

QURANIC GUIDANCE IN THE DEVELOPMENT OF EXTERNAL SHARIAH AUDIT FOR ISLAMIC FINANCIAL INSTITUTIONS IN MALAYSIA

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ABSTRACT

This article explores the guidance of the Quran in terms of formulating external Shariah audit (ESA) frameworks for Islamic Financial Institutions (IFIs) in Malaysia. It develops a conceptual framework that links Quranic values to the institutional design features of ESA such as independence, accountability, transparency, scope and corrective powers while arguing that their incorporation will enhance IFIs' Shariah compliance, public trust and their effectiveness in achieving the goals of Shariah (*Maqasid Shariah*). The study draws on the Shariah Governance Policy Document (SGPD) by Bank Negara Malaysia (BNM) on Shariah audit practices, literature review in ESA, and relevant Quranic texts and their explanation (*tafsir*). It identifies some policy implications and provides an operational checklist for Malaysian regulators, Shariah committees and external auditors.

Keywords: Shariah Governance, Shariah Audit, External Shariah Audit, Malaysian Islamic Financial Institution, Quranic Guidance

INTRODUCTION

At the global level, Malaysia is recognized as a leader in Islamic finance, with opportunities and prospects for continued growth arising from the demand of the strong market of the country's existing Muslim population, along with its potential to cater to the international market (Kamaruddin et al, 2024). Islamic banking and Takaful in Malaysia have become significant sectors within the financial system, Shariah governance is institutionalized through Shariah committees, internal Shariah audit functions, and regulatory expectations. However, concerns remain over perceived conflicts of interest, opacity, and inconsistencies in Shariah compliance claims.

Shariah governance is crucial to ensure effective Shariah implementation in IFIs and to provide a possible impact on firm performance. Shariah governance focuses on fairness towards all stakeholders by demonstrating high levels of transparency and accountability (Ahmad & Chapra, 2002). If non-Shariah compliant elements exist, this may lead to a loss of confidence and trust from stakeholders, especially from the Muslim community who entrust IFI in their fund or investments adhering to Shariah principles (Khamar et al, 2017). It cannot be disputed that as a Shariah-based institution, it is arguably expected that these Shariah-compliant institutions implement Islamic values in their market outside of the Shariah governance context. Therefore, the Shariah-based institutions need to have a sound Shariah governance model and to develop adequate methods and processes that drive to implement effective Shariah governance in the Islamic context (Hasan, 2010). This would include Shariah audit function as one of the key Shariah functions, particularly in relation to Shariah compliance being offered (Shafii et al., 2014).

ESA has been proposed by scholars and practitioners as a mechanism to strengthen accountability, enhance transparency, and provide an independent assurance that IFIs operate in accordance with Shariah. ESA within Malaysia is a developing concept in Islamic finance governance intended to provide independent assurance on the level of Shariah compliance at IFIs. Internal Shariah audit is required under BNM's Shariah Governance Framework (2010) and the Shariah Governance Policy Document (2019), whilst ESA is still voluntary. However, ESA is seen as an important tool to increase transparency, accountability, and stakeholder confidence over IFIs Shariah compliance.

The Quran serves not just as the primary source of Islamic law, but a holistic resource in establishing principles for governance, accountability, and integrity in human affairs. In the context of IFIs, a Shariah audit focuses on ensuring Shariah compliance in every activity, product, and operation through the teachings of the Quran and Sunnah (Syarif & Nadzri, 2024). Thus, the incorporation of the Quranic values and principles in the development of a Shariah audit framework is critical to ensure the audit framework is not just technical, but also spiritually and morally Islamic. This paper explores how Quranic guidance can inform the principles, objectives, and operational design of ESA for Malaysian IFIs.

LITERATURE REVIEW

Shariah governance is a key underpinning for a sound Shariah audit, as it creates the monitoring mechanism underpinning Shariah compliance. Thus, Shariah audit, methodically, demonstrates Shariah compliance. The identified objectives and expectations require bolstering through robust action plans which should consist of increasing the capacity of Shariah and supporting each of the sectors through building a robust foundation of Shariah. The desired outcome is for all Shariah-based sectors to have a robust Shariah governance and assurance framework. Securing stakeholders' trust that all actions carried out by Shariah-based sectors are in compliance with Shariah is the primary goal in terms of substance (Kamaruddin et al, 2024).

