

# **The Impact of SSB Independence on the Effectiveness of Internal Shariah Auditor among IFIs in UAE**

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## **Abstract**

This paper aims to examine the impact of Independent of Shariah Supervisory Board (ISSB) on the effectiveness of internal Shariah auditor in Islamic financial institutions (IFIs) in United Arab Emirates (UAE). The research uses a survey questionnaire to collect data from target respondents with a sample size of 100, who are selected using a simple random sampling technique. In developing SEM model and testing the hypothesis, SPSS and AMOS are used to analyse this research. The research utilizes the Islamic accountability theory to provide the foundation in explaining the impact of ISSB on Internal Shariah Auditor Effectiveness (ISAE). The research results indicate the significant positive effects of ISSB on ISAE. The SPSS analysis confirms that the construct is sufficient and capable to construct the model target of the research. The results indicate that the data actually fit the research model, which can represent the structural relations among the research variables in a proper way. This work takes an empirical approach; starting with a comprehensive review of previous literature. In order to meet the effectiveness requirements of ISA, and with reference to the idea of the ISSB, a theory of Islamic accountability is first described and then put into practice. To ensure Shariah compliance by IFIs, the effectiveness of the ISA and its direct relationship with the ISSB must be known. Therefore, the research suggests that the Islamic accountability theory serves as a theoretical basis for building a multi-dimensional conceptual framework that relies on the independence of SSB in evaluating the work, performance, and effectiveness of the ISA. From secondary sources evidence, IFIs need to increase the level of the ISSB to assure the ISAE. This research fills that gap since ISAE in IFIs has not been extensively studied in comparison to both studies of the effectiveness of external Shariah auditors in IFIs, and internal auditors undertaken by conventional financial institutions, respectively.

## **Keywords:**

Effectiveness, Islamic accountability theory, IFIs, Independence of SSB (ISSB), Internal Shariah Auditor (ISA), UAE

## **INTRODUCTION**

The subject of internal audit effectiveness has received a greater focus in the literature recently. Management is assisted by the internal auditors to ensure that an adequate internal supervision mechanism is in place and that each business operation is efficiently, economically, and legally performed (Haron et al., 2004). Internal auditors, who possess Shariah-associated knowledge and abilities, perform Shariah audit function. The Shariah audit function is undertaken by the internal audit unit of Islamic financial institutions (IFIs) so that one will not doubt the auditors' objectivity and be able to demonstrate their nonthreat independence (Shafii et al., 2013). The aim is to ensure a sound and effective internal supervision mechanism that follows Shariah policies and ideas (Yaacob, 2012). Shariah audit is the assessment on the extent of IFIs' compliance with the Shariah rules and strategies in all their activities. IFIs that offer Islamic economic services are expected to function in accordance with Islamic ethics code. They also ought to function within the Shariah limits. Thus, the Shariah Supervisory Board (SSB) serves as the consultant or supervisor to IFIs' activities to ensure IFIs' operations do not contradict the Shariah regulations and concepts. This condition will enhance the customers' confidence in the financial reports of IFIs. Besides, it also encourages those customers to make investments or deposit their funds in IFIs and utilize the IFIs' services (AAOIFI, 2020).

A Shariah Board, also known as Shariah Supervisory Board, Advisory Board, or Religious Board, certifies the IFIs' Islamic monetary products as Shariah-compliant (i.e., according to Islamic regulation). In view that Shariah law compliance is the purpose of Islamic finance existence, Islamic banks and other conventional banking institutions that provide Islamic banking services and products, should establish an SSB. The SSB functions as the banks' reference point to ensure that their products are Shariah-compliant and that their operations and activities observe Shariah ideas. One of the dominant and tremendously needed business activities within the global economic system today is the commercial enterprise activity of banking institutions. This is due to the vital function of IFIs in being a source of funds in assisting enterprises' financial position (Muda, 2017).

