in oversight accountability on Shariah related matters. It includes the Shariah audit function, Shariah research function and Shariah review function with supports by the Management team. After completed their responsibilities, SC must report to the Board of Directors as independent partition for the Board to have overall oversight on Shariah governance structure and Shariah compliance. With the fulfillment of duties by each and every partition in IFIs, a comprehensive and a truly IFIs may be achieved.

Malaysia took a further step in enhancing the framework of Shariah governance by devising the regulations that govern Shariah governance of Islamic banks, which is IFSA 2013, the Central Bank of Malaysia Act (CBA) 2009, Securities Commission Act (SCA) 1993 and the Financial Services Act (FSA) 2013 (Lahsasna & Saba, 2014), and also the existing SGF 2011 issued by the BNM are effective on the 1st of January 2011 given the detail implementation on Shariah governance. However, the extent of the implementation of legal framework on Shariah governance by the Islamic banks in Malaysia is still ambiguous.

All banks that offered Islamic financial services are bound to establish SC or Shariah board by virtue of the stipulated regulations. The main objective of SC is to advise, monitor and give Shariah ruling on case to case basis. The SC members will be appointed by the board of directors of that Islamic bank with the approval by BNM, with the requirements prescribed by the BNM. The SC then will give the Shariah ruling to the

Islamic banks. However, on matters of dispute between the SC and management of the bank, it will be referred to the SAC of BNM and the decision will be considered final (Lahsasna & Saba, 2014).

According to Hassan (2014), the SGF 2011 has the regulations on the requirements on the appointment of the SC in Islamic banks, whereas there are no such guidelines provided by the conventional institutions. Furthermore, the SC is responsible for ensuring that the business activities of Islamic banks are not against Shariah principles. Therefore, it is contended that the BNM had provides a clear guidelines for the SC to tackle responsibility as maintaining the Shariah compliance of each IFIs.

2.6.1.3 The Guidelines on Corporate Governance for Licensed Islamic Banks (GP1-i) 2013

GP1-i 2013 issued by BNM had envisages the main disclosure requirements applied to all licensed Islamic banks (Majid, Sulaiman & Ariffin, 2011). In addition, according to Mizushima (2014), GP1-i has extensive description on Shariah issues based on the 14 principles provided. It is founded that the phrase “Shariah Governance” is mentioned briefly in the Principle 1.04 only, but not clarify the nature of it. However, it only mention on the importance of Shariah compliance and discussed in detail. Then, the GP1-i states that, the SC should be within the Islamic banks as the fundamental body in ensuring Shariah compliance and that the SC’s members must be approved by BNM. Lastly, the internal audit includes the financial, management and Shariah audit.

As stated under principle 1.12 of GP1-i 2013, all Islamic banks are required to comply with the guideline and to disclose the required items needed as had been stated in the guideline. However, the Islamic banks are given the transition period of two years from 19th of June 2013 until 19th of June 2015 for the banks to comply with the guideline (GP1-i, 2013). Any Islamic banks that have non-compliance with the guideline needs to states the explanations and the alternative actions that had been taken in adherence to the guideline as stated in number 11 of Principle 2.110.

2.6.1.4 The Guidelines on Financial Reporting for Islamic Banking Institution (GP8-i) 2012

The GP8-i was issued on 12th December of 2002 and the effective date for GP8-i is on the 1st of January 2014, two years of transition period from the issuance date. SC is legally required to produce a report initiating their observation in the Islamic banks' compliance with Shariah principles. Thus, GP8-i specifies the minimum requirement of the SC report.

Among the minimum requirements needed are the content of the Shariah report on declaration of Shariah compliance certified by the SC members. The report must report inherently to the Board of Directors since the report heavily reflects the status of the SC as an independent body of the Islamic banks. Furthermore, the Board of Directors is bound by all decisions made by the SC and they have to fully take into consideration the

views of the SC on the issues related with the operational matters, the policies or business transactions of the bank of either it complies with Shariah principles (Hasan, 2010). The guideline is expected to promote greater transparency, quality and relevance of Islamic banking in Malaysia (MIFC, 2014).

2.6.2 Shariah Governance in Islamic Banking Institution Internationally

As every new thing in this world, where Islamic finance practice starts to embark, there was no special responsible body to advise, supervise or monitor Islamic banks on issues regarding Shariah matters. Shariah governance structure begins with SSB in upon the establishment of Faisal Islamic Bank of Egypt back in 1976 (Grassa, 2013).

Recently, the most significant international regulations governing Shariah governance are the AAOIFI on Governance Standard for Islamic Financial Institution No. 1 of Shari'a Supervisory Board: Appointment, Composition and Report, and another one is the IFSB – 10. (Hamza, 2013., Miskam & Nasrul, 2013).

2.6.2.1 Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI)

Today with the quick steps of growth of Islamic financial system worldwide, the standard guidelines for IFIs had been enforced for years since 1999. The most significant regulatory framework for Shariah governance is AAOIFI and IFSB. One of the roles of AAOIFI, being the Islamic international independent organisation, is the body that prepares governance standards for IFIs and its industry. AAOIFI is supported by institutional members total up to 200 members from 40 countries, including central banks, IFIs and other participants. It has gained assuring support for the implementation of its standards. From the total of 88 standards that have been issued, only seven standards that are totally applicable in governance of IFIs (AAOIFI, 2014).

The AAOIFI Governance Standards defines a Shariah board as “an independent body entrusted with the duty of directing, reviewing, supervising the activities of IFIs for a purpose of Shariah compliance and issuing legal rulings pertaining to Islamic banking and finance”. Shariah board is the main body where each and every single of matters would be determined in reference with AAOIFI. The objectives of AAOIFI are in accordance with the principles of Shariah law representing a comprehensive system in life with the Islamic banking institutions environment. It is intended to enhance the confidence of its users (AAOIFI, 2014). Hasan (2010) contended that the AAOIFI of Shariah governance standards are the imperative efforts in bringing the standardization of

Shariah practices. Meanwhile, the IFSB-10 is able to guide and promote for the best practice of Shariah governance system.

2.6.2.2 Islamic Financial Services Board (IFSB) – 10 2009: Guiding Principles on Shariah Governance Systems for Institutions Offering Islamic Financial Services

Generally, the IFSB is an international standard setting organization that stimulates and boosts the firmness and consistency of the Islamic banking industry by issuing universal comprehensive standards and guiding principles for the industry, including banking industry, capital markets and insurance sectors.

The IFSB was also established as an international body and it is based in Kuala Lumpur start on 3rd November 2012 officially and its operation begins on 10th March 2003. The main purpose for establishing this body was to promote development of a prudent and transparent IFIs industry and also Islamic banking and services through the adoption of international standards that is in accordance with Shariah principles (Hassan, 2014). IFSB has issued 24 Standards, Guiding Principles and Technical Note for IFIs (IFSB, 2012).

Specifically, the IFSB-10 is the applicable guideline on Shariah governance of Islamic banks named Guiding Principles on Shariah Governance System. Principle 3 on Definition and Scope of Shariah Governance System, ‘Shariah Governance System’

refers to “the set of institutional and organisational arrangements through which an IIFS ensures that there is effective independent oversight of Shariah compliance”. This requires a set of institutional and organizational arrangement (IBFIM, 2014) and this implies that the institution of a Shariah board is crucial to the Shariah governance system as an authoritative body to assure Shariah compliance in Islamic banking institutions (Hasan, 2010). However, in order to preserve the dignity of Islam, it would be better for the Board on Shariah governance of IFIs to have an active role in managing the institutions. Furthermore, according to Lahsasna and Saba (2014), Shariah governance is of supreme importance in the Islamic bank as it is one important point of differentiation between the conventional and Islamic banks.

Needless to say, the role of IFSB is crucial in enhancing the level of transparency and quality of corporate governance in Islamic banking institutions (Aziz, 2005). Besides, it further explains how the Shariah governance system complements the existing governance, control and the function for Shariah compliance, by having the SSB within the Islamic banks. Nevertheless, the detailed scope for compliance with Shariah and the financial requirements are vary due to the local jurisdiction in each countries, thus applying only the relevant authorities of the particular country (Kasim, Htay & Salman, 2013).

