

**ROLES OF STAKEHOLDERS' AWARENESS,  
UNDERSTANDING AND PERCEPTION OF  
SHARI'AH AUDIT ON THE RELATIONSHIPS  
BETWEEN INSTITUTIONAL MECHANISMS  
AND AUDIT SHARI'AHNESS IN NIGERIA**

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**UNIVERSITI SAINS MALAYSIA**

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by

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## LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
ACE	Advisory Committee of Experts
AIP	Approval-in-Practice
ANAN	Assoc. of National Accountants of Nigeria
B-MAS	Benchmark Minimum Academic Standards
BNM	Bank Negara Malaysia
BOFIA	Banks and Other Financial Institutions Act
CAMA	Company and Allied Matters Act
CBK	Central Bank of Kuwait
CBN	Central Bank of Nigeria
CIBN	Chartered Institute of Bankers of Nigeria
CSAA	Certified Shari'ah Adviser and Auditor
DCO	Debt Corporation Office
EAS	External Shari'ah Audit
EFIA	Enhancing Financial Innovation and Access
FRACE	Financial Reg. Advisory Council of Experts
FRCN	Financial Reporting Council of Nigeria
GDP	Gross Domestic Product
ICAN	Institute of Chartered Accountants of Nigeria
ICT	Information and Communication Technology
IFIs	Islamic financial institutions
IFSA	Islamic Financial Act
IIFA	International Islamic Fiqh Academy
ILM	Islamic legal Maxims
ISAF	Internal Shari'ah Audit Framework

ISRA	International Shari’ah Research Academy
KSO	Knowledge of Shari’ah, Skills, and Others
MCPD	Mandatory Continuing Professional Development
MS	Maqasid al-Shari’ah
NDIC	Nigeria Deposit Insurance Corporation
NIC	National Insurance Commission
NIFIs	Non-interest Financial Institutions
NUC	Nigerian Universities Commission
PC	Pension Commission
QCB	Qatar Central Bank
QFC	Qatar Financial Center
SAC	Shari’ah Advisory Committee
SB	Sterling Bank
SBP	State Bank of Pakistan IFIs
SC	Securities Commission
SOA	Standards on Auditing
STB	Sun Trust Bank
SWT	<i>Subhanahu Wa Ta'ala</i>
TJ	TAJ Bank
USM	Universiti Sains Malaysia

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**PERANAN KESEDARAN, KEFAHAMAN DAN PERSEPSI PEMEGANG  
TARUH DAN AUDIT SYARIAH TERHADAP HUBUNGAN ANTARA  
MEKANISME INSTITUSI DAN KESYARIAHAN AUDIT DI NIGERIA**

**ABSTRAK**

Keperluan mendesak bagi audit Syariah di peringkat organisasi dan pentadbiran tidak begitu disedari atau dihargai sehingga baru-baru ini dengan munculnya institusi kewangan Islam (IKI) di seluruh dunia. Perbankan Islam menjadi lebih terkenal di Nigeria dalam kalangan penduduk Islam yang ramai; bagaimanapun, ada kelemahan yang wujud dalam mekanisme institusional seperti rangka kerja perundangan dan kawal selia, pensijilan pendidikan dan profesional yang tidak mencukupi dan meniru pengauditan konvensional. Oleh itu, kajian ini menyiasat hubungan antara mekanisme institusional dan kesyariahan audit dengan kesedaran, kefahaman, dan tanggapan pemegang taruh terhadap audit syariah sebagai penyederhana dalam kalangan pemegang taruh bank Islam di Nigeria. Kajian ini menyesuaikan reka bentuk kajian tinjauan; di mana sejumlah 142 soal selidik telah diberikan kepada pemegang taruh bank Islam Nigeria. Teknik kuasa dua terkecil separa dan pemodelan persamaan berstruktur digunakan untuk menguji hipotesis. Dapatan kajian menyokong ketiga-tiga kesan langsung hipotesis mekanisme institusional iaitu "Paksa", "Normatif", dan "Mimetik" terhadap kesyariahan audit. Tambahan pula, "Kesedaran Pemegang Taruh" menyederhanakan hubungan antara mekanisme institusional "mimetik" dan kesyariahan audit. Ini menunjukkan bahawa bank Islam di Nigeria adalah responsif terhadap tekanan institusi yang berpunca daripada prinsip dan peraturan syariah, serta undang-undang dan peraturan tempatan yang lain. Untuk memastikan syari'ah audit yang optimum di Nigeria, pengawal selia seperti Bank Pusat Nigeria (CBN), National

Deposit Insurance Corporation (NDIC) dan Majlis Pelaporan Kewangan Nigeria (FRCN) harus menyediakan rangka kerja audit syariah khusus dan/atau Akta.

