

Safeguarding Shariah Compliance: Evaluating Internal Control Effectiveness in Malaysian Islamic Financial Institutions

Nur Laili Ab Ghani

UKM-Graduate School of Business, Universiti Kebangsaan Malaysia, 43600 UKM Bangi, Selangor, Malaysia

Corresponding Author Email: nurlaili@ukm.edu.my

Noraini Mohd Ariffin

Department of Accounting, Kulliyah of Economics and Management Sciences, International Islamic University Malaysia, Jalan Gombak, 53100 Kuala Lumpur, Malaysia

Abdul Rahim Abdul Rahman

Chairman, Education Committee, Majlis Agama Islam Wilayah Persekutuan (MAIWP), Menara MAIWP, No. 55, Lorong Haji Hussein 2, 50300 Kuala Lumpur, Malaysia

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Abstract

Islamic financial institutions (IFIs) establish internal control systems to achieve operational effectiveness and efficiency, dependable financial reporting and regulatory adherence. Although IFIs have implemented the internal control systems to manage Shariah non-compliance risks, evaluation of their effectiveness remains relatively unexplored. This study assesses the effectiveness of internal control systems applied in Malaysian IFIs. A quantitative approach was utilised, employing a survey questionnaire to gather data from 47 IFIs in Malaysia. This study utilises the COSO Internal Control Framework, adapted to align with IFIs' business operations and criteria specified in the Shariah Governance Policy Document released by Bank Negara Malaysia. Findings reveal that majority IFIs have implemented effective internal control systems. IFIs have created proficient control environments that foster necessary structure to facilitate evaluation of risks linked to failing to comply with Shariah principles. Nevertheless, improvement is needed in developing reliable policies and procedures to facilitate the implementation of management directives aimed at reducing risks that may hinder the attainment of Shariah compliance objectives. This study provides valuable insights into internal control system effectiveness and underscores the importance of implementing robust control functions and fostering a Shariah compliance culture to enhance the management of Shariah non-compliance risks.

Keywords: Internal Control System, Shariah Compliance, Shariah Governance, Control Function, Islamic Financial Institution

Introduction

An internal control system (ICS) within organisations is designed to establish compliance with applicable regulations as well as laws while preserving the organisation's assets. Fundamentally, implementing a strong ICS is crucial in shaping the foundation of financial institutions, the organisational structure, management empowerment, the formulation with regard to policies and procedures and the setting of organisational objectives (Root, 1998). In the context of banking industry, Otoo, Kaur and Rather (2023) perceived that ICS crucially important in achieving organisational effectiveness. The Committee of Sponsoring Organizations of the Treadway Commission (COSO) developed the COSO Internal Control Framework to aid in creating a control environment (CE), performing risk assessments (RAs), executing control activities (CA), enabling information and communication (IC), and conducting monitoring processes within financial institutions (COSO, 2013).

This study states that a robust ICS possesses significant importance in shaping the organizational structure within Islamic financial institutions (IFIs), establishing Shariah compliant objectives, granting management the accountability to supervise Shariah compliance operations and formulation of policies and procedures aligned with Shariah principles (Hanefah, Kamaruddin, Salleh, Shafii and Zakaria, 2020). The incorporation with regard to an effective ICS is crucial for promoting a culture of accountability in upholding Shariah principles at all levels (Ab Ghani, Mohd Ariffin and Abdul Rahman, 2022). Furthermore, the control function in IFIs are perceived as a crucial function in mitigating the occurrence of Shariah non-compliance activities which could potentially expose IFIs to reputational risks.

IFIs face various obstacles when it comes to their internal control mechanisms. The challenges at hand encompass a range of issues, including but not limited to the lack of standardisation on Shariah principles and internal control practices across IFIs, limited Shariah experts and implementation of comprehensive monitoring mechanism (Ab Ghani and Abdul Rahman, 2015; Sani and Abubakar, 2021). Moreover, Islamic finance industry is continuously influenced by extensive innovation of technology such as the establishment of digital banking and significant increase in the velocity of Islamic financial transactions due to the high demand from stakeholders (Ayedh, Mahyudin, Abdul Samat and Muhamad Isa, 2021). IFIs have established ICS to achieve operational effectiveness and efficiency, dependable financial reporting and regulatory adherence. However, while IFIs have implemented ICS to manage Shariah non-compliance risks (SNCR), systematic evaluation of their effectiveness remains relatively unexplored, creating a significant knowledge gap that this study addresses. This calls for further research into the effectiveness with regard to the ICS to assess the existing practices of IFIs in handling risks related to Shariah non-compliance.