2.7 The Shariah Governance Disclosure Ratio

In fulfilling the guidelines that had been stated in the regulations, these application by verses of al-Quran would be suitable. Firstly, in surah al-Haqqah, verse 19 to 20,

“Then as for him who is given his book in his right hand, he will say:
Read my book! Surely I knew that I shall meet my account”.
(al-Haqqah, 69: 19-20)

By this verse, it is understandable that it is the responsibility of every individual to fulfill their obligations. Same goes to the SSB and SC that they need to fulfill the requirement of the laws to satisfy the guidelines that had been provided by the BNM. Therefore, being truthfulness in separating the truth and falsehood is the main key in order to be accountable by Allah SWT, as in Surah al-Baqarah, verse 42,

“And do not mix up the truth with the falsehood, nor hide the truth while you know it”.
(al-Baqarah, 2:42)

Another one in surah al-Haqqah, verse 51 where the truth is only the truth, not to mix up with falsehood.

“But verily it is truth of assured certainty”.
(al-Haqqah, 69: 51)

Particularly, disclosure ratio defined as “a qualitative based instrument designed to measure a series of items which, when the scores for the items are aggregated, gives a surrogate score indicative of the level of disclosure in the specific context for which the ratio was devised” Majid, Sulaiman and Ariffin (2011). Few studies had employed Shariah governance disclosure ratio as the method of measurement for Shariah governance disclosure.

Ousama and Fatima (2010) resisted in their study that the primary task is to develop a disclosure ratio, when having a disclosure checklist of different disclosure items. As a result, the study’s disclosure ratio includes Islamic items in addition to conventional items. The study also develop the ratio in each step by referring many studies before come out with a suitable voluntary disclosure items to be measured in the disclosure ratio.

Majid, et al., (2011) contended that the use of self-made ratios to determine quality of the disclosure has been commonly used in previous studies in examining the quality of environmental and corporate social responsibility disclosure. Therefore, the similar ratio may also help any researchers in determining the quality of corporate governance information disclosed by IFIs.

In another area of study, Sulaiman, Majid and Ariffin (2011) developed a comprehensive Shariah governance disclosure ratio using the guidelines issued by the BNM, AAOIFI and IFSB by grouped 123 items into 14 dimensions as his study purpose. Content analysis was used to determine the extent of IFIs in complying with the ratio.

Darmadi (2013) had enhance the validity by carefully developed it from a number of studies and guidelines. Then, the scoring of the ratio for each bank is conducted through a content analysis, where the entire annual report of the banks is read before making any judgment for Shariah governance disclosure ratio application.

Ramli, Majid, Muhamed and Yaakub (2014) identified the sources of Shariah governance items from Shariah governance ratio that developed based on SGF of BNM. Shariah governance variables of the study are hand-collected from annual report of each of the Islamic banks. Similarly, content analysis was used to determine the extent of IFIs compliance with the developed ratio. Later, the results on the scoring of the respective Shariah governance are converted into disclosure ratio for the purpose of analysis of the study.

Therefore, by referring to these previous studies, it can be concluded that there was no specific and determined formula to calculate the ratio of every different items for Shariah

governance, but only one formula which is Shariah governance disclosure ratio that is widely used in the Shariah governance studies.

2.8 Conclusion

The new Shariah governance framework issued by BNM provides strong foundation for the betterment of Islamic banking industry. This improvement of the framework is due to increasing criticism on the decisions made by the Malaysian Shariah committees. Thus the rough pictures on the Shariah governance for Islamic banking in Malaysia are appropriately understandable. However, the compliance on the implementation of the framework by Islamic banks in Malaysia on the Shariah governance is in needed to be study in furtherance.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This study aims to identify the regulations on Shariah governance, compare it with the international standards and to scrutinize the practice of Shariah governance disclosure in Islamic banks in Malaysia. With that, the purpose of this research methodology section is to provide sufficient information on how this study is planned to be carried out as it is the vital part of every research. In this chapter, the appropriate methodology relies in the selected research design. Thus, this chapter had carefully considered for the source of used data in this study, the population design, the data collection method and the data analysis of this study.

3.2 Research Design

Research design entirely concern with the structure, plan and methods of research in order to reach the acceptable answers to research questions of this study (Chatterjee, 2000) and definitely, it involves a series of rational decision-making (Cavana, Delahaye & Sekaran, 2001). For example, utilizing the appropriate sources of data, the method of data collection and the data analysis. The elaboration of design of the study will provide a more detail understanding of the study (Creswell, 2008). This study, being the title on the Shariah governance is more related with the doctrinal research which is essentially a

library-based study, where the materials used are available in the libraries, the banks website and others. Besides, the legal research is also relevant for this study since few regulations was referred.

According to Cavana, et al. (2001), the nature of the studies, whether it is exploratory, descriptive or hypothesis testing, are fully depends on the knowledge of the research topic and area. In this particular study, the research design adopted is descriptive study and comparative study. Basically, a descriptive study is used to determine upon the situation happened. The goal of this descriptive study is to discover facts and describe in a systematic way on the reality what has happened (Yaqin, 2007). Thus, the rationality in adopting this kind of design is in order to learn about Shariah governance and describe in detail on its implementation by means of the legislation regulating Shariah governance. Secondly, the comparative study is also the systematic search for further knowledge on issue but in two or more different system. This study used comparative study to make comparison between the local regulations with the international standard and its disclosure by looking at the practice in selected Islamic banks in Malaysia.

Therefore, the qualitative research is the most suitable types of research adopted in this study. The main reason is that this study does not use any statistical analysis as in the data analysis. According to Yaqin (2007), a qualitative research involves the collection of data in the form of words, descriptions or narratives which is undeniably appropriate for this particular study on the Shariah governance disclosure. Furthermore, almost all of the

previous researches on this area of study adopted qualitative research, thus strengthen the reasons to use qualitative research.

3.3 Source of Data

The sources of data used are varied in order to obtain the comprehensive information regarding the research objectives. According to Chatterjee (2000), in legal research, the primary sources of data are direct, authoritative and does not influence by any other opinions. Among the example of primary data are the original documents or statutes or the religious scriptures or any other similar level document. In addition, the institution's annual report is the primary source of information for that particular institution, with the requirements that the document must be original and had been prepared as of necessity and not by choices. Meanwhile, the secondary sources of data are contrary to primary sources, which are opinions by the experts, books, published journals and others.

However, contrary to the business research, the already existing empirical data that exist somewhere already are commonly called secondary data, including both textual data that exist without any specific collecting activities and visual materials (Cavana, et al., 2001).

Based on the research objectives, the source of data is being specified. The first research objective is 'To scrutinize the scope of Shariah governance disclosure of Islamic banking institutions in Malaysia as required by the existing legislations', the related source of data is the primary data based on legal research but secondary data in business research as it

will refer the statutes that had been enacted by the Parliament which is IFSA 2013, and guidelines introduced by BNM, which are SGF 2011, GP1-i 2013 and GP8-i 2012.

Then the second research objective is ‘To compare the Malaysian legislations on Shariah governance disclosure with the legislations issued by the international bodies for Islamic banking and finance’, where the source of data is the same with previous research question, in addition of the international regulations on Shariah Governance to compare with Malaysian regulations which are AAOIFI and IFSB-10.

Finally, the third research objective is ‘To analyse the practice of Islamic banks in Malaysia on the compliance with the requirement of the law on the Shariah governance disclosure’ where the source of data is also the primary data in legal research but being secondary data in business research by analyzing the latest annual report of Islamic banks listed under BNM, particularly the Shariah Committee’s Report in order to disclose the extend of disclosure practices by the banks using Shariah governance disclosure ratio.

3.4 Population Design

The qualitative sampling techniques are concerned with seeking information from specific groups and subgroups in the population (Hancock, 2002). According to Cavana, et al., (2001), population refers to the entire group of people, events, or things of interest that wished to investigate. In qualitative research, the numbers of selected population are usually small as compared to quantitative research which covers very large populations

and samplings (Yaqin, 2007). In this study, the population is 16 Islamic banks in Malaysia that are listed under BNM. All of the Islamic banks are listed below in Table 3.1.

Table 3.1
The lists of Islamic banks under BNM.

No.	Islamic Banks	Nationality
1.	Affin Islamic Bank Berhad	Local
2.	Al-Rajhi Banking and Investment Corporation Malaysia Berhad.	Foreign
3.	Alliance Islamic Bank Berhad	Local
4.	Am Islamic Bank Berhad	Local
5.	Asian Finance Bank Berhad	Foreign
6.	Bank Islam Malaysia Berhad	Local
7.	Bank Muamalat Malaysia Berhad	Local
8.	CIMB Islamic Bank Berhad	Local
9.	HSBC Amanah Malaysia Berhad	Foreign
10.	Hong Leong Islamic Bank Berhad	Local
11.	Kuwait Finance House Malaysia Berhad	Foreign
12.	Maybank Islamic Berhad	Local
13.	OCBC Al-Amin Bank Berhad	Foreign
14.	Public Islamic Bank Berhad	Local
15.	RHB Islamic Bank Berhad	Local
16.	Standard Chartered Saadiq Berhad	Foreign

Source: BNM, 2015 retrieved on June 1, 2015.