Recent research has also confirmed that preceding requirements have highlighted the key role of Shariah governance in monitoring the practices and conduct of the business and activities of IFIs. These practices and activities must accord with Shariah principles (Grassa & Matoussi, 2014). In principal terms, the principal function of Shariah governance focuses on encouraging fair and just financial transactions that will provide a benefit to all parties involved while the business of the organs of Shariah governance more predominately focus on accountability and transparency to stakeholders in particular, and *ummah* (community) more generally. Also, Khalid (2020) stated that existence of audit and governance committee may also boost the effectiveness of Shariah auditors in IFIs.

Within the framework of Shariah auditing in Malaysia, BNM began an important initiative to ensure proper Shariah compliance in IFIs by first issuing the SGF, BNM in 2010 (BNM, 2010) and subsequently revising it and issuing SGPD in 2019 (BNM, 2019). In between these two instances, the passage of the Islamic Financial Services Act (IFSA 2013) occurred in 2013. SGF 2010 contained sections on Shariah risk management, Shariah review, Shariah research, and Shariah audit activities, while the IFSA was designed to create Shariah compliance in IFIs. All the requirements of SGF 2010 were made mandatory for all IFIs as legal obligations and requirements under the IFSA as stipulated in the act. IFSA also highlighted a number of penalties for Shariah non-compliance (SNC). Both SGF 2010 and IFSA 2013 were meant to ensure adequate assurance of Shariah compliance within the IFIs ecosystem in Malaysia. The SGPD 2019 further enhanced the operational oversight functions of the Shariah Committee and other Shariah control functions of increasing or

enhancing Shariah compliance in IFIs.

Abdul Rahman (2014) stated that the external Shariah auditor role was purposely underlined and excluded from the framework. On the contrary, the new SGPD of 2019 stated that the Shariah audit could be carried out by qualified internal auditors or independent external auditors. Shafii et al. (2015) noted that the source of the Shariah auditing could be achieved in three ways: internal, external, or co-sourcing. In addition, the Shariah Audit Unit could also be independent (independent stand-alone unit) like models in Kuwait, Bahrain, and Qatar (Shafii et al., 2015). Some Shariah auditors could form part of the internal audit activity (leverage model). Each model or structure will also have differing degrees of independence, appropriate to the levels of competency needed in each context respectively in Islamic Financial Institution into account. According to Arman (2013), internal Shariah audit can minimize the costs incurred and safeguard against internal information leaks, whereas the external Shariah audit can tap into a more extensive expertise and address independent opinions regarding Shariah compliance work. This is also echoed in the recent SGPD 2019, which stated that IFIs are able to appoint an independent external Shariah audit in an event deemed necessary.

The more extensive audit framework is required to standardize the Shariah audit practices of future external and internal providers. Furthermore, it would facilitate the evaluation of the performance of auditors under either a ranked or star system. In fact, IFIs would be easily distinguishable from their conventional counterparts by the presence of a comprehensive Shariah audit framework and standard guidelines in the sense that they would perform and undertake all dealings in compliance with Shariah requirements and work towards independently fulfilling the purpose for which they exist. And, with standards and guidelines it would be easy to denote explicit yardsticks for entry into Shariah audit profession and thus harmonize the practice and bring practitioners into a profession (Isa, Ariffin & Abidin, 2020).

Khalid et al. (2017), in their research on trends in Bahrain, stressed on the need for Shariah audit to be independent and competent, where independence relates to the level of reporting, direct access to those charged with governance, and the ability to report without limitations, as well as the appointment and removal of the head of the internal Shariah audit unit. Nonetheless, they found that while independence appears significant, it was not statistically significant in determining internal Shariah audit effectiveness. They suggest this is due to the Shariah audit practices differing in Bahrain, where Shariah audit can be undertaken by either internal or external auditors, and their work undertaking differences in terms of remit. The authors found that competence and work performance were statistically significant in determining Shariah audit effectiveness. Also, management support may enhance effectiveness according to Yasoja et al. (2018).