This study examines the effectiveness of the ICS within IFIs in Malaysia. The increasing complexity of SNCR poses critical challenges for IFIs as it directly affects financial stability, regulatory compliance and stakeholder confidence. The study is motivated by the significant gaps persist in the internal control mechanisms for managing SNCR, despite the regulatory

mandate from Bank Negara Malaysia (BNM) through the Shariah Governance Policy Document (SGPD) since 2019 (Bank Negara Malaysia, 2019). Effective internal control systems are essential to maintain stakeholder trust, as compliance with Shariah principles directly influences customer loyalty, investor confidence and market integrity in the expanding global Islamic finance sector.

The results obtained from this research makes three key significant contributions. First, it contributes to a theoretical understanding for its evaluation of how effectively IFIs have implemented the five elements of an effective ICS, as outlined by COSO (2013), include monitoring activities (MA), IC, CA, RA as well as the CE within the context of Shariah compliance. Secondly, it highlights actionable findings that underscore fundamental weaknesses in the Shariah control functions, such as the requirement for strong policies and procedures to enhance the successful execution of the SGPD introduced by BNM in 2019. Through SGPD, BNM places increased emphasis on the importance of cultivating a risk culture that complies with Shariah principles, with the aim of fortifying the governance practices related to Shariah compliance across all IFIs in Malaysia. Thirdly, this research contributes to improving the accountability of IFIs in ensuring objective assurance of Shariah compliance, serving as the ICS for Shariah adherence will be audited by internal Shariah auditors. It also emphasises the role of BNM as the regulatory authority in identifying and implementing necessary improvements in existing policies and oversight practices among different types of IFIs in Malaysia.

The structure of this paper is arranged as follows: the following section reviews relevant literature concerning the ICS and its proposed measures. Next section provides further details on the research methodology, which is then followed by the analysis with regards to the findings. The concluding section wraps up the paper and offers valuable insights on the contribution of this research.

Literature Review

This section presents a comprehensive review of literature on empirical studies of ICSs and the suggested measures for evaluating the effectiveness with regard to ICSs in IFIs.

Internal Control System (ICS)

One of the earliest empirical studies on ICSs for Shariah compliance was conducted by Shafii and Salleh (2010). This study specifically explores the Shariah audit practices at Bank Islam Malaysia Berhad (BIMB) as well as Bahrain Islamic Bank (BIB), focusing on the auditing of ICSs to guarantee adherence to Shariah principles. In their study, Shafii and Salleh (2010) established a checklist for Shariah internal control that integrates the COSO internal control framework with the Shariah compliance indicators established by the Accounting and Auditing Organization for IFIs (AAOIFI, 2020) and the Guideline on the Governance of Shariah Committee for IFIs (GPS1-i) (Bank Negara Malaysia, 2005). This checklist is designed to assess the effectiveness related to internal control disclosures in the annual reports of IFIs (Shafii and Salleh, 2010). It was noted that BIMB attained a significantly higher score of 92.5% in terms of Shariah compliance, in comparison to BIB's lower score of 51.8%, which was attributed to insufficient Shariah governance disclosure in its annual report (Shafii and Salleh, 2010).

Several years' later, academic interest specifically in the study of ICS for Shariah compliance expand on the internal control practices in IFIs. Yahya, Mahzan, and Abu Hasan (2018) emphasized that an effective ICS is crucial to address issues related to non-compliance with Shariah principles. In this regard, internal Shariah auditors conduct a risk-based Shariah audit process using the COSO Internal Control Framework for identifying SNCR and offer objective assurance regarding the effectiveness with regard to the ICS and its adherence to Shariah principles (Yahya et al., 2018). Moreover, Abd Rahman, Mastuki, Osman and Kasim (2020) highlighted that COSO Internal Control Framework is also adopted to determine the Shariah audit areas. The study further highlighted that the application of COSO in Shariah audit practices contributes to the effective management concerning Shariah non-compliance in IFIs (Abd Rahman et al., 2020).