These Islamic banks are listed under BNM categorized as approved Islamic banks. There are ten local Islamic banks and six foreign Islamic banks incorporated in Malaysia are accepted as Islamic banks under BNM.

3.5 Data Collection Method

After the development of the research questions, all the data are need to be collected by using, either qualitative or quantitative method (Cavana, et al., 2001). In collecting data of this study, the qualitative method is the appropriate method. The reasons is that the qualitative research does not rely on unified theoretical and methodological concepts, since a variety of different theories, methods and others related are possible in qualitative research (Eriksson & Kovalainen, 2008).

Therefore, the qualitative approach is adopted as this study involves in-depth analysis of the Shariah governance practice in Malaysia and how far the Islamic banks had complied with the Malaysian regulations under the regulation stipulated by BNM. Besides, by doing qualitative research, the implementation of Shariah governance in Islamic banks will be understandable rather than predicting and knowing the basic of it only. These benefits will be gained by content analysis technique by analytically and critically investigate on the related matters that can only be used in qualitative research method.

Furthermore, as same as before, the qualitative approach in disclosing the practice of Shariah governance in the selected Islamic banks using the disclosure index is the best approach. This refers to the definition of disclosure index, where it defined as “a qualitative based instrument designed to measure a series of items which, when the scores for the items are aggregated, gives a surrogate score indicative of the level of disclosure in the specific context for which the index was devised” (Sulaiman, et al., 2011). Thus, it

is undeniable that the qualitative method of collecting data is the relevant method for this study.

3.5.1 Developing the Shariah Governance Disclosure Ratio

The Shariah governance disclosure ratio to be used in this study was adopted in the previous studies and the regulations and guidelines chosen in this study is the basis of developing the Shariah governance disclosure ratio (Darmadi, 2013, Majid, et al., 2011, Ousama & Fatima, 2010, Ramli, Majid, Muhamed & Yaakub, 2014, Sulaiman, et al., 2011). The Shariah governance disclosure ratio items are taken from the SC report in the latest annual report of all 16 Islamic banks in Malaysia. The stages of developing Shariah governance disclosure ratio shows in the following Figure 3.1.

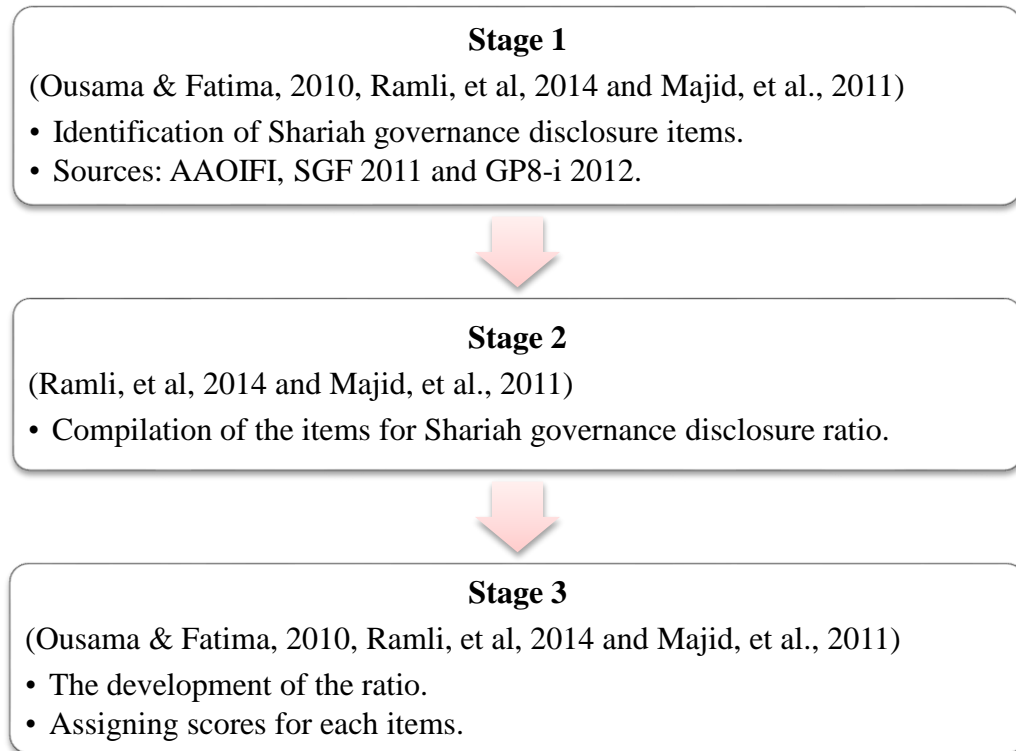


Figure 3.1
The Stages of Developing Shariah Governance Disclosure Ratio

As in Figure 3.1 above, there were three stages in structuring the Shariah governance disclosure ratio for this study. Stage 1 is the identification of the Shariah governance disclosure items based on the three stated sources which are the AAOIFI, SGF 2011 and GP8-i 2012. Only these three regulation and guidelines are available in identifying the disclosure items based on the given SC report guideline. Further, these three will be able to focus and limit the Shariah governance items specifically for Islamic banks. Thus this study only includes the items in SC report provided in the latest annual report of all Islamic banks in Malaysia.

Further, Stage 2 is the compilation of the Shariah governance disclosure ratio items. All the items under AAOIFI, SGF 2012 and GP8-i 2011 had been examined since it needs to be arranged in order to ease the progress for the next stage. The items are organized based on the common ground of disclosure items. This stage led to the inclusion of exactly 10 items to be scrutinized.

Table 3.2
Items for Shariah Governance Disclosure Ratio Scoring

No	Items
a.	Opening or Introductory paragraph
1.	Purpose of SC
2.	Management responsibility
b.	Scope paragraph on nature of work
3.	Confirm SC done proper procedure
4.	Violation and remedy
c.	Opinion paragraph
5.	Compliance of contracts etc.
6.	Profit allocation
7.	Disposal of prohibited earnings to charity
8.	Shariah compliance on zakat calculation
d.	Signatures
9.	Chairman
10.	SC members

Table 3.2 indicates items in the SC report that will be used as the scoring value for Shariah governance disclosure ratio applicable to all Islamic banks in Malaysia as had been listed in table.

Last but not least, stage 3 is to develop the final index based on the disclosure items by referring to each SC report of all Islamic banks. The disclosed items are marked as tick (✓) and the missing items are marked as (0) indicating the non-disclosure item. Then, the result of the scoring for each item was calculated using the Shariah governance disclosure ratio develop by dividing the disclosed items with the total applicable items, as shown below.

$$\text{Shariah Governance Disclosure Ratio} = \frac{\text{Disclosed items}}{\text{Total applicable items}}$$

This simple formula is widely used in disclosure studies as had been stated in the stages of developing Shariah governance disclosure ratio above.

3.6 Data Analysis and Interpretation

In the qualitative research, it is heavily dependent on the researchers' analytic and integrative skills and personal knowledge of the social context where the data is collected (Bhattacharjee, 2012). The goal of data analysis in qualitative research is to extract meaning of the research finding and how it occurred. Therefore the content analysis is adopted as the best method in analyzing the data in this study. Content analysis also had been used widely to determine the extent of Shairah governance in complying the Shariah governance disclosure ratio (Darmadi (2013), Majid et al. (2011) and Ramli, Majid, Muhamed and Yaakub (2014).

Furthermore, content analysis is a widely used method for quantifying qualitative data (Collis & Hussey, 2009). It is a procedure for the categorization of verbal or behavioral data, for purpose of classification, summarization and tabulation (Hancock, 2002). According to Yaqin (2007), content analysis refers to a systematic examination of anything that is recorded in some document or form, such as books, diaries, letters or any other relevant medium. This kind of method enables the study to analyze large amounts of textual information and systematically identify its properties in the text (Sekaran & Bougie, 2013).

Thus, by using content analysis, the needed information will be able to be examine in order to determine the practice and implementation of Shariah governance with the results of using Shariah governance disclosure ratio in Islamic banks in Malaysia. The annual reports of all the Islamic banks are the latest annual report, which is at the financial year of 2014. However, only three Islamic banks the annual report is at the financial year 2013, which are al-Rajhi Banking and Investment Corporation (Malaysia) Berhad, Asian Finance Bank Berhad and Standard Chartered Saadiq Berhad. All three Islamic banks are foreign bank incorporated in Malaysia since they did not release the 2014 annual report yet. Lastly, only one Islamic bank does not provide SC Report in its annual report, which is Alliance Islamic Bank Berhad.