Islam unequivocally and directly describes the essence and value of fairness, truthfulness and justice in the relationship of employee and employer. Islam advocates the acquisition of skills for living in this life and recognizes the struggle for good work in serving society. Islam is against unethical practices for profit including cheating, fraudulent behavior, and gambling. Islam emphasizes appropriate management of human resources. The following is a sampling of key elements and principles of appropriate management as established in the Quran and Sunnah (Azeem, Ramza & Akbar, 2013). Governance is the organized activities geared towards achieving an organization's objectives while using principles and processes of management such as planning, execution, control, and evaluation.

Thus, governance aims to ensure optimum use of resources while minimizing risk. Islam, being guided by the revelation of the Quran, offers foundational principles for governance that all of humanity, and

especially Muslims, should consider as a basis for thought and action (Syarif & Nadzri, 2024). Most importantly, Allah SWT, will ensure prosperity for those that follow through honorably with the trust they received. Whether Allah, or a human, is the trustor (Kusmilawaty et al., 2024).

METHODOLOGY

Document analysis is the systematic evaluation of written materials to extract meaning, understand context, and develop empirical knowledge (Bowen, 2009). In this study, document analysis was employed to examine several primary and secondary documents that shape the practice of Shariah auditing in Malaysia.

The primary documents analyzed include:

- Tafsir al-Quran (interpretive sources explaining selected Quranic verses related to justice, accountability, and governance);
- Islamic Financial Services Act 2013 (IFSA 2013), which establishes the regulatory framework for Islamic financial operations in Malaysia;
- Shariah Governance Policy Document (SGPD, Bank Negara Malaysia, 2019), which outlines Shariah audit and governance requirements for IFIs.

The document analysis process involved:

- Text identification – collecting Quranic verses, legal, and regulatory documents relevant to Shariah auditing;
- Content extraction – identifying key themes related to justice, accountability, transparency, and independence;
- Interpretation – linking these themes to ESA design features;
- Synthesis – developing a conceptual understanding of how Quranic guidance supports the institutionalization of ESA in Malaysian IFIs.

The purpose of analyzing these documents was to identify Quranic values and regulatory expectations that can serve as the foundation for ESA development. Each Quranic theme was then linked to its corresponding application within ESA design and operations in Malaysian IFIs. Verses such as *An-Nisā’ (4:135)*, *Al-Baqarah (2:282)*, *An-Nisā’ (4:105)*, *Al-Mā’idah (5:8)*, and *An-Nisā’ (4:58)* were selected because they encapsulate key governance concepts: independence, third-party opinion, check and balance, transparency, and good governance.

FINDINGS AND DISCUSSION

Based on the Quranic verses analysis, the study found some verses guide the development of ESA for Malaysian IFIs. The finding can be summarized in the following table:-

Table 4.1

	Quranic Guidance	Quranic Verse
1	Independency	<i>An-Nisa', 4 : 135</i>
2	Third-Party Opinion	<i>Al-Baqarah, 2 : 282</i>
3	Check and Balance	<i>An-Nisa', 4 : 105</i>
4	Transparency	<i>Al-Maidah, 5 : 8</i>

5	Good Governance	An-Nisa', 4 : 58
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1) Independency

“O you who believe! Be persistently standing firm in justice, witnesses for Allah, even if it be against yourselves or your parents and relatives. Whether one is rich or poor, Allah is more worthy of both. So follow not [your personal] inclination, lest you not be just. And if you distort or refuse [to give testimony], then indeed Allah is ever acquainted with what you do.” -

(An-Nisa', 4:135)

According to Tafsir Ibn Kathir, this verse is a comprehensive command for justice (*'adl*), urging believers to stand firm for the truth at all times. The term *“qawwāmīn bil-qist”* (steadfast in justice) emphasizes active and continuous commitment to justice, not merely passive neutrality. Ibn Katsir interprets this command as an obligation to uphold justice in all circumstances, even when it contradicts one's personal interest or affects close relatives. He stresses that true believers testify for the sake of Allah (*shuhadā'a lillāh*), not for worldly advantage or fear of others.