Meanwhile, Kamaruddin and Ramli (2018) found a positive effects of internal control practices on financial accountability within the context of Islamic non-profit organisations (NPOs) in Malaysia. In this respect, higher financial accountability is achieved when the Islamic NPOs established effective internal control process. This includes clear segregation of duties, proper documentation and records as well as precise authorisation of transactions (Kamaruddin and Ramli, 2018). The crucial and significant role of internal control components related to CE and MA is also found on financing activities in Jordan Islamic Bank (Al-Rawashdeh, 2018).

In addition, Hanefah et al. (2020) identified several weaknesses in the governance and internal control of Shariah non-compliant incomes (SNCI). These weaknesses include the absence of a comprehensive guideline for determining the classification of SNCI, inadequate governance, audit and risk management mechanisms for ensuring that SNCI is appropriately directed towards charitable purposes. Additionally, there is a lack of authorisation and reporting procedures for SNCIs, as well as a failure to conduct Shariah risk assessments (RAs) on operational risks by IFIs to identify potential SNCIs. Hanefah et al. (2020) proposed a matrix to tackle the internal control challenges related to SNCI in FIIs, which can be used to evaluate the ICS's compliance with Shariah principles. The matrix functions as a valuable instrument for evaluating the degree of Shariah compliance within IFIs when assessing their ICS. The matrix evaluates the individuals, procedures and infrastructure of the IFIs, along with additional risks such as reputational, financial and regulatory risks, in accordance with the Shariah compliance framework outlined in SGPD (Hanefah et al., 2020).

Another study has explored the potential integration of COSO principles within the Shariah compliance function of IFIs (Bouhreaoua and Djafri, 2022). The study conducted a comprehensive analysis to assess the level of adherence of the COSO Internal Control Framework to Shariah principles and fundamentals, as well explore the feasibility of its implementation within the Shariah governance framework of IFIs. Bouhreaoua and Djafri (2022) argued that COSO principles placed utmost importance to the practices of risk management, recognizing its critical role in facilitating the effective management of compliance with the Shariah principles. COSO represents a comprehensive framework covering all aspects of internal control. It incorporates the activities of IFIs in conducting auditing and risk management tasks, which are essential for the effective implementation of Shariah control function (Bouhreaoua and Djafri, 2022).

Proposed Measures

The COSO Internal Control Framework will be adapted and customised to assess the effectiveness of the ICS in IFIs. This encompasses IC, CA, RA, CE, and MA. The initial crucial component for evaluating effectiveness is the creation of the CE (COSO, 2013). The first important principle to be achieved is when organisation strengthen its dedication to upholding integrity and ethical principles among its internal stakeholders (COSO, 2013). In the context of IFIs, this principle is achieved when IFIs traditionally place a significant emphasis on effective management practices aimed at achieving Shariah compliant objectives in Islamic business operations. This commitment can be enhanced when the senior management continues to emphasise and communicate the importance of Shariah compliance to all levels (Moeller, 2014). Secondly, the Board of Directors (BOD) should fulfil its independent oversight duties on the management's development and performance of internal controls designed to guarantee compliance with Shariah principles. It is also imperative for the IFIs to establish a well-defined organisational structure that encompasses the strategic planning, efficient execution, effective control, reporting lines and periodic evaluation of various activities of the Shariah control functions. In accomplishing the Shariah compliant objectives, IFIs also need to establish the necessary competency requirements such as the knowledge, skills and experience related to Islamic business operations. Moreover, there should be an effective mechanism in IFIs to communicate and keeping all individuals accountable in ensuring proper execution of ICS responsibilities in relation to Shariah compliance.

Once the CE is established as the fundamental basis for an effective ICS in IFIs, RA component needs to be in place as the procedure to ascertain the management approach for all levels of risks. This involves setting risk-related objectives that are linked across different levels of organizational activities (Moeller, 2014). RA involves four principles, beginning with the establishment of clear objectives to effectively examine as well as determine the risks related to those objectives (COSO, 2013). In the context of Islamic business operations, it is crucial for IFIs to clearly establish the Shariah compliance objectives which could facilitate effective process in identifying and evaluating any SNCR. The second principle includes identifying and analysing all potential internal control risks that could affect the adherence to Shariah principles. This principle is also implemented in collaboration with the internal audit function (Moeller, 2014). Next principle entails the assessment to evaluate the operations and controls with the aim to identify any deficiencies that may potentially enable any Shariah non-compliant activities within the IFIs. Finally, IFIs are required to evaluate potential changes that could significantly affect the current ICS designed to meet Shariah compliance goals.