According to AAOIFI (2017), depending on the dimensions of an IFI, an unbiased department, or a part of the internal audit department shall operate the internal Shariah audit. It will operate within an IFI to scrutinize and evaluate the extent of compliance with Shariah guidelines and concepts, Fatwas, hints, and instructions issued by the IFI's SSB; hereafter known as Shariah guidelines and standards. The main objective of the internal Shariah audit is to make sure IFI discharges its obligations consistent with the Shariah rules and concepts, as decided by the IFI's SSB. The internal Shariah audit, which operates under the setup guidelines by the IFIS, is an essential component of an IFI's Shariah governance. The constitution, which shall have a say, reason, authority, and obligation (charter), will be developed by the management and in consonant with Shariah regulations and principles. The constitution will also be implemented with the aid of the IFI's SSB, and endorsed by the board of directors.

Stewart and Subramaniam (2010) add that the obligation of an internal auditor includes consultancy and assistance in corporate governance these days. IFIs have broadened their function to encompass Shariah audits in ensuring Shariah-compliant operations. This situation leads to certain problems, like the internal auditors' independence and objectivity, competency, as well as performance in undertaking their brand-new responsibilities, as outlined in AAOIFI standards. The role of an auditor may become very specific within the Islamic economic system This is because the auditors are supposed to uphold Islamic ideas, therefore, be accountable to society. This is because the auditors are supposed to uphold Islamic ideas, therefore, be

accountable to society. That is why Islamic scholars have broadly criticized the role of conventional auditors in Islamic practices. Hence, organizations with effective internal audit functions are better than those organizations that have no such function, especially when concerning fraud, detection and prevention (Coram, et al., 2008; Omar & Bakar, 2012).

Therefore, the purpose of this article is to examine the impact of SSB's traits (independence) on the efficiency of internal Shariah auditors in IFIs operating in the UAE. In order to identify the key traits that best represent the SSB, the paper studies the literature. Depending on their area of study, previous researchers have employed different features. In order to evaluate the SSBs' characteristics, no generic or standard characteristics are defined. This specific study chooses the most frequently utilized traits from earlier research to generalize the findings. Three criteria, including independence, are chosen as a result of this procedure. The impact of SSB's properties on ISAE among IFIs operating in the UAE is evaluated using the characteristics.

## **LITERATURE REVIEW**

### **History of Auditing in Islam**

Khalid and Sarea (2021) stated that the first gathering of the Prophet Muhammad (PBUH) signified the beginning of the trading network in Mecca. Consequently, the main means of exchange within the Arabian Peninsula was replaced by cash. Other than forex and exchange, the alternative for most businesses is banking. Khalid and Sarea, (2021) specified that the first gathering of the Prophet Muhammad (PBUH) signified the beginning of the trading network in Mecca. Consequently, the main means of exchange within the Arabian Peninsula was replaced by cash. Other than forex and exchange, the alternative for most businesses was banking. The Tha'if Al-Ta'if was well-known as a banker, who loaned large sums of money based on usury. Speculation on kinds and currency was another favorite activity of the Quraish. In those days, although mass illiteracy occurred among the Arabs, the trifling creativeness showed that those activities had been most effective and feasible with a few ideas of accounting and auditing.

Thus, the idea of maintaining the money owed, primarily through verbal agreement, and presenting them to the owner of the cash was famous among the Arabs, and they were also acquainted with the idea of responsibility. The main reason is to guard the societies against deviance, protect their faith and ensure their welfare in both nonsecular and worldly manners that are consistent with Shariah. All Muslims have obligations to their creator, Allah (S.W.T) to enjoin rights and forbid wrongdoing in the quantity of their know-how and abilities. The prophet (PBUH) said:

“Whosoever among you sees an act of wrongdoing should change it with his hands. If he is not able to do so, then he should change it with his tongue. If he is not able to do so, then with his heart, and this is the weakest of faith” (An-Nawawi, 40:34)

The audit feature is critical and mandatory in an Islamic environment as it depicts that the auditor's duty is not merely limited to the users of the financial statements' users. Instead, more importantly, it reflects his or her duty to the Creator, Allah (S.W.T). This is because Muslims consider their actions and thoughts are always being watched by Allah (Muraqabah). The Islamic fundamental is the edict that “surely Allah takes account of all things” (Quran,

4:86). It is to be stated that those references are to “account” in its ordinary feelings. It is about one’s duty to “account” to God on all subjects in terms of human undertakings, in which each Muslim is “responsible” (Askary & Clark, 1997). Tawfik and Bilal (2020) mention that the Islamic view towards auditing manifests in the obligation of the auditors to deal with the concerns of not only the stakeholders but also in the end, the Creator, Allah (Shafii et al., 2013, p. 29). The idea of Shariah auditing is derived particularly from the Islamic idea of *hisbah* (Yaacob & Donglah, 2012, p. 225; Mirakhor, 2000, p. 28).