Tafsir Al-Qurtubi explains that this verse embodies the core of judicial and moral integrity. He asserts that a just testimony is an act of *ibadah* (worship) because it fulfills Allah's command. The prohibition *“follow not [your personal] inclination”* warns against bias, favoritism, and emotional influence. Al-Qurtubi also notes that the mention of both rich and poor signifies that justice must not be distorted due to social status or financial interest. Tafsir Al-Tabari interprets the verse as a divine injunction to uphold impartiality in judgment and testimony. He emphasizes that being a “witness for Allah” (*shuhadā'a lillāh*) means that justice must transcend personal, familial, or tribal loyalties. Al-Tabari underlines that the final clause *“Allah is ever acquainted with what you do”* serves as a reminder of divine accountability, warning believers that injustice will not escape Allah's knowledge.

In the context of ESA, external Shariah auditor should be careful of internal biases resulting from favoritism, conflicts of interest, or simply a desire to please management or executives to keep their job. Professional skepticism is required. They should not allow their own or their organization's biases to overcome audit standards or Shariah governance obligations. In an IFI context, this means independence to matters of financial or business standing. Whether it is a major shareholder, an influential client, or a smaller participant, the audit review must be uniform. No special exception should be given based on size or influence, but, on the contrary, regulators and audit frameworks must safeguard independence from “big-player” capture (Masruki et al, 2020).

2) Third-Party Witness and Opinion

“O you who believe! When you contract a debt for a fixed term, write it down. Let a scribe write it down between you in justice. Let no scribe refuse to write as Allah has taught him. So let him write and let the one who has the obligation dictate, and let him fear Allah, his Lord. And do not tire of writing it, whether it be small or large, for its (specified) term. That is more just in the sight of Allah, stronger as evidence, and more likely to prevent doubt between you. And bring to witness two witnesses from among your men...”

(Al-Baqarah, 2:282)

Tafsir Ibn Katsir states that Allah commands the writing of the debt contract so that no injustice occurs, and

there is no dispute in the future. To write a contract is simply to make a written record of responsibility, and it is protection for both parties, the creditor, and the debtor. It also shows Allah's concern for the transparency and accountability of transactions. In Tafsir Al-Qurtubi, the direction is not limited to debt but it can be an indication of an overriding principle of writing down financial responsibility. The act of writing is a way to protect justice (*bil-qist*) and to avoid dispute, which can be thought of as the first step in internal control. Tafsir Sayyid Qutb (*Fi Zilal al-Quran*) suggests that the command demonstrates that writing and recording is acts of worship performed for the sake of Allah, and while the scrivener writes down their debt they are using the knowledge they have received from Allah. Refusing to act righteously would be morally negligent.

Within the scope of ESA, a third-party (independent) opinion is analogous to the role of "witnesses" in the Quranic text. The Shariah auditor or reviewer externally acts as an intervening, "witness" to ascertain the truthfulness of the Shariah compliance process. The auditor or reviewer must be credible, acceptable to stakeholders and be prepared to undertake their role. The third-party opinion serves the causes of justice and fairness in the Shariah compliance process by providing assurance to stakeholders that the IFI's activities were assessed objectively. It enhances credibility of the institution in the perspective of investors, depositors, regulators and society. In auditing terminology, the audit report (written documentation) and the independent auditor's opinion represent stronger evidence of compliance and governance. Disputes about whether the product or transaction was Shariah-compliant in the future would also be mitigated. The Shariah audit firm, or external Shariah auditor, must be prepared to play their role, not be dissuaded from doing so by pressure, intimidation, or conflict of interest. They need to raise their voice, state their findings, and issue their opinion (Kamaruddin et al, 2020).

3) Check and Balance

"Indeed, We have sent down to you the Book in truth so you may judge between the people by that which Allah has shown you. And do not be an advocate for the deceitful."

(An-Nisa', 4:105)

Based on Tafsir Ibn Katsir, this verse was revealed in a theft case where an innocent man was being falsely accused, while the guilty party tried to pass their crime off on someone else. Allah revealed this verse to the Prophet ﷺ to order him to judge by only what has been revealed, not to be affected by a personal bias or influence from others in the social environment. Tafsir Ibn Katsir elaborates that the Prophet ﷺ was instructed not to protect the guilty person, regardless of emotional or social pressure.

