

THE ROLE OF SHARIAH SUPERVISORY BOARD ON INTERNAL SHARIAH AUDIT EFFECTIVENESS: EVIDENCE FROM BAHRAIN

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ABSTRACT

This paper examined the role of Shariah supervisory board (SSB) on internal Shariah audit effectiveness in Islamic financial institutions (IFIs) in Bahrain. The study employed two stages of data collection and analysis: review of the literature and structured interview with SSB and Head of internal Shariah audit departments deemed important within the IFIs, to examine the role of SSB on internal Shariah audit effectiveness. The paper concluded that Islamic agency theory could serve as a theoretical foundation to build the conceptual framework on internal Shariah audit effectiveness. In the light of the theory, it was proposed that internal Shariah audit effectiveness could be enhanced by their SSB, independence and experience. Due to the position of SSB as the ultimate oversight organ in the IFIs, the SSB could influence on internal Shariah audit effectiveness in IFIs. The research perspective, this is the first study using Islamic agency theory to examines the role of SSB on internal Shariah audit effectiveness in IFIs in Bahrain.

Keywords: Internal Shariah Audit, Effectiveness, SSB, Independence, Experience, Islamic Agency Theory.

INTRODUCTION

Failures of large corporates such as Enron and WorldCom have called for emphasis on internal auditors, resulting in increased need for internal Shariah audit to monitoring role. This necessitates Islamic financial institutions (IFIs) to invest in internal auditing and improve internal Shariah audit effectiveness to ensure the achievement of organization objective (Rahman, 2011). Internal audit has become a crucial function within organizations due to the recent spate of corporate collapses and financial scandals (Schneider, 2003; Arena and Azzone, 2009). These events made internal audit as one of the contributing factors of good corporate governance, and has strongly influenced the adoption and practice of the internal audit. The effectiveness is a key issue for those interested in internal audit such as internal auditors themselves or its main customers, namely:

1. The board and audit governance committee (AGC), to whom internal audit reports.
2. Senior management, who should be sure that internal audit activities cover the principal business risks.
3. External auditors, who have a direct interest in the work of internal audit (Mihret and Yismaw, 2007).

The kingdom of Bahrain actively promotes itself as an international hub for Islamic finance. In order to achieve this goal, the Central Bank of Bahrain (CBB), through its comprehensive regulatory framework, opens its gate to local and international IFIs to operate

within the country, Bahrain is also the host to several organizations central to the development of Islamic finance i.e. the AAOIFI, Liquidity Management Centre (LMC), the International Islamic Financial Market (IIFM), the general council for Islamic banks and financial institutions (CIBAFI) and the Islamic International Rating Agency (IIRA). Most bank financings in Bahrain are in personal, trade, manufacturing and construction sector. The Bahraini Islamic bank (BisB) was the first Islamic bank in Bahrain established in 1979 and since then, the industry has been growing rapidly. Bahrain has become a country with the highest number of Islamic banks not only in the Middle East but also in the world (Iqbal & Molyneux, 2005). Since 1992, all Bahraini banks are required to adopt International Accounting Standards (IAS) and starting from 1997, they are expected to comply with AAOIFI and need to be published in addition to the audited financial statements. On the other hand, foreign banks are required to either comply with the United Kingdom (UK) or USA Generally Accepted Accounting Principles (GAAP) or to comply with (IAS) (Islam, 2003). In 2000, the CBB has set a comprehensive prudential set of regulations, which includes capital adequacy, asset quality, and management of investment accounts, corporate governance and liquidity management in ensuring IFIs have comparable standards to conventional banks. This regulatory framework has attracted confidence among the investors and customers of Islamic banking in Bahrain, hence the industry enjoys sustainable growth, product innovation and an expanding market (Iqbal & Molyneux, 2005).

There are several reasons why internal audit effectiveness remains a continuously relevant issue. First, the role of internal audit of a company is considered important in the corporate governance field. Second, the internal audit effectiveness is a new research area in internal auditing (Sarens and Abdolmohammadi, 2011), so only few studies have studied it worldwide, and several researchers have recommended the need for more research especially in developing countries (AlTwaifry et al., 2003; Mihret and Yismaw, 2007; Yee et al., 2008; Endaya and Hanefah, 2013). Third, as indicated earlier, until today, there is no consensus among researchers either about the factors influencing, or the best framework for internal audit effectiveness (Endaya and Hanefah, 2013). Previous studies in Shariah audit have looked into the relationship between internal Shariah audit characteristics and its effectiveness (Khalid et al., 2017) the needs and challenges (Rahman, 2008) of academicians and practitioners towards Shariah audit (Mulyany, 2008) professionalization of Shariah auditor (Najeeb and Ibrahim, 2013) conceptualizing the duties and rules of Shariah auditors (Othman et al., 2015) and audit framework for Shariah compliance (Shafii et al., 2010). As well as a few studies done on Shariah audit practices in IFIs focused on the scope, competency, and working practices and current framework used to perform a Shariah audit (Kasim and Sanusi, 2013; Yahya and Mahzan, 2012). However, the internal Shariah audit effectiveness has not been extensively studied compared to studies in external audits and also internal audit in conventional bank.