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**ABSTRACT**

The dire need for Shari'ah audits at the organizational and administrative levels has not been realized or appreciated until recently with the emergence of Islamic financial institutions (IFIs) across the world. Islamic banking is becoming more popular in Nigeria among the vast Muslim population; however, weaknesses do exist in the institutional mechanisms such as legal and regulatory framework, inadequate educational and a professional certifications and mimicking conventional auditing. Therefore, this study investigates the relationship between institutional mechanisms and audit shari'ahness with stakeholders' awareness, understanding, and perception of shari'ah audits as moderators among stakeholders of Islamic banks in Nigeria. The study adapts a survey research design; in which a total of 142 questionnaires were administered to stakeholders of Nigerian Islamic banks. The Partial Least Squares (PLS) and the Structural Equation Modelling techniques were used to test the hypotheses. The findings supported all three hypothesized direct effects of institutional mechanisms of "Coercive", "Normative", and "Mimetic" on audit shari'ahness. Furthermore, "Stakeholders' Awareness" moderated the relationship between the mimetic institutional mechanism and audit shari'ahness. The results showed that Islamic banks in Nigeria are responsive to institutional pressures stemming from shari'ah principles and rules, and other local laws and regulations. To ensure optimal audit shari'ahness in Nigeria, regulators such as the Central Bank of Nigeria (CBN),

National Deposit Insurance Corporation (NDIC) and Financial Reporting Council of Nigeria (FRCN) should provide adequate specific shari'ah audit framework and/or Act.

## CHAPTER 1

### INTRODUCTION

#### 1.1 Background of the Study

The tradition of Shari'ah audit traces back to the revelation of the Holy Qur'an, signifying its enduring legacy (Ahmed et al., 2019). However, its practice was limited largely to the individual level only (Khan, 1985). It was never institutionalized as a matter of priority at organizational levels or systematized formally for administrative applications. Yet, the dire need for Shari'ah audits at the organizational and administrative levels has not been realized or appreciated until recently with the global proliferation of Islamic financial institutions (IFIs) (Puad et al., 2020). These usher significant changes in many spheres of business transactions and activities, including accounting, finance, and auditing (Yazkhiruni et al., 2018), in guaranteeing adherence to the guidelines and precepts of shari'ah. "Shariah audit" refers to the all-inclusive procedure of impartially analyzing and scrutinizing all an organization's policies and procedures to ensure compliance with Islamic business laws (Puad et al., 2023). It includes the timely and regular examination carried out to offer an unbiased assessment of any company's investments and policies considering Shariah Standards (Bank Negara Malaysia, 2017). To ensure that its products comply with the Shariah Principles, a business needs to carry out Shariah audits.

However, conventional auditing practices still manifest in shari'ah audits thereby limiting its Shari'ahness. When performing a Shari'ah audit assignment, the degree to which an act or action conforms to the standards of Shari'ah or Islamic law is referred to as audit shari'ahness (Zulkifle & Sabli, 2022; Islamic Markets, 2022). Additionally, it has faced significant opposition from academics and industry

professionals (Aziz et al., 2023); in particular, attention has been drawn to the fact that certain products and services provided by Islamic banks are beginning to resemble those of conventional banks, which goes against the principles and regulations of Shari'ah (Abbas & Ali, 2019; Ahmed, 2014). There have been numerous agitations that conventional banking methods and Shari'ah criteria are mixed up, resulting in certain Islamic banks' products and services meeting all forms of contractual agreements but not the spirit or core of Islamic values (Hussain et al., 2016). For instance, in Nigeria, there are complaints from customers about the Islamic banks' products that are perceived as having high non-Shari'ah audit conformity risk (Abdulkareem, 2022).

It is notable to observe several factors that lead to low audit shari'ahness among IFIs (Kasim et al., 2009) such as inadequate knowledge of financial accounting, taxation, and other national laws contradicting the Shari'ah laws regulating the institutions by the majority of Shari'ah advisers that supervise Shari'ah compliance to guarantee audit shari'ahness. Therefore, Shari'ah advisers in many countries, Nigeria inclusive though very knowledgeable in terms of Shari'ah jurisdictions (*fiqh*), are nonetheless not knowledgeable regarding accounting, auditing, Information and Communication Technology (ICT), etc. (Arwani, 2018; Yacoob & Donglah 2012; Abdul Rahman, 2008; Mulyany, 2008; Abdul Rahman, 2008). Similarly, Arshad, et al. (2015) claimed that most of the Shari'ah advisers are outsourced by IFIs, and thus issues related to ensuring audit shari'ahness by Shari'ah advisers are affected by the scarcity of competent resources (Ali et al., 2016).

With related to the management, the attitude of auxiliary staff is another bottleneck regarding the audit shari'ahness by IFIs. This is because, mostly, management does not usually present each matter before the Board or the Shari'ah advisers. Even the ones presented rarely go through all the operational activities of the

IFIs due to time factors or paucity of staff with intellectual prowess to discern even the subtlest of loopholes. This may result in Shari'ah non-conformity by IFIs (Hassan, 2015) resulting in a low level of audit shari'ahness. These realities laid bare the need for normative mechanism to ensure adequate knowledge and professional skills and qualifications for ensuring audit shari'ahness in the Nigeria's Islamic banking sector.