3.7 Conclusion

As conclusion, in this particular chapter, the review of research methodology has been carefully elaborated in visualizing the set of rules of procedures about the way of conducting this study. Among them are the type of research conducted and the appropriate technique used to analyses data collected. In order for these analyses to be reliable and valid, the flow process of the research methodology must be done accordingly and systematically without living single small details of the research methodology.

CHAPTER FOUR

ANALYSIS AND FINDING

4.1 Introduction

In this chapter, there will be three divisions of analyses to answer all the research questions and embrace the research objectives in this study. First, examining the practice of Shariah governance in Islamic banking institutions based on the existing regulations in Malaysia with the international standard on Shariah governance of Islamic banking institutions. Second, highlight the dissimilarities of both legislations on Shariah governance of Islamic banks. Lastly, analysing the actual implementations of Shariah governance disclosure practice in the selected Islamic banks listed under the BNM by reviewing the disclosure of Shariah governance, with the example of the SC report of the Islamic banks, along with the research findings.

The main purpose of this chapter is to disclose and to reveal with real evidence on the transparency of Shariah governance in Islamic banks. Hence, it will be an eye-opener upon of the real practice of Shariah governance in Malaysia. The results might be vary due to difference practices and approaches by all Islamic banks. Thus, the way all the Islamic banks comply with Shariah governance by Islamic banks may be seen.

4.2 Different Approaches of Legislations on Shariah Governance in Islamic Banks

The licensed Islamic banks in Malaysia listed under BNM website had been recognized by the BNM itself. However, the level of compliance with the requirement of the laws was definitely varied due to the management and adherence of the institutions to the legislation, particularly by the role of the SC upon Shariah governance of the Islamic banks.

Thus, for the Islamic banks to meet the objectives of BNM, they are vested with comprehensive legal powers under the approved legislations to regulate and supervise the Islamic banking system itself. As stated under the CBA 2009, the main statute for BNM, in section 5 (1), the principal objectives and functions of BNM is to promote monetary stability and financial stability conducive to the sustainable growth of the Malaysian economy. Further, under section 5 (2) (c) of the same Act, among of the primary functions of BNM is to regulate and supervise financial institutions, including the Islamic banks, which are subject to the laws enforced by BNM. Based on these two sections, it is undeniable that BNM has a vested power in taking care of the system and management of the Islamic banks in Malaysia.

4.2.1 Malaysian Legislations on Shariah Governance in Islamic Bank

In Malaysia, the Islamic banking regulations and the regulations for conventional banking system exists separately, as stated under section 27 of CBA 2009, where the financial system in Malaysia consist both the conventional system and the Islamic financial system. Undoubtedly, Islamic banking and finance was put under the Federal List of the Federal Constitution as it is also commercial transactions although it is suitably within Islamic law. By that reason, the parliament has the power to pass any law governing the Islamic banking institutions. Besides, the decision to empower Islamic banking systems in Malaysia is a consequence from Muslim demands to have a comprehensive banking and financial system in accordance with Shariah (Hasan, 2008).

Generally, BNM will give two years for the applicable institutions to comply with the established law, policy and guidelines (BNM, 2015). The regulations are chosen based on suitability of the practically Shariah governance of the Islamic banks with the related applicable law. Particularly, this study focuses on the SC Report of each bank in measuring the level of compliance with Shariah governance. The reason is that the report shows every inches of the role of SC as the team in ensuring compliance of Islamic banks with Shariah law. Furthermore, SC Report is merely the same with auditor's report that represents an executive summary of the Shariah compliance matters of Islamic banks. Therefore, the guideline only lists down the basic disclosure and transparency requirements for the Islamic banks to be followed. Hence, it brings variation of format

and arrangement of report from the banks and it is understandable that some bank's reports are too simple that might be able to raise the issue of transparency and the function of proper governance.

Consecutively, there are three regulations in Malaysia that embrace directly with Shariah governance with regards to Shariah governance in Islamic banks, which are, IFSA 2013 as the main regulation, SGF 2011, GP1-i 2013 and GP8-i 2012 as the basic guidelines.

a. Islamic Financial Services Act (IFSA) 2013

The IFSA 2013 being the main regulation and supervision of Islamic banking institutions have the utmost responsibility in promoting financial stability and Shariah compliance in any matters related to Islamic banks operations, dealings and transactions. Only the licensed Islamic banks are applicable with the said regulation. Section 2 of IFSA understandable that the foreign Islamic banks are also embraced under IFSA in the Shariah governance matters. Among the listed foreign Islamic banks under BNM, there are six foreign Islamic banks incorporated in Malaysia, which are Al-Rajhi Banking and Investment Corporation Malaysia Berhad, Asian Finance Bank Berhad, HSBC Amanah Malaysia Berhad, Kuwait Finance House Malaysia Berhad, OCBC Al-Amin Bank Berhad and Standard Chartered Saadiq Berhad.

Under Part IV of IFSA, there are listed Shariah requirements for applicable Islamic banks. For the purpose of this present study, only Division 1 of Part IV IFSA on Shariah compliance is related and will be scrutinized. The reason is that Shariah compliance is the vital requirement for a bank to comply to be regarded as Islamic banks. It is clearly envisaged under section 28 of IFSA. Upon realizing any activity that is non-compliance with Shariah, the institution with the advice of its Shariah committee must notify on the issue, cease the non-compliance activity and rectify by reduce it in written form as stated in subsection (3) of section 28.

The SC, as had been clarified earlier, was the heart of the Islamic banks in advising the banks in assuring its business affairs and activities to comply with Shariah principles. “Shariah Committee” under section 2 of IFSA means the Shariah committee of an institution established pursuant to section 30 which states on the establishment of SC under Shariah governance of the Islamic banks. Thus, the committee has the utmost role in every Islamic bank.

However, IFSA does not specifically highlight provisions on the disclosure matters of Shariah governance but needs to cross refer the guidelines under BNM. The generalization on the disclosure in IFSA comes with a firm reason where it does bring benefits generally but not specifically. In the eyes of law, the main regulation or the statute is better to be in general since it does not need to be repealed and some small sections and then to sit in the Parliament to enact the law again and again. However, if it

is only some guidelines, corrections or to repealed the guidelines is easier since it does not need for the Ministers to enact it in the parliament that took few years to be passed.

Furthermore, as stated in Section 29 of IFSA, BNM has power to specify standards on Shariah matters of the banks in carrying on the business affair or activity where it requires the ascertainment of Islamic law. Besides, under subsection (2) of the same section, BNM also may specify standards on Shariah governance including the functions and duties of Shariah committee on matters pertaining to Shariah compliance, secondly, on proper requirements of SC member and thirdly on internal Shariah compliance functions.

Moreover, the power of BNM also comprise on any other related matter that relates to the business, affair and activity of the Islamic banks for the purpose of Shariah compliance. In short, BNM may apply any related guidelines for the Islamic banks to be complied in order to preserve the dignity of Shariah law as well as the pride of IFSA. By that reason, it is rational to claim that from time to time, BNM are fully updated with the law, policy and guidelines as to be coherently updated with the international standard.

With the empowerment of IFSA, the SC in Islamic banks was fully tied with the relevant framework and guideline in order to maintain the confidence of Islamic bank in Malaysia. The related part of the framework and guidelines are further explained below.

b. Shariah Governance Framework (SGF) 2011

The BNM has developed the SGF with the primary objective of enhancing the role of the board, the SC and the management in relation to Shariah matters, including enhancing the relevant key organs having the responsibility to execute the Shariah compliance and research functions aimed at the attainment of a Shariah based operating environment. Particularly, the SGF is designed to; (i) sets out the expectations of BNM on Islamic banks Shariah governance structures, processes and arrangements to ensure that all operations and business activities are in accordance with Shariah, (ii) provides a comprehensive guidance to the board, SC and management of Islamic banks in discharging its duties in Shariah matters, and (iii) outlines the functions relating to Shariah review, Shariah audit, Shariah risk management and Shariah research (SGF, 2011).

The SGF is applicable to all Islamic banks regulated and supervised by BNM. It is admitted by the SGF that the framework must be read together with related guidelines and others that relevant. The reason is that the guidelines are far more specific on the details that may not be envisaged by the SGF. Paragraph 2.9 of SGF states on SC in discharging their duties, it is expected to disclose sufficient information in the Islamic banks annual financial report on the state of the Islamic bank as required under GP8-i. This paragraph must be read with paragraph 8.4 of GP8-i as both connected on the SC's report.