The third component, CA, includes three principles that direct the IFIs in the selection and development of control measures that could mitigate and control any instances of Shariah non-compliance. According to Moeller (2014), the control measures may include a combination of manual and automated processes such as segregation of duties, authorisation and approvals as well as business performance reviews. Once control measures are developed, the information technology application systems need to be initiated to facilitate the achievement of Shariah compliance goals. In addition, IFIs also need to ensure that the control measures are specifically aligned with the policies and procedures in mitigating SNCR and minimize it to a level deemed acceptable.

Next, the fourth component of IC requires IFIs to use and collect pertinent information in fulfilling its internal control duties to assist in attaining Shariah compliance objectives (Moeller, 2014). A collaborative effort among the senior management, IT specialists, internal auditors and other relevant stakeholders is recommended to conduct comprehensive assessment of historical data sources related to Islamic business operations. Therefore, it is essential for IFIs to engage in internal communication of internal control information, encompassing its Shariah compliance objectives and corresponding responsibilities in order to facilitate the effective operation of other elements of internal control. On the other hand, effective external communication needs to be established whereby IFIs acquire and disseminate the information to and from external sources, enabling management and personnel to recognise any condition that could affect the attainment of Shariah compliance objectives. The communication from the management to external stakeholders must clearly communicate the importance of ICSs within IFIs by showing transparent communication channels (Moeller, 2014).

The last component of an effective ICS is MA (COSO, 2013). Within IFIs, these MA are intended to identify and evaluate instances where there are disparities between expectations and actual outcomes concerning internal control inconsistencies to operate within Shariah principles. IFIs should engage in continuous monitoring practices and promptly identify and communicate any recognised internal control deficiencies across all components of ICS. The assessment of ongoing and independent monitoring evaluations should be conducted in accordance with Shariah compliance criteria (Moeller, 2014). Any internal control weaknesses discovered during this process must be swiftly reported to the appropriate parties within IFIs who have the authority to implement corrective actions in a timely manner. Once any identified deficiencies have been assessed, it is imperative for the management to ensure that the rectification efforts are promptly carried out and finally reduce the Shariah non-compliance matters.

The preceding discussion concerning the 17 principles, embedded within the 5 components with regard to the COSO Internal Control Framework aims to give structured guidance for implementing an effective ICS. Building a strong ICS is of vital importance for achieving Shariah compliance objectives in Islamic business operations. Table 1 presents a concise summary of the 5 components, along with the 17 principles, that are employed for assessing the effectiveness with regard to the ICS related to Shariah compliance within IFIs in Malaysia.

Table 1

Measurement of Effective Internal Control System with regard to Shariah Compliance