In line with this, Abdul Rahman (2008), observed that audit shari'ahness is an internal issue, thus Shari'ah audit needs to be carried out by the internal auditor of the IFIs. Even though this may inspire confidence and trust on the part of the stakeholder, the internal auditor may not be denied as an employee of the organization and thus the management may temper his independence, confidentiality, objectivity, knowledge, and skills in performing his duties (Chapra & Ahmed, 2002). In the same vein, regulations typically mandate that the external Shari'ah audit functions be carried out annually to offer an unbiased evaluation of the degree of appropriateness and conformity of the IFIs with established guidelines and processes (Najeeb & Ibrahim, 2014; Kasim & Sanusi, 2013; Syafei, 2005; Rahim et al., 2004).

Therefore, several nations have worked assiduously to create a Shari'ah Governance Framework to ensure that there is sensible Shari'ah audit exercise in the operations of their respective IFIs to assure audit shari'ahness (Alam et al., 2021; Malkawi, 2013). For instance, the Islamic Financial Act (IFSA, 2013) was released by Malaysia, one of the world's top nations in Islamic banking industry. To be more precise, Section 37 of the legislation mandates that all IFIs designate a person or people to carry out a Shari'ah audit (Omar, 2019). Additionally, in 2014, after recognizing the remarkable expansion and development in the Islamic banking industry, the State Bank of Pakistan (SBP) released the Shari'ah Governance Framework (2014) for Islamic banks, Islamic banking affiliates, and traditional banks with Islamic banking windows.

Within the Nigerian Islamic financing sector, the Islamic banking sector is a specialized but expanding segment. Its market share increased to 0.7% in 3Q20 (3Q19: 0.3%), and as of the end of June 2022, its total assets stood at N543.08 billion (USD 1.189 billion), or 0.84% of all the assets in the banking industry. Total deposits reached N199.35 billion (USD 432 million), while total credits stood at N208.20 billion (USD 452 million). These figures represent 0.47% and 0.77% of the banking industry's deposit and credit, respectively (IFSB, 2023). The Central Bank of Nigeria (CBN) is the main engine driving the increasing market share; it has authorized the establishment of several Islamic banks in recent years. Owing to the remarkable expansion and adoption of Islamic banking in Nigeria, the CBN published guidelines on Shari'ah governance for Non-interest Financial Institutions (NIFIs) in 2011 (CBN 2011) to guarantee shari'ahness audits by NIFIs. The primary goal of creating such a Shari'ah framework is to guarantee audit shari'ahness.

Despite these advancements, Nigeria's Shari'ah Governance rules, which operate on the principles of Islamic Commercial Jurisdictions, did not explicitly define Islamic financial institutions (IFIs), although they did provide some insight into what they are (Abikan & Ahmad, 2017). Consequently, NIFIs and IFIs are synonymous in Nigeria (Umar & Kurawa, 2021). To overcome this obstacle, the CBN created a framework or set of guidelines for the administration of Islamic banking in Nigeria while also becoming a full member of the IFSB in 2009 (Ishaaq El-Mubarak et al., 2020).

It is important to highlight that NIFIs are only required to conduct internal Shari'ah audits. As a result, the lack of an external mechanism for Shari'ah audits leaves a gap in the assurance of Shari'ah compliance for internal audits among Nigerian NIFIs. Because of this, internal shari'ah audits frequently mimic traditional audits. The

standard external audit is modified to meet the Companies and Allied Matters Act (CAMA) 2020, as amended, which mandates that all registered companies conduct an annual audit to safeguard the interests of all parties involved. This demonstrates that the CBN's Shariah rules lack sufficient coercive tools.

Also, the reasonable assurance given by audited accounts should boost the stakeholders' confidence and trust in the general operations of the institutions. Although NIFIs meet the requirements for the institutionalization of Shari'ah audit at the internal level, it is unlikely that Shari'ah internal audit by itself will give stakeholders an acceptable level of assurance regarding the degree of audit Shari'ahnes of the institutions' operations. This practice depicts inadequate institutionalisation of shariah audit in the Nigerian Islamic banking sector.

Likewise, with respect to external Shari'ah audit issues, including roles, responsibilities, fees, professional standards, and all other related matters, the guidelines stipulated that all NIFIs must adhere to the pertinent standards released by organizations that set standards, such as the Nigerian Accounting Standards Boards (NASB), the International Financial Service Board (IFSB), and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). The guidelines' Section 12(2) made it clear that the applicable requirements of the financial accounting and auditing standards published by AAOIFI would apply in cases where other transactions, products, or activities are not covered by these standards. The regulations' most important requirement is that the AAOIFI standards must always be consulted if there are any gaps or exceptions (Ishaaq et al., 2020; Abikan & Ahmad 2017).