Therefore, the objective of this paper is to examine the role of SSB on internal Shariah audit effectiveness in IFIs in Bahrain using Islamic agency theory. The remaining parts of this paper are organized as follows: the second section discusses the literature review on Islamic agency theory and SSB effectiveness, followed by independence and experience of internal Shariah audit. The third section explains the research methodology employed in this study, research findings are reviewed and discussed in section four, final section highlights the conclusion and future research.

LITERATURE REVIEW

Islamic Agency Theory

An agency theory defines a contract under which one or more persons (principal) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent (Jensen and Meckling, 1976). The principal is the owner or managers of the organization who delegate and transfer responsibilities or capital to the agent. The agent is the managers/employees of an organization who manage the firm's business transactions for the owner/principal. Jensen and Meckling (1976) Proponents of the agency theory, define the agency relationship as a contractual relationship between the shareholder as the principal and the managers as the agent who are given some authorities to perform services on behalf of the principal. Agency problem is more intense in the case of Islamic banks as while investors in conventional banks have a level of certainty in their returns, in Islamic banks the profit as well as possible incurred loss and consequently the risk is shared between the banks and its investors (Siddiqui, 2001).

A person can assign his business to an agent, for the latter to perform and act on his behalf. However, the agency contract is subject to regulations where the essential elements of the agency contract as the same as the general Islamic contract, except the nature and scope of the authority are subject to certain conditions. As a principal (muwakeel), he is obligated to give his authority to an appointed agent. As insane a minor principal cannot be part of any agency contract. However, a minor person can appoint an agent for the performance that can benefit the minor but not so for transactions that entail for the minor (Shamsuddin and Ismail, 2013).

On the other hand, an agent can perform his actions but he is restricted to the general rule laid down by the principal. Hanafi, Hambali and Shafi'I sectarians further explained that an agent does not have an authority to dispose the principal's assets (subject matter) and a minor is not eligible to act as an agent to others. The position for the agency contract's subject matter is the act for the performance of which the agent is appointed. The agent should be informed about the limitations of his performance. In the case of his disposition, it must be lawful and permissible by the principal and it is also required that the action is witnessed. The agent duties include:

1. Exercising care and skills.
2. Not permitting the appointment of another person to do his job.
3. Not misusing confidential information for his own benefit (Mansuri, 2006).

Thus, according to Safieddine (2009), the issue in Islamic banks is not limited to the separation of ownership and control, but extends to the separation of cash flow and control which makes the agency problem in Islamic banks more complicated than conventional banks (Safieddine, 2009). From the very beginning Islam emphasizes on the importance of relationship, any relationship given in this world, especially for Muslim people should begin with the relationship with Allah s.w.t. As mentioned in the Quran *"Behold a host of gathered against you, so beware of them- whereupon this only increases their faith, so that they answered, God is enough for us; and how excellent a guardian is He"*. Relying on faith through building a concrete relationship with Allah s.w.t, this would also determine a good relationship with other humans and other living things in this world. In the Islamic economics field, the relationship with others may exist between e.g. the capital provider (rabbul mal) and entrepreneur (mudarib), among capital providers or partners, buyers and seller, agent (wakeel) and principal (muwakkel),

contractor (wakif) and beneficiaries (muawikif), pledge (marhun) and asset owner (murtahin). Generally, this relationship creates a principal-agent relationship, several researchers have explore the Islamic economics as a field in relation to the principal-agent relationship (Umer and Habib, 2002, Pratomo and Ismail, 2006, Ghafar b. Ismail and Tohirin, 2010, Sarker, 1999).

Since our lives must be guided by Tawhid, hence, this study can use Tawhid epistemology as the guiding principles in the agency theory. Unity, Khalifah, (vicegerent), Ihsan is the principled basis of the agency theory in Islam. The agency problems can be reduced through the concept of unity which means cooperation and participation in the organization which does not exist in the conventional agency theory (Shamsuddin and Ismail, 2013). Our social life or business activities cannot be done without instilling the concept of unity. Thus the internal Shariah auditors in Islamic-oriented agency relationship has to apply Islamic Shariah rules and principles that issues by AAOIFI as well as Fatwas and guidelines issues by SSB.