Components	Principles
Control Environment	<ol style="list-style-type: none"> 1. Set up a strong leadership culture for promoting ethical values as well as ensuring Shariah compliance at all levels of business activities. 2. Maintain independence of the BOD from the management team in order to establish a clear direction, standards of conduct and effective ICS that ensures adherence to Shariah principles within the IFIs. 3. Establish an optimal organisational structure and define transparent reporting channels from the functions related to Shariah compliance. 4. Implement a robust a succession plan designed to successfully attract, establish, as well as retain competent individuals who are in alignment with the objectives of Shariah compliance within the IFIs. 5. Establish a mechanism to enable communication and enhance accountability among individuals with regards to the performance of internal controls for Shariah compliance within the IFIs.
Risk Assessment	<ol style="list-style-type: none"> 6. Establish well-defined objectives that facilitates the process of identifying and assessing risks linked to failure in complying with Shariah principles. 7. Implement a comprehensive management process to effectively manage and reduce risks related to non-compliance with Shariah principles, thereby working towards achieving its objectives. 8. Deliberate the potential for fraud when assessing the risks related to Shariah non-compliance in order to achieve the objectives of IFIs. 9. Evaluate potential modifications that may considerably impact the effectiveness of ICSs in ensuring adherence to Shariah principles.
Control Activities	<ol style="list-style-type: none"> 10. Select and execute measures aimed at mitigating and controlling instances of Shariah non-compliance, thereby facilitating the achievement of its objectives within acceptable parameters. 11. Identify and execute technology-driven initiatives aimed at facilitating the attainment of Shariah compliance objectives. 12. Implement policies as well as procedures complying with Shariah principles, set clear expectations, and ensure these policies are effectively carried out in operations.
Information and Communication	<ol style="list-style-type: none"> 13. Employs pertinent and reliable information to support efficient operations of internal controls for the purpose of ensuring compliance with Shariah principles. 14. Communicate information pertaining to internal controls for Shariah compliance to internal stakeholders within the IFIs. 15. Conveys matters pertaining to the influence of internal controls for Shariah compliance to external stakeholders.
Monitoring Activities	<ol style="list-style-type: none"> 16. Engage in ongoing and independent assessment to examine the presence and effectiveness of each internal control component in ensuring adherence to Shariah principles. 17. Evaluate and quickly reports any internal control weaknesses pertaining to Shariah compliance to the necessary parties responsible for taking corrective actions, including senior management and the Board of Directors (BOD).

Source: Bank Negara Malaysia (2019); Moeller (2014)

Research Methodology

The primary objective of the study is to assess the effectiveness of the ICS at the institutional level, with a particular emphasis on analysing each individual IFI as the central unit of analysis. In Malaysia, there are 47 IFIs, which include 16 Islamic banks (IBs), Islamic windows in 7 commercial banks (IWCB), 3 investment banks (IWIB), as well as 6 Islamic banking businesses within Development Financial Institutions (DFIs), 11 Takaful operators (TO) and 4 Retakaful operators (RTO). The representative sample in each IFI is the Head of Shariah audit. These individuals will be responsible for providing relevant information regarding the effectiveness concerning ICS in maintaining compliance with Shariah principles within the business operations of IFIs.

A survey questionnaire was designed to assess the effectiveness of the ICS. It covers the 5 components as well as 17 principles derived from the COSO Internal Control Framework mentioned above as its benchmark. The principles within each component is modified to correspond with the distinct attributes of IFIs' business activities as the requirement by SGPD. The study has conducted prior verification test with several selected experts with accounting and Islamic finance background to establish the validity of the measurement, thereby ensuring its substantive accuracy (Anderson and Gerbing, 1991). The subsequent phase of the research includes the development of the final survey questionnaires by considering the valuable input provided by the participants during the expert validation test.

The respondents, specifically the Head of Shariah Audit, were asked to examine the effectiveness with regard to the ICS using a 5-point Likert scale (5 = Highly effective, 4 = Effective, 3 = Somewhat effective, 2 = Ineffective, 1 = Highly ineffective). Note that these responses serve as indicators for assessing the effectiveness with regard to the ICS implemented within the relevant IFIs. These indicators specifically relate to the successful implementation of the 5 components and 17 principles that constitute an effective ICS. The data collected from the survey questionnaire is analysed using SPSS (Pallant, 2016). Here, descriptive statistical analysis is conducted to calculate the total mean scores for each component and principle related to an effective ICS. Then, a descriptive ranking profile is produced to highlight the total means score for each IFI and emphasised the respective IFI with the scoring scale ranging from '5' indicating a highly effective ICS to '1' representing a highly ineffective ICS.

Findings and Discussion

This study distributed the survey questionnaire to 47 IFIs and received 39 responses in return. The other 8 IFIs were unable to participate in the survey due to confidentiality concerns. Furthermore, attempts to contact certain respondents from these IFIs were unsuccessful and some survey questionnaires were returned with incomplete responses. Overall, 82.98% (39 out of 47) response rate is considered high to carry out a thorough and comparative assessment on the effectiveness with regard to the ICSs across different IFIs in Malaysia.

This study primarily analyses and discusses the efficiency of the ICS within individual IFIs in Malaysia. To determine the level of effectiveness, the evaluation focuses on the implementation of key components essential to a robust ICS. These elements encompass MA, IC, CA, RA as well as the CE (COSO, 2013). Table 2 displays the ranking profile of the ICS's

effectiveness for each IFI in Malaysia relying on total mean scores (TMS). This ranking analysis indicates best practices for an effective ICS across different IFIs types, which is the focus of this investigation. In addition, the findings may provide valuable perspectives for other IFIs and regulatory bodies, indicating potential improvements that can be adopted.