The phrase "Do not be an advocate for the deceitful" serves as general, divine instruction that the Prophet SAW should not support someone who makes false claims or hides a wrongful act.

Tafsir Al-Qurtubi explains that this verse clarifies the principle of justice based on divine direction, not personal preference. He states that even the Prophet ﷺ, who is the most trustworthy of people, was reminded to go by the evidence and the revelation, teaching that beings can't bypass the law of justice. Tafsir Al-Qurtubi directs this idea to the command of "judge between people," where he charges humans with the lesson to enforce rules against preference for bias or advocacy for the dishonest. To continue, he weaves this verse into the responsibility of witnesses and judges regarding the justice of issuing judgments that demonstrate awareness, impartiality, and autonomy. Tafsir Al-Tabari interprets this verse to caution against supporting deceitful groups or people simply because of sympathy, status, or relationships.

He emphasizes that the Prophet ﷺ served as a judge to enforce God's justice without hesitation, even when judging among his own companions. This establishes a baseline morality that to be honest, you must put aside loyalties, and your pursuit of justice cannot be influenced by emotional or social issues.

With regard to ESA in respect of a shareholder or party related to a shareholder, the check and balances mechanism must treat all transactions, parties, and units equally. In the case of a major shareholder or related party, the audit must similarly not be "pleading" for those involved in the process, irrespective of whether or not the check and balances mechanism constitutes an organizational choice. Trivialize it not, the checks and balances mechanism has legitimate ethical bases from Quranic injunctions for justice and trust. Checks and balances seek to organize an oversight that is independently provided, has the right separation of roles, is adequately supported by evidence that is clear and transparent, and where remediation is at the system's disposal.

The notion of needing a "judge between people" implies that an independent third party is needed. In the context of an audit, this supports the employment of an independent external Shariah audit firm, peer reviews, and independent Shariah board reviews. In order for the external Shariah auditor to be independent, the reporting line must make it clear that they are a truly external auditor and not employees or extensions of management. As the verse stipulates not to be a "pleader for the deceitful," the auditor should not be compelled to be an advocate for management when noncompliance occurs (Yahya, 2018).

4) Transparency

"O you who believe! Be persistently standing firm for Allah, witnesses in justice, and do not let the hatred of a people prevent you from being just. Be just; that is nearer to righteousness. And fear Allah; indeed, Allah is well aware of what you do."

(Al-Maidah, 5:8)

Tafsir Ibn Katsir explains that this verse instructs the believers to always stand firm for justice (*al-qist*) purely for the sake of Allah, whether the judgment concerns a friend or an enemy. Ibn Katsir stresses that true justice (*'adl*) is closer to God-consciousness (*taqwa*) because fairness is an act of worship, and injustice is a violation of divine command. He cites the example of Prophet ﷺ who remained fair even to those who opposed him. Tafsir Al-Tabari interprets this verse as a universal injunction commanding Muslims to adhere to justice in all affairs, especially when bearing witness or judging between people. He states that justice (*'adl*) must be done for Allah, meaning one's intentions and actions should be guided by divine accountability, not worldly gain. Tafsir Al-Qurtubi links this verse to governance and accountability. He quotes scholars who say that justice (*al-'adl*) is the balance (*mizan*) that maintains social harmony. Hence, there must be mechanisms to ensure accountability and oversight.

In ESA context, transparency through documentation and truthful recording prevents deception and protects rights as a concept parallel to audit evidence and disclosure. Transparency requires proper record-keeping and openness, ensuring every transaction is verifiable. Transparency is an *amanah*; an ethical trust that protects justice in all transactions, reflecting the external auditor's responsibility to ensure full, fair disclosure. Audit documentation is a foundation for transparency and evidence-based reporting. Transparent audit trails prevent misinterpretation of Shariah compliance. Transparency in audit reports ensures that stakeholders, regulators, and the public receive truthful information regarding the institution's Shariah compliance. The transparency principle in auditing mirrors warning against hidden motives or

secrecy in governance. External Shariah auditors, as trustees of public confidence, must ensure their work is openly verifiable, well-document-ed, and free from concealment (Aziz et al, 2019).