Khalifah (vicegerent) and Ihsan reflect well the Islamic agency theory relationship. As information asymmetry becomes one agency problem, where the principal (muwakeel) does not have the ability to access the entire agent's (wakil) information, so that, no such information asymmetry is assumed when both parties are engaged in a relationship with Allah. An agent (wakil), knows that they have an obligation to provide for the best interest of the principals (muwakkel). Both parties believed that Allah has the perfect knowledge and each of their actions will be accountable in the hereafter, therefore, each of their actions and decisions has to realign with the clearly codified agency contract (Shamsuddin and Ismail, 2013). According to Shamsuddin and Ismail (2013) the conventional agency theory dominates self-interest and individualism. It tries which try to maximize its own utilities and consequently creates agency problems that cannot be resolved. This is the main point of contrast between the conventional and Islamic agency theory contract with special concept of Tawhid, Unity and also social features of Ikhlas (sincerity). Other features are Itqan (knowledge), Amanah (truthfulness), Syura (mutual consultation), justice and implementing activities in accordance with Islamic teachings based on epistemological source of Islam; Quran and Hadith. Therefore, it can be stated that, the Islamic agency theory uses the Quran and Hadith to determine the features and framework of the economic relationship practices in the IFIs. The successful practices of the Islamic agency theory should contribute to the development of the Islamic economic system. As Haneef (2005) reported that Islamic economics, *"is an approach to and (process of) interpreting and solving the man's economic problems based on values, norms, laws and institutions found in and derived from, all sources of knowledge (in Islam)"*.

The Islamic agency theory teaches us partnership members to practice respect, gratitude, patience, tolerance and also to believe not only in the economic reward/outcome as in the conventional agency theory but also in spiritual rewards (blessings from Allah). The practice of lying, shirking, conceit and jealousy must be avoided by each party. This acquires continuous Islamic teachings and training of the partnership member for them to be educated with spiritual knowledge. Islam recognizes the knowledge process of each individual, seeking knowledge is a continuous process in Islam. Furthermore, the spreading of knowledge has been encouraged by the Prophet Mohammed (p.b.u.h). *"Allah illuminates a man who hears hadith from me preserves it carefully and passes it on to other"*

Therefore, it is crucial to implement the Islamic training which emphasizes on the importance of knowledge, individual development and ethical oriented practices in the organization. Such it can be stated that the Islamic agency theory uses the Quran and Hadith to determine the features and framework of the economic relationship practices in IFIs, the

development of the Islamic economic system will be successful when Islamic agency theory practices. There are evidences suggest that a positive relationship between audit committees and auditor independence. Basically, a positive relationship between audit and governance committee and internal Shariah auditor effectiveness means that the existence of audit and governance committee will enhance internal Shariah auditor effectiveness. Teoh and Lim (1996) found the formation of audit committees has a strong positive impact on enhancing auditor independence. Goodwin and Yeo (2001) Found that an effective audit committee cans strength the position of the internal auditors function by acting as independent forum in which internal auditors may raise matters affecting management.

Shariah Supervisory Board (SSB)

According to Accounting and auditing organizations for Islamic financial institutions (AAOIFI) (2010), GSIFI No. 1 a SSB is an independent body of specialized jurists in Fiqh almua'malat (Islamic commercial jurisprudence). However, the SSB may include a member other than those specialized in Fiqh almua'malat, but who should be an expert in the field of IFIs and with knowledge of Fiqh almua'malat. The SSB is entrusted with the duty of directing, reviewing and supervising the activities of IFI in order to ensure that they are in compliance with the Islamic Shariah rules and principles. The Fatwa and rulings of SSB shall be binding on the IFI. Every IFI shall have a SSB to be appointed by the shareholder in their annual general meeting upon the recommendation of the board of directors taking into consideration the local legislation and regulations, in term of composition the SSB shall consist of at least three members, the SSB may seek the services of consultants who have expertise in business, economics, law, accounting and/or others. The SSB should not include directors or significant shareholders of the IFI, the dismissal of a member of SSB shall require a recommendation by the board of directors and be subject to the approval of the shareholders in a general meeting (AAOIFI, 2010).

On the other hand, SSB members should be independence, they should not become involved in management decisions of IFI and that they or their family members should not be employed as a senior executive officer or have a substantial shareholding in the IFI (AAOIFI, 2010). The Central bank of Bahrain (CBB) requires all banks to establish an independence Shariah supervision committee in compliance with AAOIFI's governance standards for IFI No's 1 and 2 (CBB, 2014). It further states:

"All Islamic banks licensees must comply with all AAOIFI issued accounting standards as well as the applicable Shariah board of AAOIFI. The Islamic banks licensee must have a separate function of Shariah review to verify compliance with the above. The internal Shariah review must be carried out in accordance with AAOIFI governance standards No. 3. The Shariah review function may be located in the internal audit function of the Islamic banks licensee (CBB, 2014)."