Table 4.1 below shows the example of minimum annual disclosure is given as basic guideline for the applicable Islamic banks.

Table 4.1
Examples for Shariah Committee's Report

<p>Shariah Committee's Report</p> <p><i>In the name of Allah, the Beneficent, the Merciful</i></p> <p>In compliance with the letter of appointment, we are required to submit the following report:</p> <p>We have reviewed the principles and the contracts relating to the transactions and applications introduced by the ABC Islamic Financial Institutions during the period ended XX/XX/XXXX. We have also conducted our review to form an opinion as to whether the ABC Islamic Financial Institution has complied with the Shariah principles and with the Shariah rulings issued by the Shariah Advisory Council of Bank Negara Malaysia, as well as Shariah decisions made by us.</p> <p>The management of ABC Islamic Financial Institution is responsible for ensuring that the financial institution conducts its business in accordance with Shariah principles. It is our responsibility to form an independent opinion, based on our review of the operations of the ABC Islamic Financial Institution, and to report to you.</p> <p>We have assessed the work carried out by Shariah review and Shariah audit which included examining, on a test basis, each type of transaction, the relevant documentation and procedures adopted by the ABC Islamic Financial Institution.</p> <p>We planned and performed our review so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the ABC Islamic Financial Institution has not violated the Shariah principles.</p> <p>In our opinion:</p> <ol style="list-style-type: none">1. The contracts, the transactions and dealings entered into by the ABC Islamic Financial Institution during the year ended XX/XX/XXXX that we have reviewed are in compliance with the Shariah principles;2. The allocation of profit and charging of losses relating to investment accounts conform to the basis that had been approved by us in accordance with Shariah principles; <p>(where appropriate, the opinion paragraph shall also include the following matters:)</p> <ol style="list-style-type: none">3. All earning that have been realized from sources or by means prohibited by the Shariah principles have been considered for disposal to charitable causes; and4. The calculation of zakat is in compliance with Shariah principles. <p>We, all the member of the Shariah Committee of ABC Islamic Financial Institution, do hereby confirm that the operations of the ABC Islamic Financial Institution for the year ended XX/XX/XXXX have been conducted in conformity with the Shariah principles.</p> <p>Chairman of the Shariah Committee:</p> <p style="text-align: center;">(Name:)</p> <p>Shariah Committee:</p> <p style="text-align: center;">(Name:)</p>
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Source: SGF 2011

c. Guidelines on Corporate Governance for Licensed Islamic Banks (GP1-i) 2013

As relate to this study, the primary objective of the GP1-i is to promote the implementation of effective and standards of corporate governance practices by Islamic banks. Among them are Principle 1.04 (iv) on Importance of Corporate Governance to comply with Shariah principles and the regulations. Secondly, Principle 2.02 on Principles of Corporate Governance of Islamic banks. Thirdly, Principle 2.10 (vi) and (vii) on the Major Responsibilities of the Board. Next, Principle 2.19 on SC and Principle 2.99 and 2.100 on Internal Audit in compliance with Shariah. Last but not least, Principle 2.110 on the Comprehensive Disclosure Requirement by SC (Mizushima, 2014).

It is clear that in GP1-i 2013, the Shariah governance is one of the concerns in the guideline. Particularly in Principle 2.19, it is a requirement to establish SC within the Islamic banks as governing bodies apart from having the Board Committees only. Furthermore, Principle 2.110 of GP1-i 2013 also required to observe the GP8-i 2012 on a comprehensive disclosure requirement by BNM. It is for the purpose of having thorough Shariah governance within Islamic banks. Particularly, under the same Principle 2.110, it is required for the SC to endorse a report in stating the conformity of the operation by Islamic banks to be in accordance with Shariah principles. The guideline also related with SGF 2011 and GP8-i 2012.

d. Guidelines on Financial Reporting for Islamic Banking Institutions (GP8-i) 2012

The GP8-i is applicable to Islamic banks licensed under IFSA 2013 and effective after 1st of January 2014, two years of transition period after the issuance date by BNM. The primary objective of the GP8-i is to outline the basis for disclosure of reports and financial statements of Islamic banks in carrying out its banking and finance activities. For example, to facilitate the stakeholders in evaluating and assessing the Islamic banks' financial position and performance, and to ensure the Shariah compatibility of the Islamic banks activities and compliance.

Among the guidelines that shall be read together with the GP8-i is the SGF 2011 as stated under principle 5.1 (c) of GP8-i and under principle 2.9 of SGF. The GP8-i set out the minimum disclosure requirement that should be observed by the Islamic banks to ensure that all the financial and non-financial activities, such as administrative section, reporting requirements and others are reported and well understood.

Under paragraph 8, the minimum disclosure requirements are listed, particularly for SC Report as required under paragraph 8.4, to meet the requirement in paragraph 2.9 of the SGF in compliance with Shariah principles, the Islamic banks must disclose the SC Report as part of the Annual Report and signed at least by two SC members. Further, the SC Report must consist of these three information, firstly, the opening or introductory paragraph, particularly on the identification of the purpose of the SC engagement and a

clear statement of management's responsibility in ensuring compliance with Shariah principles. Secondly, the scope paragraph describing the nature of the work performed with the confirmation that the SC has performed appropriate tests, procedures and review work as appropriate. And last but not least, the paragraph expressing the SC opinion on the Islamic banks' compliance with Shariah with regard to:

- (i) the compliance of contracts and related documentation used;
- (ii) the appropriateness of Shariah basis of allocation of profit between shareholders and investment account holders; and where appropriate
- (iii) the disposal of any earnings from prohibited sources/ means to charitable causes;
- (iv) the compliance of zakat computation with Shariah; and
- (v) any known violations of fatwas, rulings and guidelines by the management of reporting institutions and action taken to remedy the violations.

As had been stated earlier, the example or the template for the SC Report had been provided in paragraph 2.9 of SGF as the basic reference for the Islamic banks in complying with paragraph 8.4 of the GP8-i.

4.2.2 International Standard on Shariah Governance in Islamic Banks

According to BNM (2015), there are over 300 IFIs worldwide across 75 countries. Presently, Malaysia is among the most developed Islamic banking markets in the world. Since 2009, the BNM had approved significant numbers of Islamic banks operating in Malaysia including six foreign owned entities, few conventional institutions having established Islamic subsidiaries. For the foreign Islamic banks incorporated in Malaysia, it is logical for them to follow the international Islamic banks guideline.

However, as had been stated earlier, once a bank incorporated in Malaysia, it is tied with Malaysian legislations to suit the Malaysian environment. The most relevant international standard for Islamic banks is the IFSB and the AAOIFI 2010. IFSB being a general guideline, had touch a bit on the Shariah Advisory Council, but not on the disclosure of Shariah Governance of Islamic banks, thus AAOIFI is referred since it does envisages on the disclosure on Shariah governance.

a. Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) 2010

AAOIFI is an independent Islamic international corporate body that prepares the accounting, auditing, governance, ethics and Shariah standards for IFIs. The standards have introduced greater harmonization of Islamic finance practices globally. To be noted, Malaysia has issued few guidelines based on AAOIFI's standards and pronouncements (AAOIFI, 2014).

As stated in the International Standard of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) 2010, its objectives are:

1. To develop accounting and auditing thoughts relevant to Islamic financial institutions;
2. To disseminate accounting and auditing thoughts relevant to Islamic financial institutions and its applications through training seminars, publication of periodical newsletters, carrying out and commissioning of research and other means;
3. To prepare, promulgate and interpret accounting and auditing standards for Islamic financial institutions; and
4. To review and amend accounting and auditing standards for Islamic financial institutions.

AAOIFI carries out its objectives in accordance with the precepts of Shariah law in conformity with the environment of developed Islamic banking institution. It comes with six sections, which are, Shariah Standard, Accounting Standard, Auditing Standard, Governance Standards, Ethics and Guidance Notes. The most applicable section is the Governance that consists of seven governance standard, where the relevant standard for this study is the first standard, namely Governance Standard for IFIs No. 1 under governance section, on Shariah Supervisory Board: Appointment, Composition and Report. Besides, it is effective for the financial statements since 1999.

The example of the SSB report shows in Table 4.2 and according to section 9 of AAOIFI, the basic elements should contain the following matters:

- a) Title;
- b) Addressee;
- c) Opening or introductory paragraph;
- d) Scope paragraph describing the nature of the work performed;
- e) Opinion paragraph containing an expression of opinion on the compliance of the Islamic financial institution with Islamic Shariah Rules and Principles;
- f) Date of report; and
- g) Signature of the members of Shariah supervisory board.