### **Objectives of Islamic Law (Maqasid Al-Shariah)**

The idea of Maqasid Al-Shariah or better targets of Islamic law has gradually captured the eyes of cutting-edge Muslim scholars in solving contemporary problems. Ibn Ashur describes Maqasid Al-Shariah as “the deeper meaning and internal aspects of know-how (Hikam) taken into consideration through the lawgiver in all or most of the areas and occasions of rules”. He additionally explains that the significance of the expertise of Maqasid Al-Shariah for Mujtahids is no longer dwells in the simplest form of information and interpreting the texts of Shariah, but also to discover solutions to the brand-new issues dealing with Muslims, in which those texts are silent (ISRA & Finance, 2013).

The primary goal of Shariah is the belief of the gain of the humans (Maslaha of the Ummah), regarding their affairs both in this world and the hereafter (Laldin, 2006). Generally, the Shariah is held in all its parts, in the pursuit of securing the gain of humankind and protecting them from corruption and evil (Ashur, 2006; Laldin, 2006; Chapra, 2008; Kamali, 2008). The following are among the Shariah’s goals: educating the individual (Tahdhib al-Fard), upholding justice (Adalah) and public interest (Maslahah).

### **Shariah and Financial Audit in UAE**

Shariah has many aspirations, some of which are primary and secondary. The secret is to shield and preserve the faith, assets, intellectual property, life, family, and honor (Saifuddeen, et al., 2013). The secondary one is to improve social protection (Ogunbado & Ahmed, 2015; Mohamad, 2015). A discussion of the Islamic worldview may additionally assist in elucidating a framework in which Islamic accounting and corporate reporting can be jointly developed (Sulaiman, 2005). Tawheed (Oneness of God, i.e., Allah) is the precept that Muslims believe in Allah as the Supreme Being, the One and Only. UAE is known to be the pioneer in promoting Islamic finance and banking. The first commercial Islamic bank, Dubai Islamic Bank (DIB), was established in 1975. UAE issued Federal Law no (6) of 1985 regarding Islamic banks, financial institutions, and investment companies. Currently, there are seven Islamic banks, which are operating in the UAE. The Gulf Cooperation Council (GCC) banking sector has taken significant strides in terms of digitization, product expansion and customer acquisition. Islamic banks in the UAE and the regions have also kept pace and garnered considerable attention. Earlier this year, Dubai Islamic Bank has completed the acquisition of rival Noor Bank with total assets exceeding Dhs275bn.

The United Arab Emirates is the hub of Gulf Cooperation Council countries for several reasons, including its unique environment in Islamic banking. UAE has adopted a set of standards including corporate governance standards. It is the aim of the standards to protect the rights of investors and encourage investment in various sectors, including the Islamic banking sector. The Islamic banking emergence is often associated with Islamic revival and the desire of Muslims to live all aspects of their lives following Islamic teachings.

The United Arab Emirates is a country that has a significant role in the development of Islamic banks and finance. Most bank financings in UAE are involved in the personnel, trade, manufacturing, and construction sectors. UAE has the highest number of Islamic banks both in the Middle East and the world, as well (Iqbal & Molyneux, 2005). Similar to other banks worldwide, all UAE banks are also required to adopt the International Financial Reporting Standards (IFRS). In 2000, capital adequacy, asset quality, and management of investment accounts are included in the CB UAE comprehensive prudential set of regulations development. The regulatory framework has instilled the confidence among the Islamic banks investors and customers in UAE (Iqbal & Molyneux, 2005).