Overall, the study indicated a satisfactory level of effective ICSs in IFIs in Malaysia, as indicated by an overall mean score of 4.032, as shown in Table 2. This is important to highlight that this level of effectiveness is accomplished by incorporating the 5 components listed above. Almost every component of an effective ICS has a mean score just above 4.000. It is crucial to observe, however, that only the CA component indicates a relatively lower level of effective ICS. The study also found that most IFIs exhibit an effective ICS. The data clearly shows that just over half of the IFIs (22 out of 39) accomplished a mean score exceeding 4.000, as presented in Table 2.

As shown in Table 2, the findings emphasize that the CE stands out as the most crucial component in ensuring the effectiveness concerning the ICS. This finding is reinforced by the calculated total mean score of 4.144. The results suggest that a significant number of IFIs have successfully implemented appropriate standards, procedures and frameworks that serve as the basic for employing an effective ICS at different levels. These measures are particularly effective in mitigating risks related to failing to comply with Shariah principles. Similarly, Sani and Abubakar (2021) also emphasised that IFIs need an effective governance and stable financial system as a viable operational instrument in implementing the risk-based Shariah audit framework. This helps to ensure overall level of adherence to Shariah rules and principles.

Nevertheless, Table 2 indicates that the CA component exhibits the lowest total mean score of 3.876 across most IFIs. This finding implies that there are differences in the implementation of technology-driven initiatives within the CE to achieve Shariah compliance objectives in multiple types of IFIs. The results might be attributed to the lack of CA established in smaller IFIs. Prior research has indicated that the size has an impact on the effectiveness of control measures established in organisation (Alzeban and Gwilliam, 2014; Ahmad et al., 2009). Regarding IFIs, having lower total assets can present a challenge for the smaller IFIs in terms of meeting the increased operational expenses required to establish an effective control measures (Abdul Rahman et al., 2017).

Table 2

Ranking Profile of Effective Internal Control System in Each Islamic Financial Institution

Islamic Financial Institution	Components of Effective ICS					Total Mean Score	Ranking	Range	Total IFIs
	Control Environment	Risk Assessment	Control Activities	Information & Communication	Monitoring Activities				
IB6	5.00	5.00	5.00	5.00	5.00	5.00	1	5.000-5.000 (Highly Effective)	5
IB8	5.00	5.00	5.00	5.00	5.00	5.00	1		
IB12	5.00	5.00	5.00	5.00	5.00	5.00	1		
IB14	5.00	5.00	5.00	5.00	5.00	5.00	1		
TO3	5.00	5.00	5.00	5.00	5.00	5.00	1		
IWIB3	4.80	5.00	4.67	5.00	5.00	4.88	2	4.000-4.999 (Effective)	17
TO7	5.00	5.00	4.33	5.00	5.00	4.88	2		
IWCB3	5.00	5.00	4.00	5.00	5.00	4.82	3		
DFI3	4.80	4.75	4.67	4.67	4.50	4.71	4		
TO9	4.60	4.50	4.00	4.00	4.50	4.35	5		
IWCB5	4.60	4.00	4.00	4.67	4.00	4.29	6		
IWCB6	4.80	4.25	4.00	4.00	4.00	4.29	6		
TO1	4.40	4.00	4.00	4.33	4.00	4.18	7		
IB4	4.20	4.00	3.67	4.00	4.50	4.06	8		
TO4	4.20	4.00	4.00	4.00	4.00	4.06	8		
IWCB1	4.00	4.00	4.00	4.00	4.00	4.00	9		
IWCB4	4.00	4.00	4.00	4.00	4.00	4.00	9		
IB7	4.00	4.00	4.00	4.00	4.00	4.00	9		
IB9	4.00	4.00	4.00	4.00	4.00	4.00	9		
DFI6	4.00	4.00	4.00	4.00	4.00	4.00	9		
TO8	4.00	4.00	4.00	4.00	4.00	4.00	9		
TO10	4.00	4.00	4.00	4.00	4.00	4.00	9		
DFI4	4.40	3.25	4.00	4.00	4.00	3.94	10	3.000-3.999 (Somewhat Effective)	15
TO5	4.00	4.50	3.67	3.67	3.50	3.94	10		
DFI5	4.00	3.75	3.67	4.00	4.00	3.88	11		
RTO1	4.00	3.75	4.00	3.67	4.00	3.88	11		
IB2	4.00	4.00	3.00	4.00	3.50	3.76	12		
IB1	4.40	4.25	3.00	3.00	3.00	3.71	13		
IB15	4.00	3.75	4.00	3.00	3.00	3.65	14		
DFI1	3.60	3.75	4.00	3.00	4.00	3.65	14		
IWIB1	3.40	3.75	3.67	4.00	3.50	3.65	14		
IB13	4.00	3.75	2.50	3.33	3.00	3.50	15		
IWCB7	3.40	3.50	3.00	3.67	3.50	3.41	16		
TO2	4.00	3.50	2.67	3.00	3.50	3.41	16		
TO11	4.00	3.25	2.67	3.00	4.00	3.41	16		
IB11	3.00	3.25	3.67	3.33	3.50	3.29	17		
DFI2	3.40	3.25	3.33	3.00	3.50	3.29	17		
IB16	2.00	1.50	4.00	4.00	3.00	2.71	18	2.000-2.999 (Ineffective)	2
RTO3	2.60	3.00	2.00	3.00	2.50	2.65	19		
Total Mean Scores	4.144	4.032	3.876	4.009	4.013	4.032			39
Mean Score Ranking	1	2	5	4	3				