Table 4.2
Example Report of Shariah Supervisory Board.

<p style="text-align: center;">In the name of Allah, the Beneficent, the Merciful</p> <p>To the Shareholders of The Example Islamic Financial Institution</p> <p><i>Assalam Alaikum Wa Rahmat Allah Wa Barakatuh</i></p> <p>In compliance with the letter of appointment, we are required to submit the following report:</p> <p>We have reviewed the principles and the contracts relating to the transactions and applications introduced by the Example Islamic Financial Institution during the period ended. We have also conducted our review to form an opinion as to whether the Example Islamic Financial Institution has complied with Shari'a Rules and Principles and also with the specific fatwas, rulings and guidelines issued by us.</p> <p>The Example Islamic Financial Institution's management is responsible for ensuring that the financial institution conducts its business in accordance with Islamic Shari'a Rules and Principles. It is our responsibility to form an independent opinion, based on our review of the operations of the Example Islamic Financial Institution, and to report to you.</p> <p>We conducted our review which included examining, on a test basis each type of transaction, the relevant documentation and procedures adopted by the Example Islamic Financial Institution.</p> <p>We planned and performed our review so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Example Islamic Financial Institution has not violated Islamic Shari'a Rules and Principles.</p> <p>In our opinion:</p> <ul style="list-style-type: none">a) the contracts, transactions and dealings entered into by the Example Islamic Financial Institution during the year ended ... that we have reviewed are in compliance with the Islamic Shari'a Rules and Principles;b) the allocation of profit and charging of losses relating to investment accounts conform to the basis that had been approved by us in accordance with Islamic Shari'a Rules and Principles; <p>(where appropriate, the opinion paragraph shall also include the following matters:)</p> <ul style="list-style-type: none">c) all earning that have been realized from sources or by means prohibited by the Islamic Shari'a Rules and Principles have been disposed of to charitable causes; andd) the calculation of Zakah is in compliance with Islamic Shari'a Rules and Principles. <p>We beg Allah the Almighty to grant us all the success and straight-forwardness.</p> <p>Wassalam Alaikum Wa Rahmat Allah Wa Barakatuh</p> <p>(Names and signature of the members of the Shari'a supervisory board)</p> <p>Place and Date</p>

Source: AAOIFI 2010

4.3 Comparative Analysis among Regulations on SC / SSB Report

The SC Report is vital as means of communicating information on Islamic banks operations to be used by decision makers from internal and external of Islamic banks. Furthermore, it is the most adequate reflection on non-financial effects of the Islamic banks operations. Therefore, it is logical to see different method by Islamic banks in presenting their SC Reports. Table 4.3 shows the distinguish approach by Malaysian legislation which are SGF and GP8-i as compared to the international standard of AAOIFI for SC/SSB Report.

Table 4.3: Different approach of SC / SSB Report.

Items	Legislation/ International standard	SGF & GP8-i	AAOIFI
1. Title		X	√
2. Addressee		X	√
Opening or Introductory Paragraph			
3. i. purpose of SC's / SSB's engagement.		√	√
ii. management's responsibility on compliance with Shariah principles.			
Scope Paragraph			
4. i. confirmation that SC / SSB has performed appropriate tests, procedures and review.		√	√
ii.violation in management and remedy taken.			
Opinion Paragraph			
5. i. Shariah compliance on contracts, transactions and dealings.		√	√
ii.allocation of profit.			
iii. disposal prohibited earnings to charity.			
iv. zakat calculation compliance with Shariah principles.			
6. Date of Report		X	√
7. Signature of Members		√	√

The Table 4.3 above shows the comparison between local and international legislation. The symbol 'X' shows that the title and the addressee does not required by the SGF and GP8-i, the same goes to the date of report. Further, for the signature of the members of Board / Committee, the SGF and GP8-i only require at least two members signing the report, but the AAOIFI requires all the members of SSB to sign the report. These findings are in line with Hasan (2010) that found the format of SC's report in GP8-i is lacking of a few important information as compared to the AAOIFI Governance Standard for IFI No. 1 on SSB upon the report, where the AAOIFI requires several additional information on Shariah compliance matters such as its activities, transactions and operations done by the IFIs.

However, it is to be noted that the comparison on AAOIFI as an international standard and SGF and GP8-i as specifically Malaysian guidelines are only on the part of the composition of the SC and SSB Report only. It is definitely different since the domestic guideline must be suitable with the local format of practice.

4.4 Shariah Governance Disclosure Ratio

Table 4.4 shows Islamic banks analysis for Shariah governance disclosure ratio on compliance with the regulations. For each bank, the overall ratio was calculated on the compliance with items under the SGF and GP8-i. The annual report referred for all Islamic banks was the latest annual report which is for the year ended 2014. However,

only three Islamic banks annual report was in 2013 since they do not release the 2014 annual report yet, which are al-Rajhi Banking and Investment Corporation, Asian Finance Bank Berhad and Standard Chartered Saadiq Berhad.

The result shows that, among the items that need to be disclosed; only half of it had been fulfilled by all Islamic banks. All five items are the purpose of SC engagement, the management responsibility on Shariah compliance, confirmation on SC doing a proper test, procedure and review in their nature of work, the statement on the compliance of contracts and documents used and lastly on appropriate allocation of profit among shareholders. The most unaware item that had been neglected by majority of the Islamic banks is the signature from the SC member where only five banks are actually get the signature while the other nine banks takes it as not important.

Furthermore, the results for the average ratio indicates that only three from 16 Islamic banks disclose all of the requirement given by the SGF and GP8-i, the banks are Am Islamic Bank Berhad, HSBC Amanah Malaysia Berhad and Kuwait Finance House Malaysia Berhad, thus being considered as Shariah compliance under Shariah governance in SC Report. In contrast with the Islamic banks that got low ratio where the Islamic banks are al-Rajhi Banking and Investment Corporation Malaysia Berhad, Bank Muamalat Malaysia Berhad and OCBC al-Amin Bank Berhad.

Table 4.4
Shariah Governance Disclosure Ratio of Islamic Banks

Items	Banks	Affin Islamic	Al-Rajhi	Am Islamic	Asian Finance	BIMB	BMMB	CIMB Islamic	HSBC Amanah	Hong Leong Islamic	KFH	Maybank Islamic	OCBC al-Amin	Public Islamic	RHB Islamic	Standard Chartered Saadiq	Average results on each item
a. Opening or introductory paragraph																	
1. purpose of SC	√	√	√	√	√	√	√	√	√	√	√	√	√	√	√	√	1
2. management responsibility	√	√	√	√	√	√	√	√	√	√	√	√	√	√	√	√	1
b. Scope paragraph on nature of work																	
3. confirm SC done proper procedure	√	√	√	√	√	√	√	√	√	√	√	√	√	√	√	√	1
4. violation and remedy	√	√	√	√	√	√	0	√	√	√	√	0	√	√	√	√	0.87
c. Opinion paragraph																	
5. compliance of contracts etc.	√	√	√	√	√	√	√	√	√	√	√	√	√	√	√	√	1
6. profit allocation	√	√	√	√	√	√	√	√	√	√	√	√	√	√	√	√	1
7. disposal of prohibited earnings to charity	√	√	√	√	√	√	√	√	√	√	√	√	0	√	√	√	0.93
8. Shariah compliance on zakat calculation	√	0	√	0	√	√	0	√	√	√	√	√	√	√	√	√	0.80
d. Signatures																	
9. chairman	0	0	√	√	0	0	√	√	0	√	√	0	0	0	0	0	0.40
10. SC member	0	0	√	0	0	0	√	√	0	√	√	0	0	0	0	0	0.33
Average ratio	0.8	0.7	1	0.8	0.8	0.7	0.9	1	0.8	1	0.9	0.7	0.8	0.8	0.8	0.8	

The summary of the items that must be disclosed and the average ratio score for each Islamic bank is presented in the following figures. Firstly, Figure 4.1 on the summary of average Shariah governance disclosure ratio on each items based on Table 4.4.