Even with the majority Muslim populace in Nigeria, the Islamic banking industry is becoming more and more well-liked, yet the shariah audit is not sufficiently

covered by the Nigerian Shari'ah governance framework's rules. All aspects of Shari'ah audit practices such as qualification requirements of Shari'ah auditors, the scope of Shari'ah audit functions, competency of Shari'ah auditors, modalities for appointing the Shari'ah auditor, and when to carry out the Shari'ah audit functions are not captured in the guidelines. The AAOIFI standards are adopted as an alternative, but even at that, the governance standards, of which the shariah audit is part are partially adopted. Additionally, Islamic accounting and by extension shariah audit is not adequately captured in the accounting curriculum of Nigerian institutions of higher learning as well as professional bodies. Hence, these institutional mechanisms of shari'ah audit towards ensuring audit shari'ahness in Nigeria are weak.

Given the vital roles of having robust guidelines and a knowledge base of shariah audit in ensuring audit Shari'ahness of IFIs in Nigeria and its status the need arose to investigate the level and roles of institutional mechanisms in ensuring audit shari'ahness among Islamic banks in the country. This study is motivated by the above issues and realities.

## **1.2 Statement of Problem**

Islamic banking is becoming more popular in Nigeria among the vast Muslim population, which reached 53.5% which is projected to reach 60% (123 million people) by 20230 (Yeboua, et. al. 2022). Interestingly, in 2021 and 2019, the CBN granted authorization for Lotus Bank Limited and TajBank Limited to operate as non-interest banks (NIBs). These additions joined Ja'iz Bank as the sole fully operational Islamic bank.

Moreover, Ja'iz Bank, the leading fully licensed Islamic bank in the nation, experienced a significant growth in gross earnings, rising by 32% from N19.6 billion

in 2020 to N25.84 billion in 2021. Likewise, Profit Before Tax (PBT) saw a notable increase, jumping by 43% from N3.07 billion in 2020 to N4.37 billion in 2021 (Ja'iz Bank Annual Report, 2022).

The remarkable expansion of the Islamic banking sector and the shifting nature of the global economy led to complexities in financial products and services supplied and demanded by stakeholders, hence audit shari'ahness challenges may arise. The primary goals of the audit's shari'ahness are, among other things, to make sure that all IFI operations comply with Shari'ah rules and that no divine law pertaining to the contract is breached (Sohail et al., 2021; Abbas & Ali 2019; Omar, 2019).

Moreover, in the Nigerian context, banks are peculiar with the issue of non-conformity with the provision of law such as the case of Skye Bank, when the Skye Bank board and senior management were forced to leave their positions by the CBN due to their infamous acts and disregard for the law. This led to spending of \$366m by the Asset Management Corporation to salvage the Skye Bank, Arik Airline, and Sterling Bank from collapse (Premium time, 2017, May 2). Consequently, CBN terminated Skye's license and moved its assets and debts to Polaris Bank, a bridge bank that had just received its license. This has exposed weaknesses in the institutional mechanisms of auditing system in Nigeria, which Islamic banks may tend to mimic in the absence of strong audit shari'ahness. Therefore, effective utilization of institutional mechanisms of Shari'ah audit will certainly mitigate these negative tendencies.

In this regard, the Central Bank of Nigeria (CBN) published guidelines in 2011 requiring all Islamic banks with licenses to abide by the rules set forth in the CBN-issued Code of Corporate Governance for Banks in Nigeria, as well as any subsequently released changes. They must also abide by the pertinent corporate

governance rules found in the Banks and Other Financial Institutions Act (BOFIA) of 1991 and the Companies and Allied Matters Act (CAMA) of 2020, as amended. However, all these coercive and normative mechanisms in the form of Laws, Acts and Codes were originally developed for conventional banks that are fundamentally more focused on economic and material aspects only and, hence, may not address consumers, companies, industry and the nation's needs for Islamic banking products and services.

Similarly, these acts, regulations, and rules do not fully address all aspects of Shari'ah audit obligations. Inadequate coverage persists in areas like the qualifications and appointment procedures for Shari'ah auditors, the scope of Shari'ah audits, timelines, the content of Shari'ah audit reports, and other relevant issues which hinders the provision of effective Islamic banking products and services to consumers, companies, industry and the nation at large.