Source: Authors

Upon analysing the ranking profile of each IFI, it is evident from Table 2 that 5 IFIs stands out as the top performer achieving an exceptional overall mean score of 5.000. These 5 IFIs which have implemented a highly effective ICS include 4 Islamic banks (IB6, IB8, IB12 as well as IB14) along with one Takaful operator (TO3) were identified. The research revealed that these IFIs accomplished a highly effective mean score in all aspects related to the ICS. This achievement is attributed to the robust dedication of these IFIs in improving the ICS's effectiveness, which significantly strengthens the management of risks related to non-compliance with Shariah principles.

According to the annual report, IB6, a fully-fledged Islamic bank, had already put in place its own Shariah governance framework and ICS to ensure Shariah compliance prior to the initial issuance of the SGF in 2010 (Bank Negara Malaysia, 2010). This highlights that the BoDs as well as senior management of Islamic banks have been actively fostering a strong culture of Shariah compliance and providing clear guidance in implementing an effective ICS to ensure adherence to Shariah principles across all levels. With a highly effective CE, IB6 has set up a strong basis to enhance the accountability among individuals that could facilitate the assessment of SNCR, effective communication and ongoing monitoring on any Shariah matters. The comprehension of its role as a fully operational IB and the creation of a culture that aligns with Shariah principles are crucial in distinguishing IB6 from other IFIs in Malaysia (Hassan & Christopher, 2005; Chapra & Ahmad, 2002).

Besides that, IB8, IB12 and IB14 are among the biggest Islamic banks in Malaysia, which operate as Islamic subsidiaries of local conventional banks. Being a prominent and largest IBs in Malaysia, they already have the best practices and examples of effective ICS from the banking Group. Hence, these Islamic subsidiaries of conventional banks only need to modify the internal control practices to align with the characteristics of Islamic banking operations and implement robust mechanism in ensuring Shariah compliance. The findings also demonstrate that these IBs possibly have ample resources to be allocated in establishing an optimal organisation structure of the Shariah control functions, implementing comprehensive management process to effectively manage SNCR and executing technology-driven initiatives at facilitating the achievement of Shariah compliance objectives (Wan Abdullah, Percy and Stewart, 2015). Similarly, TO3 is the Takaful operator that is established under the same Group as IB12. Hence, IB12 and TO3 could have the same vision and strong leadership culture to ensure Shariah compliance at every tier of business operation.