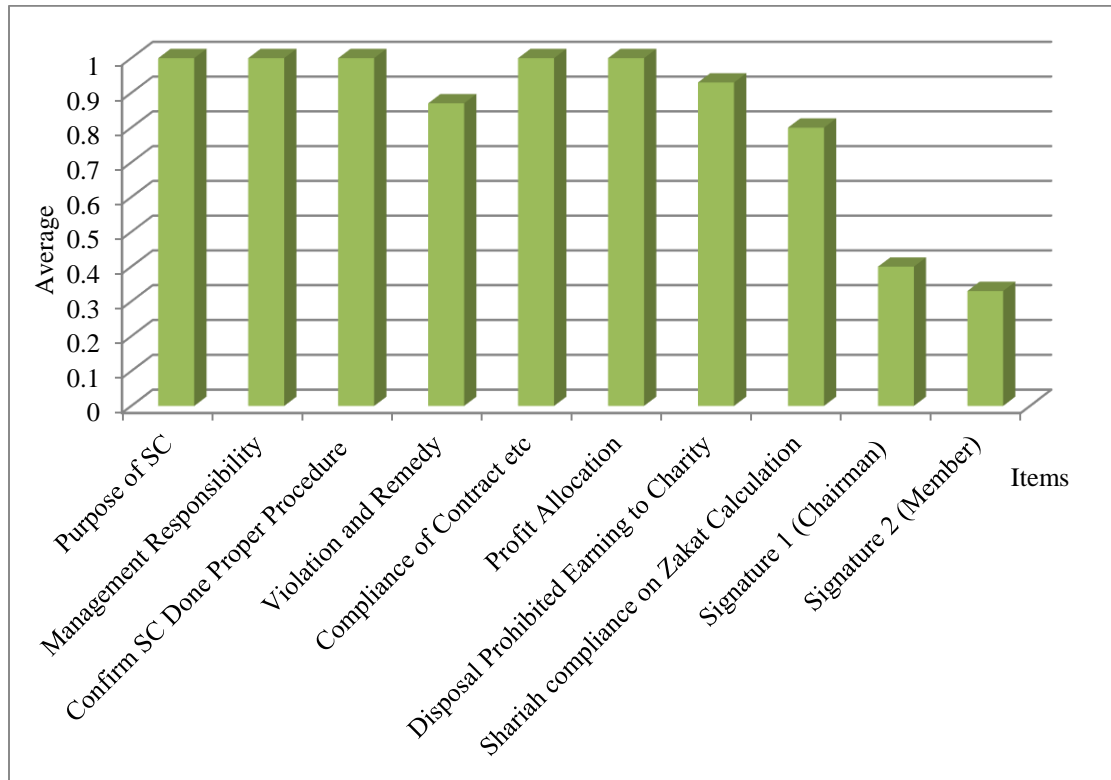


Figure 4.1
Summary of average Shariah governance disclosure ratio on each item

From the above figure, it shows that the average of the score for each item is high except for the last part, which is the signature of the SC members. To be compared with the international standard, the local signature requirement is more lenient since all members of SC must sign below the SSB Report as required by the AAOIFI.

Next, Figure 4.2 above shows the summary of average Shariah governance disclosure ratio on each Islamic banks based on Table 4.4:

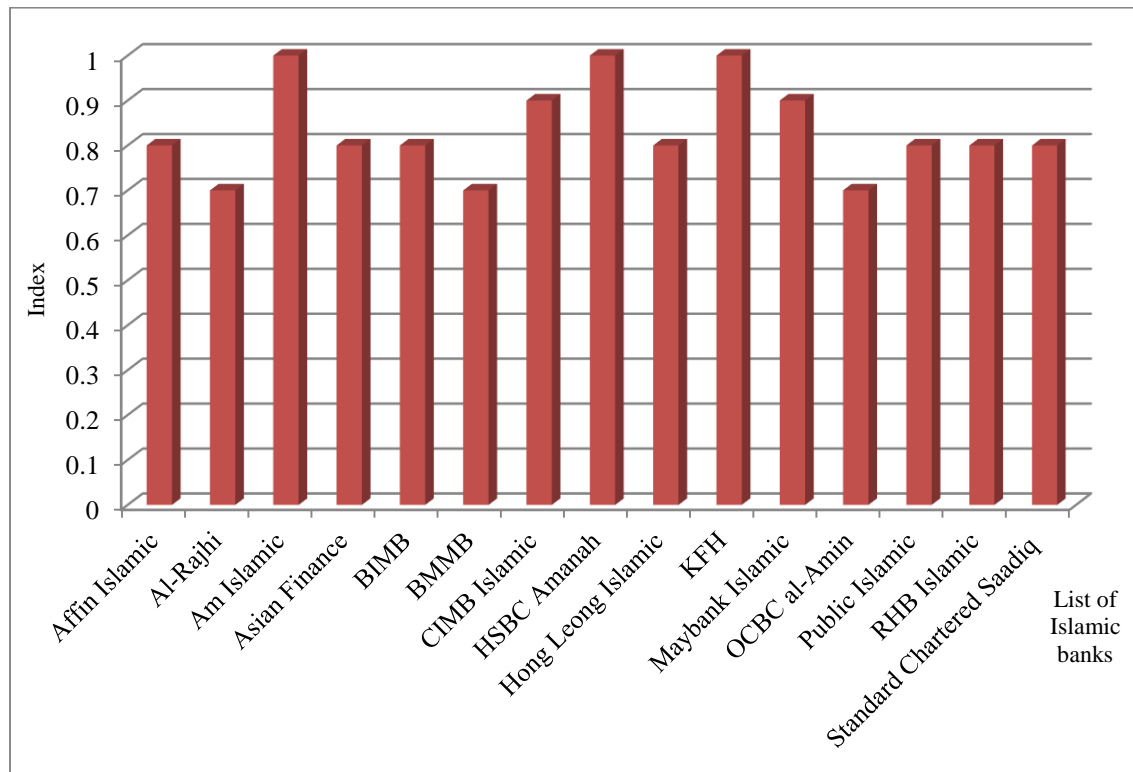


Figure 4.2
Summary of average Shariah governance disclosure ratio on each Islamic banks

Among all of the Islamic banks there is only small gap between the Islamic banks that fulfilled the guideline given and the banks that does not fully followed. It is to be noted that among the three banks that fully followed the guideline, two of them are the foreign Islamic banks that was incorporated in Malaysia. The same goes to the three Islamic banks that get lowest score because of failed to fulfilled three items from the guideline; two of them are the foreign Islamic banks that were incorporated in Malaysia.

CIMB Islamic Bank Berhad and Maybank Islamic Berhad does not fulfilled only one item which is the paragraph on zakat calculation based on Shariah compliance and the other is violation of fatwas, ruling and guidelines and remedy for the violation. The rest of the Islamic banks do not fulfilled two items which are the signature parts where most of them only lists down the member of SC but not signed it. This matter may be argued as the other banks had successfully having the member to signed the report.

However, it must bear in mind that the low score on Shariah governance disclosure ratio does not renders the Islamic banks as non-compliance with Shariah or does not become an Islamic bank anymore, however, it is only not compliance with the guidelines that had been specifically outlined by BNM. It is for the sake of the trustworthiness and for public confidence towards the Islamic banks.

4.5 Conclusion

There are still lacks of adherence to the requirements of regulation made by the authorities. Undoubtedly, this matter would affect the confidence from the stakeholders. However, everything required times to heal from defects. Thus, when Malaysia had been claimed to be the leader in the global Islamic banking and finance industry, it has taken much time and expertise to improve and develop the system through the regulations to standardize Islamic banking practices in Malaysia.

CHAPTER 5

CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

Chapter five being the final chapter concludes the study by summarizing every single point precisely. Then, focused conclusion will be reflected on the penalty for non-compliance of Shariah governance disclosure to enlighten the effect of the requirements needed. Finally, this chapter comes together with logical recommendations and suggestion for further research clearly derives from finding of the study and lastly some limitations of this study.

5.2 Research Summary and Findings

The purpose of this study is to disclose the Shariah governance facts and its practices in Islamic banks in Malaysia. In order to meet this purpose, several research objectives had been offered. The first objective is to scrutinize the scope of Shariah governance disclosure of Islamic banking institutions in Malaysia as required by the existing legislations. Shariah compliance had become the vital issue in the Islamic banking area as to plant the confidence in the heart of the stakeholders since the legality of having a full fledged Islamic banks could be easily shaken by internal and external influences. Thus is it

the role of the SC of each and every Islamic bank to preserve the purpose of having Islamic banks. To govern reliability of Shariah governance of the Islamic banks, there are few closely related regulations upon Shariah governance and the requirement of having a SC in adherence to the related legislations, which are IFSA 2013, SGF 2011, GP1-i 2013 and GP8-i 2012 in Malaysia.