Regarding the Shariah supervisory system, Bahrain is characterized by the existence of a dual SSB at both national and institutional levels (Grassa, 2013). Indeed, the CBB has established the National Shariah Advisory Board on the central bank to verify the compliance of the activities with Shariah principles. Forming a SSB is the responsibility of Islamic banks only, as the most noticeable purpose behind that is to legitimate state for participating Muslim customers that the financially offered product or service is acceptable from an Islamic lawful

perspective. Generally, a member of the SSB is appointed by the shareholders of the banks, and their remuneration is proposed by the management and approved by the Board of Directors. In addition, the SSB has the right to employ a Shariah internal auditor to supervise the daily dealings and to report directly to them about any transactions that do not comply with Shariah rules and principles (Al-Mahmoud, 2007). It would be difficult for SSB to meet its Shariah governance obligations without the support from a well-functioning internal Shariah audit. Therefore, SSB will have an impact on the internal Shariah audit effectiveness. AAOIFI and previous literature suggests that independence and objectivity; educational qualifications, and numbers of board members are likely to be connected with the effectiveness of SSB.

According to GSIFI No. 5 issued by AAOIFI (2010) Independence, for the purpose of this standard, is an “*an attitude of mind which does not allow the viewpoints and conclusions of its possessor to become reliant on or subordinate to the influences and pressures of conflicting interests. It is achieved through organizational status and objectivity*”. The principle of objectivity imposes obligations on SSB members, to be fair, intellectually honest and free of conflict of interests (neutral). The importance of the independence of SSB members for an IFI emanates for its role in:

1. Enhancing the public confidence in the IFI as compliant in its application of Shariah rules and principles.
2. Achieving the fundamental objectives of an IFI by enhancing independence and objectivity of its SSB.

SSB members have a responsibility to the public who rely on the services provided by them that require independence. The public includes clients, credit grantors, government, employers, investors and others who rely on the objectivity and integrity of SSB members to ensure Shariah compliance with regard to the activities of IFI.

Internal Shariah Audit Effectiveness

According to the Institute of internal audit (2010), effectiveness can be defined as degree, including quality to which established objectiveness is achieved. Bank Negara Malaysia (2010) defines effectiveness as objective to ensure a sound and effective internal control system for Shariah compliant. (Badara and Saidin, 2013), in their research highlighted a few definitions of the effectiveness term. It means that internal audit effectiveness can be defined as the degree to which established objectives are achieved (Badara and Saidin, 2013). Most of the researcher agrees that a program can be seen as effective if its outcomes go along with its objective (Ahmad et al., 2009; Ussahawanitchakit, 2012). Therefore, from the above definition, this paper defined internal Shariah auditors to achieve established objectives within IFIs. Previous research related to internal audit effectiveness is conducted by Ahmad (Ahmad et al., 2009; Arena and Azzone, 2009; Badara and Saidin, 2014; Mihret and Yismaw, 2007). Traditionally, the role of internal audit focused on financial compliance and on monitoring through having a good internal control in place (Alzaban, 2014). However, internal Shariah auditin has grown significantly in importance; it includes Shariah consulting on Shariah compliance within IFIs.

Alzeban (2014) provides evidence as to the manner in which competence, size of internal audit department, relationship between internal and external auditors, independence of internal auditor, and extent of management support for the internal audit function, contribute to perceived the effectiveness of internal audit function in the Saudi public sector. Data was obtained from managers and internal auditors. Multiple regression analysis was used to examine the association between internal audit effectiveness and five principle factors they are; competence of internal

audit department, size of internal audit department, and relationship between internal and external auditors, management support for internal audit and independence of internal audit. The results suggested that, the role of management support for the internal audit function acts a key driver of internal audit effectiveness, this study adds to existing literature on internal auditing Saudi Arabia. Thus, the results of this study may not translate easily to either other developing countries without similar oil reserves, or to developed countries with a long tradition of commercial enterprise, public sectors institutions, and form of governance within those entities. Different authors have attempted to measure effectiveness from different perspectives, focusing on internal audit processes, output and outcomes. Focusing on process, Mihret and Yismaw (2007) used a case study to demonstrate that internal audit effectiveness is a result of the interplay among four factors: internal audit quality, management support, organizational setting attributes of the audited.