Aligned with the points, the current study noted a lack of institutionalization regarding the coercive and normative aspects of Shari'ah audit mechanisms as observed in Malaysian, Indonesian, and Bangladeshi practices within the Nigerian context. This absence raises concerns regarding the assurance of Shari'ah compliance in audits. For example, the Nigeria Shari'ah guideline under section 12.2 provided that all issues be referred to AAOIFI standards for any loopholes and gaps not covered therein. Therefore, Nigeria up to now has not developed unique guidelines that cover the basic issues related to the Shari'ah audit for Islamic banks in the country. Thus, it relies maximally on AAOIFI standards regardless of its peculiarities concerning the above-mentioned issues. Furthermore, noteworthy is the fact that the AAOIFI Standards on auditing, which is the Framework of Auditing, are not yet complete; are still in the draft stage; and continue to face numerous challenges in gaining institutional

legitimacy. Therefore this poses challenges to the operations of IFIs in Nigeria. Furthermore, its standards have not yet been updated to specifically address the problems and conceptual framework of the Shariah audit (Mulyany et al., 2021).

Hence, to solve the problem of weak audit shari'ahness in Nigerian Islamic banks, isomorphism pressures are conceived as institutional mechanisms of Shari'ah audit under institutional theory (DiMaggio & Powell (1983) to address the issue. This is because isomorphism under institutional theory believes that all institutions become the same over time or adopt the same strategies or laws that are like an institutional mechanism. Therefore, Nigerian Islamic Banks urgently need institutional mechanisms for Shari'ah audit processes. Additionally, extant literature documented three dimensions of institutional theory that can be utilized by this study to overcome the problem of audit shari'ahness in the sector. These are 'coercive' which can be utilized to attain legitimacy; 'normative,' for professionalization and 'mimetic' to eliminate the uncertainty. Also, 'coercive' originates from external pressures such as government regulations (DiMaggio & Powell, 1983; Carruthers, 1995). According to Carruthers (1995), the "normative" indicates how a group of people in related professions conduct their business in comparable settings. Meanwhile, the professions depend on these "normative" practices and work to create cultural norms that are pertinent to their objectives and viewpoints (Scott, 1995). For mimetic mechanisms, institutions are under pressure to "mimic" and institutionalize the operating procedures of successful businesses as a result of uncertainty (Puad et al., 2023; Carruthers, 1995). Therefore, to become successful in ensuring audit shari'ahness, stakeholders in the Nigerian Islamic Banking industry urgently need to deploy proper institutional mechanisms of Shari'ah audit, which is derived from these three (3) dimensions of institutional theory (coercive, normative, and mimetic) and proper awareness,

understanding and perception of the Shari'ah audit. Moreover, inability to urgently establish the scope and nature of audit shari'ahness in Nigeria, non-compliance risk will persist and hence Islamic banks tend to become conventional banks in reality.

However, there are mixed results regarding the relationship between institutional mechanisms of Shari'ah audit and audit shari'ahness (Omar, 2019; Sohail et al., 2021; Abbas & Ali, 2019). To this end, it is important to note that these institutional mechanisms do not operate in a vacuum; their effectiveness is affected by some features of stakeholders such as awareness, understanding and perception. In this regard, stakeholders' awareness, understanding, and perception play a strategic role in relating the institutional mechanisms of Shari'ah audit and audit Shari'ahness.

Based on the aforementioned, this study delves into the connection between the institutional mechanisms of Shari'ah audit and audit shari'ahness among Nigerian Islamic banks. The conceptual framework of this study operates on the premise that audit shari'ahness is increasingly recognized as essential for upholding the injunctions of Allah SWT and ensuring full compliance. In summary, the problem statement can be articulated as follows: What is the relationship between the institutional mechanisms of Shari'ah audit (coercive, normative, and mimetic mechanisms) and audit shari'ahness in the Nigerian context, taking into account the roles of stakeholders' awareness, understanding, and perception of Shari'ah audit?

### **1.3 Research Objectives**

The research objectives are listed below, taking into consideration the problem statement that was previously stated:

- i) To examine the relationship between the institutional mechanisms of Shari'ah audit (coercive, normative, and mimetic) and audit shari'ahness amongst Nigerian Islamic banks.
- ii) To assess the moderating roles of Stakeholders' awareness, understanding, and perception of the Shari'ah audit on the relationship between the institutional mechanisms of Shari'ah audit (coercive, normative, and mimetic) and audit shari'ahness amongst Nigerian Islamic Banks.

### **1.4 Research Questions**

Following the above-mentioned study objectives, the following research questions are developed:

- i) Do the institutional mechanisms of Shari'ah audit (Coercive, normative, and mimetic) relate to audit shari'ahness among Nigerian Islamic banks?
- ii) Does Stakeholders' awareness, understanding, and perception of the Shari'ah Audit moderate the relationship between institutional mechanisms of Shari'ah audit (coercive, normative, and mimetic) and audit shari'ahness in Nigerian Islamic Banks?