Apart from that, it is observed that only 2 out of 6 Islamic banking businesses in DFIs have been ranked among the top 10 IFIs for establishing an effective ICS. These DFIs operate an Islamic banking business and become the financial intermediaries for the agricultural sector along with small and medium enterprises in Malaysia. However, the other 4 out of 6 DFIs only established a moderate level of effective ICS with the mean scores of 3.94 (DFI4), 3.88 (DFI5), 3.65 (DFI1) and 3.29 (DFI2) based on the ranking profile in Table 2. These DFIs have lacked the implementation of RA component such as to facilitate a comprehensive process of managing SNCR. As a specialised institution providing a broad range of customised financial products as well as services required by the targeted strategic sectors, the BOD might be focusing on establishing the standards of conduct for effective ICS in general rather than

specifically on Shariah compliance matters. This indicates higher accountability and commitment of the BOD to improve the CE at all levels (Chapra and Ahmed, 2002). The size of Islamic banking business in DFIs might be small to have a wide allocation of resources in implementing a well-defined objective related to the management of risks related to non-compliance with Shariah principles.

This study also found that 1 Islamic bank (IB16) and 1 Retakaful operator (RTO3) are the two lowest scorers to determine an ineffective ICS. It is noted that the CE and RA are the 2 significant contributing components for the findings. IB16 and RTO3 could encounter challenges in establishing an effective control measures due to its comparatively lower total assets. This possess difficulties in terms of covering the higher operational expenses necessary for an effective ICS establishment. This includes establishing an optimal organisational structure and executing a comprehensive Shariah risk management process to align with the objectives of Shariah compliance within the IFIs. Additionally, the smaller scale of Retakaful operations in RTO3 may pose challenges in effectively managing risks of Shariah non-compliance. Therefore, it is difficult for RTO3 to have adequate resources and capabilities to enhance the accountability in performing the internal controls for Shariah compliance.

Conclusion

This research emphasised the importance of implementing an effective ICS across all IFIs. The effectiveness of such a system is assessed by how well IFIs achieve compliance with relevant regulations and laws, reliable financial reporting, as well as operational efficiency. The research findings suggest that most IFIs, particularly especially fully-fledged Islamic banks and Islamic subsidiaries of local conventional banks, have successfully implemented strong internal control measures to manage risks linked to failing to comply with Shariah principles. Nevertheless, there remains an opportunity to improve the CE by implementing comprehensive guidelines and processes that appropriately correspond with management's directives. The implementation of this enhancement is of utmost importance to mitigate potential risks that may impede the attainment of Shariah compliance goals in IFIs.

The findings are mainly contributed by the organisational structure of the IFIs to operate Islamic business operations and various sizes of IFIs in Malaysia. Given the supportive tone at the top to establish the Shariah compliance culture, these IFIs could execute robust control measures in achieving the Shariah compliance goals and reducing the risks related to Shariah non-compliance activities. These successful strategies could be adopted by other IFIs to establish an effective ICS as well as improve their accountability in managing SNCR.

This study offers valuable insights that highlight the effectiveness with respect to the ICS in IFIs along with the significance of establishing effective control functions and cultivating a Shariah compliance culture. These measures are indispensable for better risk management concerning non-compliance with Shariah principles. The findings provide significant implications for regulatory policy and industry practices to support BNM in developing better Shariah governance structure and monitoring for the SGPD, which underlines improved board oversight, increased independence of Shariah Committees and greater expectations for the development of Shariah compliance culture. In practice, the findings contribute in strengthening the accountabilities of the BOD to set a clear direction in establishing the CE

which could further enhance an effective control measures and communication of any Shariah matters in IFIs. As a consequence, effective implementation of the control functions could be strengthened and facilitate better incorporation of Shariah principles into the business operations of IFIs. In addition, this study accelerates industry-wide transformation through standardisation of evidence-based measures for internal control excellence, strengthening Malaysia's position and emergence as a leading Islamic finance hub and facilitating cross-border harmonisation of Shariah governance frameworks critical to the continued globalisation of the sector.

The research acknowledges specific limitations, such as the adoption of the SGPD and COSO Internal Control Framework to guide the creation of the measurement and research tools. Additionally, the study acknowledges the existence of response bias that may be associated with the adoption of survey questionnaires as the selected research tool. In order to mitigate the aforementioned limitations, a range of measures were implemented. The process involved the implementation of expert validation tests to ascertain the face validity and appropriateness of the questions utilised to assess the effectiveness with regard to the ICS.

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