Ahmad et al. (2009) found few factors that affect the internal audit effectiveness in a Malaysian public sector, such as lack of training and support from management, lack of employees, and negative perception of management towards the recommended solutions given by the internal auditors. In addition, the internal audit effectiveness relates to understanding the stakeholders' expectations towards the performance of an organization. It is found that the internal audit function could deliver an effective performance of internal audit when the internal auditors understand the expectations of the board of directors, CEO, and operating management in the institutions (Feizizadeh, 2012). Effective internal Shariah auditor professionals have the following characteristics: the ability to align the structure of internal Shariah audit with the dynamics of the Islamics banks' operations; there should be a strong relationship between the management skills for maintaining appropriate and SSB needs and expectations. Beside the above, the level of training, education, experience as well as professional qualifications of the internal auditors influenced the effectiveness of internal audit (Al-Twajiry et al., 2003). Hence, an effective internal Shariah auditor is the one who assist IFIs in meeting their objectives; therefore, IFIs should ensure that their internal Shariah audit is effective to create value and effectiveness in such organization.

Internal Shariah Audit Independence

The concept of audit independence has a long story and still remains contentious concept today. Hence, independence was assumed to mean integrity, honesty, and objectivity, including freedom from the control of those whose records are being reviewed (Hudaib and Haniffa, 2009). As all definitions of internal audit contain the word 'independence' thus it is an important characteristic that has to be included to ensure that internal audit is sufficiently effective. The more independent the internal audit, the more likely it will be able to perform their duties freely and objectively otherwise, it has little use. Therefore, independence of internal audit will determine the level of autonomy of internal audit activity that facilitates individual auditors' objectivity (Mihret and Yismaw, 2007).

The internal Shariah auditor must carry out their task with independence and objectivity as it is their responsibility to ensure IFI's compliance with Shariah laws and principles. Lack of independence of internal Shariah auditors will affect the credibility of internal Shariah auditors and which could results in lack of worth of the assurance given by the internal Shariah auditor. The full benefit of Shariah auditors cannot be realized if they are not wholly and truly independent as the social purpose will be frustrated. The self-review threat may occur as there is no clear line of separation of duties being determined (Kasim and Sanusi, 2013). An independent

auditor must be free from restrictions or bias if he is to be totally independent (Shafii et al., 2015).

Independence is achieved through the organizational status of internal audit and the objectivity of internal auditors (Abdullah et al., 2013). All the outcome of Shariah audit function listed to be SSB may engage independence issues since the SSB of IFIs is responsible in decisions, opinions related to Shariah matters. Shariah auditor must maintain a high level of independence to keep the confidence of users relying on their reports, the internal Shariah auditor must report directly to the board of directors and SSB to ensure independent from the operating unit they audit.

According to Islamic agency theory, taken individually, is based within the limits of one's capability for an individual is accountable for his deeds. Essentially, the Islamic agency theory is applicable to every facet of life. Therefore, in addressing the issue of internal Shariah audit effectiveness, which is the apex of the IFI, through Islamic agency theory simply means that the internal Shariah auditor is agent to SSB. For instance, the independence of internal Shariah audit department and the level of authority to which the internal Shariah audit staff report is the most important criteria influencing the objectivity of its work seem to be initial bases for internal Shariah rules and principle. It added that, organizational independence is more crucial to the effectiveness of the internal auditors, as it protects the auditor from pressure or threat, and increases the objectivity of the auditing work (Cohen and Sayag, 2010, Vinten and Van Peurse, 2005).

Previously study suggests that lack of independence is an obstacle to satisfactory internal audit performance in some developed countries. In Sudan, Brierley et al. (2001) suggest that internal audit should report to the highest level within the organization to ensure that corrective action is taken to implement internal audit recommendation. On the other hand, Van der Schyf (2000) noted the lack of independence of internal audit in South African public sector as an issue facing internal audit function. In particular, he identified concerns regarding lines of communication and levels of reporting and their implications for independence. In Malaysia, Baharud-din et al. (2014) found that, there were significant positive relationships among the factors analysed in this study such as auditor competency, auditors' independence and objectivity and management support the effectiveness of internal audit in public sector. Thus, the effectiveness of internal audit will depend strongly to the attributes of the factors analysed in this study. To ensure effectiveness, the internal Shariah audit reports should be presented, reviewed and endorsed by SSBs of IFIs. The internal Shariah auditors should have an independent mental attitude. Internal Shariah auditors must strive to maintain a high level of independence to retain the confidence of the users relying on their reports (Rahman, 2011).