## **1.5 Scope of the Study**

The bounds and parameters that a study must function inside are defined by its scope in research (Simon & Goes, 2013). In other words, the research seeks to address the problems that will fit within a certain circumference or parameters. The present study, therefore, looks at the institutional frameworks of Shari'ah audit in Islamic banks among IFIs in Nigeria. The present study centers on the Islamic banking industry in Nigeria, having been chosen for its fundamental significance in shaping the operational and marketing strategies of other Islamic financial institutions (IFIs) striving to acquire a substantial share of the country's financial market. As the pioneering Islamic sector in Nigeria, it serves as the cornerstone for the development of other IFIs in the country. Therefore, if there are proper institutional mechanisms of Shari'ah audit for ensuring audit shari'ahness in the sector, other sectors will adopt the same strategy if they want to remain relevant in the country.

Four banks in Nigeria—Ja'iz Bank, TAJ Bank (TB), Lotus Bank, and The Alternative Bank Limited—function as fully fledged Islamic banks. Furthermore, Sterling Bank (SB) and SunTrust Bank (STB) are two banks that provide Islamic windows (CBN, 2019). The Ja'iz bank was licensed as a full-fledged non-interest bank with regional authorization in 2011 and started with two (2) branches. Moreover, the bank was upgraded to national authorization in August 2016. Currently, the bank has forty-seven (47) branches and two (2) cash management units across the nation. Additionally, TAJ Bank (TB) opened two branches before receiving a regional authorization license in July 2019 to operate as a full-fledged non-interest bank. It was upgraded to national authorization in July 2022. The bank currently has twenty-two (22) branches and four (4) cash centers across the nation. Lotus Bank obtained its license as a full-fledged non-interest bank on March 25, 2021, with an initial regional

authorization allowing operation from a single branch. Subsequently, in January 2023, it was granted national authorization, expanding its coverage across Nigeria with twenty-nine (29) branches and seven (7) cash centers. Remarkably, in June 2023, another bank, "the Alternative Bank Limited", was permitted to function as a fully-fledged Islamic bank.

Moreover, Sterling Bank is one of the conventional banks with a non-Interest window licensed in December 2013. While SunTrust Bank (STB) is licensed as a window Islamic bank. It started with regional authorization in February 2019 with two (2) branches. The bank upgraded to national authorization in July 2022. Currently, it has eighteen (18) branches across the nation. Therefore, this study covers all Full-fledged non-Interest Banks nationwide and conventional banks with non-Interest Windows.

## **1.6 Significance of the Study**

Understanding the importance Nigerian Islamic banks take on guaranteeing audit shari'ahnes is greatly enhanced by this research through institutionalizing shari'ah audits. It explores the roles of stakeholders' awareness, understanding, and perception of Shari'ah audit as moderating variables. This study holds importance due to the critical need for services provided by Nigerian Islamic banks, given the substantial Muslim population in the country. Nigerian Islamic banks are established with the purpose of promoting, fostering, and advancing the application of Islamic principles within the financial and real sectors. These institutions offer modern financial services while adhering to Shari'ah rules and principles. Nigerian Islamic banks play a significant role in economic development and prosperity by facilitating

equitable income distribution through products such as Musharakah, among others (Sa'id, 2020).

The study of Islamic banks in the Nigerian context is viable in terms of increasing the Gross Domestic Product (GDP) witnessing remarkable economic growth within a short period. Although, the sector in the country is niche yet a growing segment with its market share rising to 70% in 2020 against 30% in 2019 and total assets of about USD732 million (IFSB, 2020). Thus, one of the factors that make this study significant is the inclusion of institutional mechanisms of Shari'ah audit in ensuring audit shari'ahness. Thus, comprehensive institutional mechanisms of Shari'ah audit are crucial for ensuring the availability of a Shari'ah audit manual in Nigerian Islamic banks. Without such mechanisms, achieving audit shari'ahness remains a significant challenge in the country.

### **1.6.1 Theoretical Contribution**

The central tenet of institutional theory emphasizes the isomorphism, or similarity, of practices over time. In the context of this study, it pertains to the standardization of audit shari'ahness through the consistent application of Shari'ah laws and principles within Nigerian Islamic banks. This ensures that the overarching objectives of audit shari'ahness are uniformly pursued across these institutions.

Second, the Maqasid al-Shari'ah theory underscores the imperative for Islamic banks to adhere to Shari'ah rules and principles, thereby fulfilling the highest objectives of Shari'ah. This entails satisfying the diverse stakeholders with whom Islamic banks interact. Moreover, the theory underscores the crucial role of institutional engagement in shaping decisions pertaining to audit shari'ahness, ensuring alignment with the highest objectives of Shari'ah within Nigerian Islamic

banks. In this context, the concept of isomorphism is exemplified through the establishment of Shari'ah audit practices, aligning with the principle that organizations tend to adopt similar practices. This is achieved by adhering to Shari'ah rules and principles, which serve as the foundation for Shari'ah audit. The three isomorphic pressures, conceptualized in this study as institutional mechanisms of Shari'ah audit, contribute to the standardization and adoption of these practices across Islamic banks. These institutional mechanisms of Shari'ah audit are coercive, mimetic, and normative. Furthermore, the entrenchment of institutional mechanisms of Shari'ah audit to conform with major characteristics of institutional theory (coercive, normative, and mimetic) and more relevant to the context of Nigeria. Hence, this study underscores the significance of institutional mechanisms in Shari'ah audit, aligning with the primary goal of Islamic Financial Institutions (IFIs) to fulfill the highest objectives of Maqasidil-Shari'ah. These mechanisms serve as the unifying force that brings together Muslims at both individual and institutional levels, including Islamic banks, fostering cohesion and adherence to common principles over time. This notion resonates with the directives of Allah (SWT) in the Holy Qur'an (Q: 3:103)