In addition, there are few foreign Islamic banks that incorporated in Malaysia as their strategies in being widely operates and to be recognized as international Islamic banks to give chances for the stakeholders as well as the Islamic banks itself in diversifying their branches. By that, the second research objective is popped out as to compare the Malaysian legislations on Shariah governance disclosure with the legislations issued by the international bodies for Islamic banking and finance. The most famous and recognized international bodies or standards are the AAOIFI and IFSB. These two standards have initially discussed on the Shariah governance having SSB in monitoring the governance of the Islamic banks itself complying the Shariah requirements. As the result, the Malaysian legislations on Shariah governance is more detail than the international standard, however the requirements upon the SC report is more or less the same with prerequisite of Malaysian legislation.

Last but not least, after scrutinizing the requirements by the stated law, it is appropriate to look at the practice of SC report itself as part of Shariah governance by having the third objective that is to analyse the practice of Islamic banks in Malaysia on the compliance

with the requirement of the law on the Shariah governance disclosure. The applicable banks are taken from BNM website where the Islamic banks listed are the approved full-fledged Islamic banks by BNM itself. The finding shows that all Islamic banks are aware with the requirements of a complete SC report, however, only three Islamic banks fulfilled all the basic details of the report and only two Islamic banks lack only one of the items needed. Besides, majority of the Islamic banks lack of two items which are the signature by the members of the SC.

In short, as compared to the international standard, the Malaysian regulations are more comprehensive. This shows by the variance of statute and guidelines that are applicable to every detail of the Shariah governance disclosure. To be compared, the international standard only two, which is the AAOIFI and the IFSB, but only AAOIFI is applicable with the SC report. Meanwhile, Malaysian legislation comprises of IFSA 2012, SGF 2012, GP1-i 2013 and GP8-i 2012. Besides, the international standard does not come with the punishment for non-compliance with the requirement, as compared to Malaysian legislation that comes complete with the penalty of non-adherence as stated under IFSA 2012.

5.2 Penalty for Non-Compliance of Shariah Governance Disclosure

As stated earlier, the ultimate purpose of the establishment of the SC in Islamic banking institutions is to ensure Shariah compliance on its operations and products. It is compulsory for all Islamic banks to have provision on the establishment of SC in their Articles of Association and Memorandum of Association (Hasan, 2008). Thus, by having the legally recognized SC, their function must be met too. To check whether their functions and their responsibility have been fulfilled or not, the SC Report is the main evidence showing all the duties of the committee in ensuring Shariah compliance of the bank.

Therefore, the obligation to comply with the requirement of laws is mandatory. Upon contravention of section 28 (1) until (3) of IFSA on Shariah compliance and under the same section 28, subsection (5) with section 29 (5) envisages that a conviction is appropriate as committing an offence, thus liable to maximum eight years imprisonment or maximum fine twenty-five million ringgit.

Furthermore, in section 29 (6) of IFSA, any Islamic banks that fails to comply with any regulations and guidelines specified by BNM, commits an offence and upon conviction will be liable to imprisonment maximum for eight years or fine not more than twenty five million ringgit or both. However, there are no cited cases yet for conviction under this section.

5.3 Recommendations

The doctrine of Shariah governance disclosure is actually still new in Malaysian Islamic banking institutions, especially the Shariah governance disclosure ratio in showing the compliance of Islamic banks with the requirements by BNM. However, Shariah governance disclosure ratio is the only approach for the Islamic banks to realize which part is complies with the regulations, and which part is not. Besides, the stakeholders also will definitely able to see the banks performance every year and their improvements. It is the duty of the authoritative body to construct a comprehensive legislation with basis or justification in order to avoid any confusion in adherence of the law. Otherwise, there will emerge bad perceptions towards the Islamic banking institutions and even worst, to the religion being the only complete way of life.

Thus, for a better application of Shariah governance disclosure in Islamic banks in Malaysia, being the main hub of Islamic banking and finance, the following possible recommendations and suggestions can be enforce:

- a. The core recommendation is the standardization in term of the Shariah governance disclosure between the international standard and the local standard, especially on the SC Report as had been scrutinized in this study. It will be more ideal to combine both local and international requirements in our local guidelines to be the most comprehensive regulation of all other countries

rather than being independent but unable to follow and adapt the international standards. For example, the last requirement in SGF and GP8-i needs only two members of SC signing the SC Report. However, AAOIFI being the international standard requires all members of the committee to sign. Personally, the signatures by all the members of SC are more convincing for confidence towards Islamic banks.

- b. Secondly, the effective date for IFSA is June 2013, SGF is January 2011 and GP8-i is January 2014. All of them had already been effective, thus, it is the duty of the Islamic banks to follow the stipulated guidelines for their own benefit. It is understandable that being a big financial institution, there are so much to be settled first before some change can be made. However, with the full commitment from every single related officer, anything is possible to be enforced. Thus, it is suggested to have a committee for monitoring the progress of the change that needs to be made and to impose some light punishment, for example low monetary penalty or others, thus the SC will be more aware with the requirement of laws.
- c. Thirdly, the amount of penalty is also must be considered. Being the center of Islamic banking and finance practice, the legislation is needed in order to protect and safeguard the legislations. This is because, the existed penalty that already stated seems to be taken lightly by the Islamic banks while the compliance will added value for an Islamic banks being an IFIs holding the

name of this divine religion. Thus, it is recommended to increase the amount of fine and the length of time for imprisonment or both in considerable manner but seems hefty.

These are among considerable suggestions and recommendations that could be made by the BNM itself. However, these recommendations must not be seen as the impediments for Shariah governance disclosure practice because the enforcement of these recommendations might leads to consistency and wider acceptance by stakeholders locally as well as internationally. In fact, these should be seen as something that will improve the confidence by all stakeholders. As the result, it will make Malaysian Islamic finance and banking more transparent and understandable.

5.4 Limitation of the Study

This study is limited to some certain extent and it is excluded on some objectives related to the topic for discussion. Some of the issues and few parts of Shariah governance are not discussed. This study only focused on the adherence of regulations for Shariah governance. As the matter of fact, Part IV of IFSA discussed on Shariah requirements and there are three divisions, which are Shariah compliance, Shariah governance and audit on Shariah compliance. However, only section 27 until 29 are applicable for this study in order to ensure the compliance of Shariah by SC, thus relates to the regulations and guidelines made by BNM as stated under section 28 of IFSA 2013.

In addition, the issue on the national policy also affected the reasoning of following the standard of SC report. It is also to be noted that each nation are inconsistent with each other at some level, Thus, the comparative analysis also had been made with the international standard since there are Islamic banks incorporated in Malaysia. There might be clash on the adherence of both local legislations by IFSA, SGF, GP1-i and GP8-i, with the international standard by AAOIFI and IFSB.

Having fully rely on the legislation matter, there might be loopholes and weaknesses in this study on the reliable sources for the disclosure of Shariah governance on products of the Islamic banks in complying with Shariah principles, the governance on SC itself and also the Shariah views by mazahib or ulama' upon Shariah compliance matters in the Shariah governance. Thus it is an opportunity for further research to cover those areas in extending this study. It is an honor for this study being completed in other related area.

5.5 Conclusion

This study particularly concerns on the disclosure of Shariah governance of Malaysian Islamic banks. The governing body is none other than, BNM as the central bank of Malaysia monitoring every transaction and dealings of Islamic banks. Nonetheless, the concept, the purpose is only contributed towards the betterment of human being as a Muslims. In short, with the prediction of future globalisation, the Muslim market player should take care of the quality to be acceptable by every level of people.

As had been seen in this study, it is believe that the Shariah governance disclosure can be improved from time to time. This can be proved by looking at all the regulations and guidelines that are not comprehensive enough since the series of legislations that are repealed once it is irrelevant and unacceptable to be applied. The only reason is that all the regulations are only human made law and thus there is no such thing as a complete legislation for all of the practice, especially in Islamic banks. There are only basic rules that must be adhere and follow for every Muslims that is to avoid what is haram and to follow what is halal in the eyes of Islamic teaching. In addition, a prominent scholar nowadays, Sheikh Yusof al-Qardhawi had stated that, 'If something is entirely harmful, it is haram and if it is entirely beneficial, it is halal'.

In conclusion, with the aim for the globalization of Islamic banking practice, Islamic banks should take the advantage of the potential benefits arising from the acceptance by the international player. Besides, Malaysia had been positively recognized as one of the global Islamic finance and banking since being the active player in the industry. Therefore, Malaysian Islamic banking must empower the foundation of the practice on Islamic finance and banking first by adhere to each and every requirement of the regulations and the Shariah principles so that no further problems will be emerge.

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