5) Good Governance

“Indeed, Allah commands you to render trusts to whom they are due, and when you judge between people to judge with justice. Excellent is that which Allah instructs you. Indeed, Allah is ever Hearing and Seeing.”

(An-Nisa’, 4:58)

Tafsir Ibn Katsir explains that this verse was revealed in the context of entrusting responsibilities and positions to those who deserve them. “Render the trusts to whom they are due” means fulfilling duties faithfully whether material, moral, or administrative. He emphasizes that *amanah* encompasses all forms of responsibility, including governance, financial transactions, and testimonies. The second command, “judge with justice,” extends to leaders, judges, and decision-makers, who must base their judgments on fairness and truth, free from bias or concealment. Tafsir Al-Qurtubi highlights that this verse addresses both rulers and individuals. He states that *amanah* includes the duty to communicate information honestly and manage the affairs of others with integrity. Tafsir Al-Qurtubi interprets *amanah* as a moral commitment to clarity and openness in delivering what is due. In the context of audit, this reflects the ethical obligation to report Shariah non-compliance transparently, without fear or favor.

Tafsir Al-Tabari interprets “render the trusts” as obeying Allah’s commands in the management of both public and private affairs. He relates it to the trust placed upon those in authority, warning against betraying such trust through deception or secrecy. Justice in judgment, he says, is the act of making decisions transparently, according to divine guidance rather than personal interest.

In ESA context, it represents a systematic mechanism to ensure that *amanah* is fulfilled within IFIs to ensure that governance, transparency, and compliance are maintained through independent review. External Shariah auditors function as guardians of public trust over Islamic financial institutions. Upholding *amanah* requires implementing sound governance frameworks that ensure decisions and audits are free from manipulation or conflict of interest. Good governance in Shariah audit means that auditors as trustees must act fairly, transparently, and without favoritism, ensuring that all Shariah requirements are fulfilled and reported honestly. The auditor verifies whether management has discharged their trust responsibly, thereby maintaining public confidence in the institution’s governance (Basiruddin & Ahmed, 2019).

CONCLUSION

This study has demonstrated that the Quran provides foundational guidance for the conceptualization and institutionalization of ESA within Malaysian IFIs. Through document analysis and literature synthesis, the research identified several key Quranic guidance such as independence, third-party opinion, check and balance, transparency, and good governance. Each of these values not only reinforces the technical dimensions of auditing but also embeds spiritual, ethical, and moral accountability in line with Islamic jurisprudence.

The analysis revealed that Quranic injunctions such as those in Surah An-Nisā' (4:135, 4:105, 4:58), Surah Al-Baqarah (2:282), and Surah Al-Ma'idah (5:8) provide a moral compass for auditors and institutions alike. These verses collectively emphasize justice (*'adl*), trust (*amanah*), and transparency (*al-qist*) as divine imperatives that form the basis for good governance and Shariah assurance. In the context of ESA, they translate into operational principles such as independence from management influence, objective third-party evaluation, systematic oversight, comprehensive documentation, and ethical responsibility in judgment and reporting. The incorporation of Quranic guidance into ESA development enhances both regulatory and ethical dimensions of Shariah auditing in Malaysia. It aligns the practice of audit with *Maqasid al-Shariah* as the higher objectives of Shariah by ensuring fairness, safeguarding stakeholders' interests, and maintaining the integrity of Islamic financial operations.

Furthermore, aligning ESA with Quranic values supports the mandates of the Shariah Governance Policy Document (2019) issued by BNM, bridging divine guidance with contemporary regulatory expectations. In conclusion, the study asserts that the integration of Quranic principles into the design and implementation of external Shariah audits is not merely complementary but necessary for ensuring a holistic, ethical, and accountable financial governance framework. It recommends that policymakers, regulators, and practitioners institutionalize ESA as a core Shariah assurance mechanism, guided by the Quran's emphasis on justice, trust, and good governance. This integration will enhance public confidence, reinforce institutional credibility, and ultimately fulfill the divine objectives of fairness and accountability in Islamic finance.

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