In conclusion, this study furnishes empirical evidence that could serve as a valuable resource for researchers and students interested in delving deeper into the connection that exists between among the variables examined in this study in future research endeavors.

### **1.6.2 Practical Contribution**

The research endeavors to foster confidence among managers and investors through the provision of interest-free products and services adhering to Islamic principles, thus steering clear of transactions involving gambling (Maysir) and uncertainty (Gharar). By steadfastly aligning with Shari'ah rules, this endeavor aims to nurture trust and assurance among both potential and current investors. Consequently, with the implementation of institutional mechanisms of Shari'ah audit, managers will extend their services to various segments of the economy, guided by Shari'ah rules and principles, encompassing not only Nigerian Islamic banks but also other sectors of the economy.

Second, this study provides greater clarity on the audit shari'ahness which is more concerned with the Islamic banks in attending to numerous stakeholders. As such, audit shari'ahness is elucidated to offer a comprehensive understanding of the practical measures undertaken by Nigerian Islamic banks to fulfill stakeholders' expectations.

Thirdly, examining stakeholders' awareness, understanding, and perception of Shari'ah audit as moderating variables affecting the relationship between institutional mechanisms of Shari'ah audit and audit shari'ahness in Nigeria elucidates the most relevant factors influencing the relationship between predictors and the assessment of audit shari'ahness in the country. Investigating these variables, as conducted in this study, significantly enhances the comprehension of audit shari'ahness within the Nigerian context.

Fourthly, this study provides crucial insights for policymakers and standard setters in Nigeria, offering guidance for the refinement of guidelines within the

Shari'ah governance framework. By explicitly delineating the principles of Shari'ah audit, it lays the groundwork for strengthening regulatory frameworks in accordance with Islamic principles. Consequently, with the institutional mechanisms of Shari'ah audit, policymakers can comprehensively outline all aspects of Shari'ah audits in the guidelines, including their functions, scope, competency, professional requirements, and the legal framework governing the roles of Shari'ah auditors.

### **1.7 Definition of Terms**

To ensure that researchers have a common understanding of the terms used throughout the research process, this section offers functional descriptions of the major variables under inquiry in the current research. A comprehensive explanation of these variables will be presented in the literature review chapter. There are three types of variables included in this study: moderating, independent, and dependent other terms used in this study.

#### **Dependent Variables: Audit Shari'ahness**

When conducting shari'ah audit functions, Nigerian Islamic banks' level of audit conformance with shari'ah provisions is known as audit shari'ahness. Additionally, audit Shari'ahness describes how closely Shari'ah rules and guidelines are followed while carrying out shari'ah audit assignments. This variable represents the extent to which audit processes and practices within Islamic banks conform to Shari'ah principles. It could include aspects such as adherence to Islamic finance principles, avoidance of prohibited activities (e.g., riba, gharar), and the integrity of Shari'ah audit procedures (Rizqiani & Yulianto 2020; Mohd Noor et al. 2018).

## **Independent Variables: Institutional Mechanisms of Shari'ah Audit**

This concept refers to the mechanisms designed to incorporate Shari'ah audit procedures into the operational activities of Islamic banks. This variable refers to the coercive, normative, and mimetic processes put in place by regulatory bodies and institutions to ensure compliance with Shari'ah principles in Islamic banks. These mechanisms (coercive, normative, and mimetic) processes are defined as follows:

### **Coercive Process**

Coercive is the adoption or adoption of certain processes, strategies, laws, or guidelines by force through certain stakeholders (DiMaggio and Powell, 1983). It is one of the dimensions of an institutional theory that has an element of force in its application. Coercive pressures arise when the institution changes its practices or adopts certain rules due to the pressures from dominant stakeholders or actors (for example laws, guidelines, and or tax offices) added to gain more legitimacy. As the name implied, coercive adoptions of certain laws and guidelines by force by certain stakeholders as an institution have no alternative but to abide by the pressure from such stakeholders (Meyer, & Rowan, 1977; Zucker, 1977; DiMaggio & Powell, 1983; Scott, 1995).

### **Normative Process**

Normative influence refers to the phenomenon wherein companies adopt a more professional approach and adhere to industry-specific guidelines (Liu et al., 2023). This influence arises when norms and peer groups exert pressure on institutions to adopt behaviours or practices perceived as normal within a particular group. Similar training backgrounds lead to similar practices acceptance by the institutions; non-

adoption or divergence from the group's norms may result in punishments (Briscoe et al., 2015).