### **Banking Sector in UAE**

The financial services sector contributed about 8.3% to the GDP of the country in 2018. UAE's banking sector has remained the cornerstone for the growth of the domestic economy. The United Arab Emirates (UAE) economy grew by 1.3% in 2019 and -3.5% in 2020. Owing to its oil-driven economy, real GDP had grown 2.8 % and 3.3 % in 2018 and 2019, respectively. According to CB UAE's Economic Indicators Report of 2019, the Consumer Price Index (CPI) declined by 0.9% in 2019. The Shariah Supreme Authority for the Islamic Financial Services Industry in the UAE has become the major driver of the Islamic financial services industry in the Emirates.

For the first time, the committee sets Shariah standards for all its Islamic banking, its products and tools, as well as business ethics, governance, accounting, and auditing. The assets of Islamic banks in the UAE have increased by 146.3 billion dirhams and 36.2% over the past year. According to the latest statistics from the Emirates Central Bank, Islamic banks account for 20.4% of the total banking sector's assets.

### **Independence of SSB & Internal Shariah Auditor Effectiveness**

Khalid et al., (2021) reveal that to be powerful, the Shariah supervisors should take the delivery of freedom. Additionally, the management should respect the supervisors' decisions. Furthermore, the credibility of the IBs' tracking is questionable, should it does not materialize. This approach stipulates that the supervision of Shariah compliance must be under the Board Of Director, not the management. Through this, the ISSB has to agree or disagree with the control's proposals or selections (Khalid et al., 2018).

The internal Shariah auditors needs to increase their efficiency and effectiveness because of IFIs' relationships with Shariah auditing. Particular factors have given some impacts to the effectiveness of internal Shariah auditors in IFIs, such as Maqasid al-Shariah dimension shortage in auditing IFIs' performance as well as the absence of ISA traits (Khalid et al., 2017).

### **METHODOLOGY**

The research may be designed in a scientific manner including statistics collection, analysis of findings, and properly supported evidence (Pallant, 2010). SPSS is the statistical software used for data evaluation. This approach is selected because it can reach as many UAE's IFIs as possible. Most of the questions are adapted from AAOIFI standards and former studies. The questionnaire, which is initially written in English, is translated into the Arabic language. The choice of a survey questionnaire as a data gathering method is due to its efficiency, affordability, and effectiveness in confirming the answers. The unit of analysis is defined as

the degree of exploration that the study focuses on. In addition, the analysis includes individuals, groups and dyads (Thompson & Walker, 1982). The main unit of analysis being investigated by this study is the Internal Shariah auditors, Shariah supervisory board, Audit and governance committee, accountants, and Chief executive officers of IFIs in UAE (Adams et al., 2007). A quantitative approach using Structural Equation Modelling (SEM) is utilized as the main research design. The actual survey questionnaire is collected from 100 respondents and the data are analysed using statistical software SPSS & AMOS for data evaluation in determining the impact of ISBC on ISAE.

Sampling is the process of gaining facts about a total populace with the aid of investigating a part of it. Methods of sampling are typically characterized into non-probability and probability techniques (Haque, 2010). This method involves the investigation of a diagnosed difficulty via examining the relationships among the variables. Sampling is the method of selecting a section from the target population that correctly and satisfactorily represents the entire population (Sekaran & Bougie, 2016). This approach is applied to seven full-fledged Islamic banks within the UAE, particularly: Dubai Islamic Bank, Al Hilal Bank, and Ajman Bank. Data collection is the most critical phase of studies that require evidence. Data can be amassed from every member of the network through questionnaires distributed by the researcher. Initially, the questionnaires are distributed to the respondents' heads of internal Shariah auditors (Sapsford & Jupp, 2006). The questionnaire is primarily based on the 5-point Likert scale. Through this method, the information is turned into collected statistics. 100 feedbacks have been received from the abovementioned seven banks for analysis. As for the limitation, the researcher only chooses respondents from the 7 full-fledged Islamic banks out of the many IFIs in UAE.

## **RESULT AND DISCUSSION**

### **Basic Demographic Respondents Profile**

Table 1 below presents the basic demographic profiles including gender, educational achievement, occupation, and experience for all 100 respondents.