Therefore, a key characteristic of an effective internal Shariah audit is the independence with which it operates. The strength of an internal Shariah audit effectiveness must be assessed with respect to the level of independence. It enjoys from senior management and operating responsibilities. Internal Shariah auditors should be sufficiently independence from those they are required to audit. However, they can both conduct their work without interference.

Internal Shariah Audit Experience

Audit experience refers to different kind of knowledge and skills which the auditor obtains as a results in length of tenure on the job practice in the auditing professions which enhance his effectiveness (Mihret and Yismaw, 2007). Shariah audit experience is an essential factor that to be considered when it comes to internal Shariah auditor effectiveness, because it

enables Shariah auditor to provide good Shariah audit results as well as good recommendation. Additionally, it enhances the internal Shariah auditor's abilities to possess the discipline, knowledge and skills essential to the effectiveness of internal Shariah auditor, proficiency in Islamic Shariah rules and principles in general, and Fiqh al-muamalat in particular, is required in performing internal Shariah auditor (AAOIFI, 2010). When an internal Shariah auditor has many years of experience, he/she can make a right a decision, decide fast and deal with any situation. Consistent with agency Islamic theory and its proponents, expert individuals' internal Shariah auditor help in IFIs growth because they have a clear insight about how to deal with process and accomplish their tasks with superior quality (Safieddine, 2009).

Thus, the internal auditors who are attached to the IFI must not only have the qualification which in Shariah knowledge, but also need to have an additional Shariah auditing experience, skills and training. The effectiveness of internal Shariah auditors depends substantially on the quality, training and experience of its staff. Thereafter, steps should be taken to provide the necessary experience, training and continuing professional education (Shafii et al., 2014). Thus, internal Shariah auditors with more Shariah audit experience tend to perform best audit practices, achieve superior audit outcomes, and gain outstanding audit success. Practically, this is should also be an area of research in the IFIs. Various researchers have postulated that audit experience can have an impact on the internal audit issues (Al-Twaijry et al., 2003, Wang et al., 2012). A study done by Badara and Saidin (2014) on the internal audit effectiveness from a Nigerian perspective found that the audit experience has a significant positive relationship with internal audit effectiveness. Auditors with more experience have a good comprehension of the decision process and place greater reliance on the net income variable.

Kasim and Sanusi (2013) suggests that, Shariah auditors should have specialized qualifications both in Shariah and accounting. They suggested that firms who audits IFIs should have necessary technical accounting qualifications required. One of their recommendations was that university includes Shariah auditing courses in its syllabus or introduces double majors in accounting and Shariah so that future accountants or auditors have the necessary skills and knowledge in Shariah audit. In addition, Najeeb and Hameed (2013) argued the needs for Shariah auditing by creating an Association of Chartered Shariah Accountants and Auditors (ACSAA). This will result in the long run economic benefits. It is important that the internal Shariah auditor working in IFIs should by be nature good Muslims and must know Shariah requirements relating to the institution's operations.

Thus, the process of Shariah auditing will be more effective and sound if the internal auditor has relevant and adequate knowledge on Islamic Fiqh Muamalat and Islamic legal contract/maxims. The knowledge of these two areas will enhance the process of the auditing as the internal auditor will be more appreciated and alert on the issues of Shariah non-compliance (Yahya and Mahzan, 2012). Due to the unique role to be fulfilled by IFIs Shariah auditor, they should ideally be knowledgeable in both Shariah (Islamic law) and Fiqh Muamalat (commercial and accounting practices). Shariah is divine law, while Fiqh is a product of human understanding of the Shariah. Fiqh has now become the legacy of Islamic law which covers almost all areas of law pertaining to the "Islamic way of life" including financial contract of products (Bakar, 2006).

Internal Shariah auditors with experience possess different kind of unique knowledge (Ussahawanitchakit, 2012), competencies, capabilities and skill as a result of length of tenure on the job practice in the auditing professions which enhance their efficiency (Wright, 1997) and effectiveness (Mihret and Yismaw, 2007) via developing the knowledge bases of the unique risks. Audit experiences enable internal Shariah auditors to provide good Shariah audit results as

well as good recommendation. Additionally, the experiences enhance the internal Shariah auditors' abilities to possess the discipline, knowledge and skills essential to the independence of internal Shariah auditor, proficiency in Islamic Shariah rules and principles in general, and Fiqh al-muamalat in particular (AAOIFI, 2010). Internal Shariah auditors with many years of experience can make a right decision, decide fast and deal with any situation. Expert individuals' internal Shariah auditor help in Islamic banks growth because they have a clear insight about how to deal with process and accomplish their tasks with superior quality. In other words, the internal Shariah auditors show:

1. Independence of mind/in fact or actual independence and their ability to maintain a proper attitude in the planning of the audit program.
2. Independence in appearance/perceived independence or public or others perceptions of the auditor's independence (Mautz and Sharaf, 1961). Here, they have achieved independence objectivity and organizational status (Murtuza and Abdallah, 2007). Thus, the following proposition is postulated: internal Shariah audit experience is positively related to effectiveness of internal Shariah auditors in Islamic banks.

Independence of internal shariah audit subjects to the set-up of reporting in the IFIs structure. The independence of internal Shariah auditors will be determined ultimately by SSB. Having proposed a positive relationship between experience and effectiveness, the Islamic agency theory further informs that the Shariah uses of experiences in achieving effectiveness by internal Shariah auditors. This means that if SSB is fully playing their role; more uses of experiences by the internal Shariah auditors are encouraged, thus leading to more effectiveness. In other words, there are Shariah matches between the uses of experiences by the internal Shariah auditors toward achieving their effectiveness to that SSBs approvals, leading to more achieved effectiveness, thus consolidating the earlier relationship (experience-effectiveness relationship) by making it stronger at higher moderate of SSB, i.e. SSB is fully discharging its roles.

SSBs roles are to ensure that the IFI has the appropriate controls which include internal audit in place and that these controls are functioning properly. This will improve transparency and disclosure in financial reporting; and enhancing the public's confidence of the IFI as genuine in its application of Shariah rules and principles (AAOIFI, 2010). If matches are found between the experiences of internal Shariah auditors and the responsibilities of SSB in approving the reviews of the internal Shariah auditors, the effectiveness of internal Shariah auditors are strengthened and becoming stronger. Furthermore, when IFIs provides a board with high experts, they help to understand external environment (Safieddien, 2009) and as a results, will improve effectiveness of internal Shariah auditors even further. The positive relationship between internal Shariah audit independence, experience and effectiveness of internal Shariah auditors is stronger when the moderate of SSB is higher.

RESEARCH METHOD

The study reviewed literature from previous studies, an interview has been developed guide to which contains certain guiding questions, while being flexible to delve into issues that emerge during the course of each interview. Structured interview took place with different individuals of SSB, Head of internal Shariah audit departments deemed important within the IFIs. As mentioned earlier, this study is to examine the role of SSB on internal Shariah audit effectiveness in IFIs. In Bahrain. The respondents were given some freedom to explain their thoughts and experiences without following sequenced questions and predetermined specific answer categories. The study also analysed the qualification, background of certain groups of

interview respondents, namely the SSB members. Specifically, the study identified the qualification, background by ascertaining the first degree obtained from these interview respondents. Information pertaining to this qualification was gathered from the annual reports and websites of IFIs. Meantime, the selection of the interviewees was generally based on convenience sampling (Sekaran and Bougie, 2010).

DISCUSSION AND CONCLUSION

As the first step in examining the internal Shariah audit independence, the researcher reviewed the organizational structure of the IFIs. This is to establish the organizational position of the internal Shariah audit department within IFIs. From the organizational structure of the IFIs, it is clear that internal Shariah audit departments are part of corporate Shariah governance of IFIs. It shows that, the department of internal Shariah auditing seems to be linked directly to the CEO and SSB. Therefore, this paper asked several questions relating to internal Shariah audit function in IFIs in Bahrain. Hence, it is perceived to be effective on how, internal Shariah auditors maintain their effectiveness.

Direct contact between internal Shariah audit and the board of directors enhances internal Shariah audit departments. Thus, the researcher asked question on independence to Heads of internal Shariah audit, to establish whether their Head of internal Shariah audit department contact directly with the boards of directors. Although the AAOIFI (2010) stated that, on completion of the internal Shariah audit, at least a quarterly written report shall be prepared and addressed to the board of directors and copied to SSB and management. Organizational charts of the IFIs showed that the position of the internal Shariah audit department is not linked directly to the board of directors. Head of internal Shariah audit stated thus:

"We do not have direct link contact with the boards of directors. But rather we have direct contact with the chief executive officer, SSB and AGC who can contact the board of directors directly if necessary. Because we do not attend the board of directors meetings the SSB and CEO used to present our internal Shariah audit reports on behalf of our department, the communication between us and the board of directors is limited to following up the decisions of the board only, and to sending a copy to the department of internal Shariah audit to enable them to monitor the implementation of decision. And thus, prepare reports indicating the extent to which the various departments should implement recommendations to clarify decisions to enable preparation of these reports for the chief executive officer to submit to the board of directors"

This statement is confirmed by SSBs they indicated that:

"It is not important for the board of directors to be communicated and consulted directly with internal Shariah audit departments. The reason is that, we meet the board of directors regularly and it is our responsibility to raise the work of internal Shariah audit to the board."