**Table 1 Basic demographic**

Description	Frequency	Percentage %
Gender		
Female	8	8
Male	92	92
Educational Achievement		
Bachelor	30	30
Master	40	40
Ph.D.	30	30
Occupation		
CEO	10	10
Internal Shariah auditor	40	40
Shariah supervisory board	20	20
Audit governance Committee	10	10
Accountant	20	20

Experience		
Less than 5 Years	10	10
Between 6-10 Years	40	40
Between 11-15 Years	20	20
Between 16-20 Years	10	10
Over 20 Years	20	20
(n=100)		

**Descriptive Statistics**

Five-dimensional Likert scale is used to ensure that the constructs items are presented in a measurable uniform scale. Through this approach, the relative impact that is associated with SSB's independence on Internal Shariah auditor effectiveness is analysed. Several statistical indicators are used to describe the items' characteristics of the study sample such as mean and standard deviation. The results are presented in Table 2 below:

**Table 2 Descriptive Statistics**

Construct	Mean	Standard Deviation
ISAE1	4.02	1.239
ISAE2	4.25	1.048
ISAE3	4.00	1.295
ISAE4	4.08	1.212
ISAE5	4.23	1.238
ISAE6	3.98	1.371
ISAE7	3.99	1.267
ISSB1	3.92	1.253
ISSB2	4.23	1.109
ISSB3	4.15	1.123
ISSB4	4.22	1.106
ISSB5	3.79	1.313
ISSB6	3.94	1.324
ISSB7	3.94	1.391
ISSB8	3.98	1.470

ISAE: Internal Shariah Auditor Effectiveness, ISSB: Independence of SSB

**Reliability Test Results**

The reliability test aims to ensure the consistency and stability of the questionnaire. Cronbach Alpha is used to test the internal consistency. Table 3 below indicates that all constructs achieve

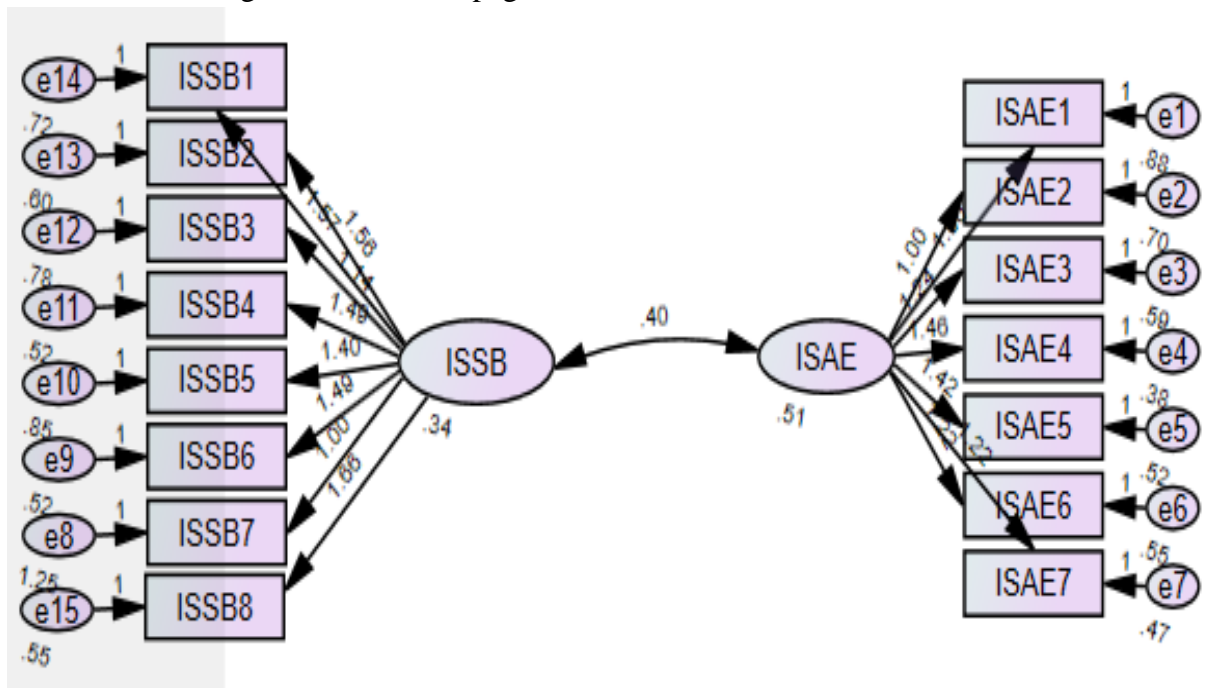
high Cronbach Alpha values of 0.889 and 0.881, which are greater than 0.7, respectively. The values indicate a high degree of internal consistency for all constructs.

**Table 3 Reliability Test Results**

No	Construct	Items Number	Alpha Value
1	Independence SSB	8	0.889
4	ISA Effectiveness	7	0.881

**Measurement Model Evaluation**

Once all the tests have confirmed the reliability of the data and the readiness for further analysis, CFA for the model is constructed using AMOS. The developed measurement model is introduced in Figure 1 in the next page.



**Figure 1: Measurement Model Evaluation**

**Table 4: Regression Weights**

Relation	Estimate	St. Error	C.R.	P
ISAE1 <--- ISAE	1			
ISAE2 <--- ISAE	0.995	0.096	10.42	***
ISAE3 <--- ISAE	1.236	0.106	11.648	***
ISAE4 <--- ISAE	1.46	0.115	12.715	***
ISAE5 <--- ISAE	1.416	0.115	12.275	***
ISAE6 <--- ISAE	1.221	0.104	11.721	***
ISAE7 <--- ISAE	1.216	0.102	11.973	***
ISSB7 <--- ISSB	1			
ISSB6 <--- ISSB	1.491	0.168	8.862	***
ISSB5 <--- ISSB	1.395	0.168	8.319	***



ISSB4 <---	ISSB	1.486	0.168	8.86	***
ISSB3 <---	ISSB	1.141	0.144	7.948	***
ISSB2 <---	ISSB	1.565	0.177	8.827	***
ISSB1 <---	ISSB	1.567	0.18	8.689	***
ISSB8 <---	ISSB	1.658	0.185	8.965	***

**Table 5: Covariances**

Relation	Estimate	St. Error	C.R.	P
ISAE <--> ISSB	0.401	0.059	6.808	***

This relation is tested by the hypothesis that there is a significant effect of Independence (ISSB) on ISAE. As shown in Table 5, the path coefficient of ISAE on ISSB is 0.401, which indicates that the increase in ISSB by one unit leads to an increase in ISSB by 0.401. This estimate has a standard error (SE) of 0.059 and a critical ratio (CR) of 6.808. The probability (P) of getting this ratio is \*\*\*, which is less than 0.001. This means that the regression weight for ISSB in predicting the ISAE is significant at level 0.02. This confirms the significant positive effect of Independence SSB particularly on ISAE. Thus, the proposed hypothesis is supported.

The SSB creates a more controlled environment in delivering the auditing process. Its independence from other SSB helps in ISA effectiveness and delivering all the necessary information to enable IFIs to perform their business activities accurately. Moreover, results show that independence of SSB have positively associated to the internal Shariah auditor effectiveness. This result is consistent with Karim (1990) which states that credibility of the financial information produced by an IFI depends on the independence of the SSB. Therefore, the hypothesis is supported; that is, the higher the independence of the SSB, the higher the effectiveness of internal Shariah auditors.

**CONCLUSION**

In conclusion, this paper finds strong support from independence of the SSB on the effectiveness of the internal Shariah auditor. The formation of ISSB tends to increase the level of internal Shariah auditors and result in high effectiveness. The results of the direct impact of SSB independence on the effectiveness of the ISA is in line with Islamic accountability theory. Independent SSB positively affects the ISA effectiveness. This way, the interest of the Muslim Ummah will be protected given the independence of SSB. Moreover, sufficient high status of SSB in IFIs structure will result in better communication with management and ensure its independence from the others.

In this study, we highlight the issue of internal shariah auditor, as an individual, rather than addressing the issue of internal Shariah audit effectiveness, as a group. However, lacking this type of research is critical in developing countries, especially in emerging and transitional economies. Here, the findings drawn from this paper will serve to enhance customer confidence in IFIs across UAE as it gives empirical evidence regarding the extent to which ISSB play a central role in promoting the performance of IFIs in the UAE. Finally, although this is the first study that examines the relationships ISB and the effectiveness of internal Shariah auditors in IFIs in the UAE, the study results can be useful for further research in internal Shariah auditor in the IFIs.

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