This finding is consistent with (Khalid et al., 2017) who found that the independence of internal Shariah audit does not significantly affect the internal Shariah audit effectiveness in IFIs in Bahrain. Therefore, the Heads of internal Shariah audit department should have direct communication with the board of directors to ensure its independence. They are to provide a means for the Head on internal Shariah audit and the board of directors to keep each other informed on issues of Masalahah (Public interest) (AAOIFI, 2010). The subordination of the

internal Shariah audit department to the board of directors enhances its independence and subsequent powers. It also provides the board of directors with an efficient tool in understanding and reviewing operations within the organization (Yee et al., 2008).

However, to ensure the independence of internal Shariah audit, the board of directors should approve the appointment and removal of Head of internal Shariah audit. Therefore, another question which establishes the independence of the internal Shariah audit department within the IFI is the identity of the person who has the right to appoint or remove the Head of internal Shariah audit. A question directed to Head of internal Shariah audit, related to the decision appoint or remove the Head of internal Shariah audit and focused on who has the right to make such a decision. In all IFIs under study, the AGC has the right to appoint or remove the Head of internal Shariah audit. Accordingly, the respondents stated:

“The Head of internal Shariah audit department is appointed by an AGC, and the board of directors confirms the decision to appoint him. Then a copy of this decision is sent to the human resources department, and the director of human resources informs the Head of internal Shariah audit of his appointment. A copy of this appointment is distributed to various departments and branches within the IFI”

Regarding the experience of internal Shariah audit the responses indicate that the internal Shariah auditors low levels of experience because due to small size of some of IFIs therefore, IFI appointed internal Shariah auditors as outsources not to work permanently in the internal audit department. IFIs tend to rotate employees to and from the internal department, resulting in a quick turnover of employees. On the other hand, those who appointed permanently will be transferred to internal Shariah audit departments from other departments without any preparation, experience or training. Thereafter, the internal Shariah auditor may be transferred to other department and so on. One internal Shariah auditor observes:

“In some cases, I noticed that the main problem is that there is no basic structure for internal Shariah auditors in IFIs; internal Shariah auditors are transferred to other departments from other departments without any training. Therefore, internal Shariah auditors who are transferred to internal Shariah audit departments do not have experience”.

Therefore, the low level of professional qualification and quick rotation of employees from and to the internal audit department resulted in internal auditors having low levels of experience in auditing. However, AGC believe that working in different departments within the IFIs allows internal Shariah auditors to become proficient in performing audits. One AGC explained:

“We believe that the turnover of all staff within the organization is important for experience. Expertise requires knowledge that must be met before the internal Shariah auditors are entitled to perform Shariah audits.”

CONCLUSIONS

The paper examines the role of SSB on internal Shariah audit effectiveness in IFIs in Bahrain under Islamic agency theory. Existing literature review shows limitation of studies on internal Shariah auditors' effectiveness related to Shariah audit independence and experience in

IFIs. This paper in a way is an effort towards adding more literature on the subject under study and contributing towards a better understanding of the internal Shariah auditors' effectiveness in IFIs which requires different set of human capital. This paper propounds that Islamic agency theory could be used in building a conceptual framework of internal Shariah audit effectiveness. Experience, independence and SSB were conceptualized. Effectiveness could be enhanced by more independence and experienced internal Shariah auditors. Experience as part of nature in Islamic agency theory should be utilized to make auditing related decisions independence of others. Due to the position of SSB as the ultimate oversighting organ in the IFIs, the SSB could influence the relationship between independence, experience and effectiveness of internal Shariah auditors.

Overall, the interview results presented above have provided online understanding the role of SSB on the effectiveness of internal Shariah audit in IFIs. The appointment of Head of internal Shariah audit has been discussed as having a direct association with the SSB roles and functions. It is apparent from the evidence collected for analyses of interviews and documentation that the Head of internal Shariah audit contact and interact directly with the SSB and rather than with the board of directors. In all IFIs, internal Shariah audit departments prepare and submit audit reports to them for discussion. Regarding the appointment or removal of Head of internal Shariah audit, the nomination is made by the AGC. Then, the board of director confirms the decision of appointment. Therefore, internal Shariah auditors do not have the freedom to access and audit all documents and aspects of activity in the IFI. Thus, it was further proposed that independence, experience relationship is stronger at higher level of SSB. However, the findings of this paper are limited to small number of participants in the data collection process. More variables can be added to this model such as size of internal Shariah audit, scope of internal audit, cooperative between internal and external auditor and Shariah compliance officer.

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