### **Mimetic Process**

Mimetic under institutional theory assumes that institutions can imitate successful organizations that have common features (Teo et al., 2003). In other words, organizations can imitate successful organizations (mimetic isomorphism) that have scaled from the acceptance or institutionalization of specific standards or specialization (El-Gazzar et al., 1999; Craig, 2006). This means institutions are liable to adopt the practices of successful institutions and therefore come to resemble them.

### **Moderating Variables:**

#### **Awareness**

The state of being aware of events, things, or sensory patterns is the capacity to experience, feel, or be cognizant of them (Gafoor, 2012). In a broader sense, awareness is the state or attribute of knowing. Thus, "Stakeholders' Awareness of Shari'ah Audit" (STAW) in the context of this study stakeholders' awareness (STAW) refers to the level of knowledge and understanding among relevant stakeholders, such as regulators (FRACE), Managers of Islamic Banks, Shari'ah scholars known as ACE, internal Shari'ah auditors, and other stakeholders which include staff of the supervisory department at CBN and NDIC respectively, regarding Shari'ah audit processes and their importance in Nigerian Islamic banking sectors.

#### **Understanding**

It means grasping the meaning, significance, or nature of something. But it goes beyond just knowing facts—it involves connecting ideas, seeing relationships, and being able to apply what you've learned in different situations (De Quincey, 2005).

This study is a variable of stakeholders' understanding (STUG) that reflects the depth of comprehension and insight that stakeholders possess regarding the intricacies and implications of Shari'ah audit in the Islamic banking sector. It goes beyond mere awareness to encompass a nuanced understanding of Shari'ah audit and its application in Nigerian Islamic banks.

### **Perception**

Perception is all about how individual or group of people interpret and make sense of the world around him or them through his their senses-sight, sound, touch, taste, and smell. Perception is more than just receiving raw data; but about how his or their brain organizes, filters, and interprets that data based on past experiences, expectations, and context (Van Jaarsveld, 2010). Perception often refers to the action of sensory organs, such as vision, hearing, and touch that allow us to interact with the environment and perceive the world around us (Diaconu, 2024). Hence, this variable, stakeholders' perception (STPC) of Shari'ah audit, refers to stakeholders' attitudes( past experiences, expectations, context, beliefs and opinions regarding the effectiveness, credibility, and significance of Shari'ah audit in ensuring compliance and ethical conduct within Islamic banks. It encompasses stakeholders' subjective evaluations and judgments of Shari'ah audit processes and outcomes In Nigerian Islamic banks.

### **Other Terms:**

#### **Shari'ah Audit**

Shari'ah audit involves ensuring that Islamic financial institutions maintain consistency with Islamic Shariah principles, policies, instructions, and provisions throughout their operations. This commitment aims to fulfill the needs of Muslim

customers and other stakeholders while striving to achieve the highest objectives of Shariah, known as Maqasid al-Shari'ah (Lahsasna, (2016).

### **Institutional Mechanisms**

The explanatory (independent) variable in this current study is “institutional mechanisms of Shari'ah audit” which is measured by using three (3) independent dimensions of institutional theory (coercive, normative, and mimetic pressures) conceived in this study as institutional mechanisms of Shari'ah audit. Prior studies that used proxies include Puad, Abdullah & Shafii (2023); Alam, Karbhari, & Rahman, (2021); Karbhari, Alam, & Rahman, (2021); Antoniuk et al., (2021); Alam et al., (2020); Chekavinskaya, 2019; Fulton (2017); etc.

## **1.8 Organization of the Study**

The organization of this study is as follows:

Chapter one serves as the introduction to the entire study. The chapter addresses preliminary aspects, providing background information and outlining the organization of the study. It presents the statement of the problem that led to the research questions, which in turn drive the objectives of the study. Additionally, it discusses the scope of the study, its significance, and the motivation behind conducting the research. Finally, the chapter includes definitions of key terms relevant to the study.

Chapter two comprises the literature review and hypotheses development of this study. It delves into a review of the major variables, including conceptual aspects of Shari'ah, definitions, and the scope of Shari'ah audit. Furthermore, it explores the historical development of audit shari'ahness and investigates the relationship between institutional mechanisms of Shari'ah audit and audit shari'ahness. Additionally, the

chapter examines how stakeholders' aspects, such as awareness, understanding, and perception of Shari'ah audit, influence this relationship. Moreover, it conducts a comprehensive review of empirical literature relevant to all variables under investigation, aiming to identify any gaps in the existing literature. The chapter also discusses the theoretical perspective of audit shari'ahness, grounding the theory, and developing hypotheses based on the reviewed literature.

Chapter three focuses on the research methodology. It thoroughly discusses the systematic techniques employed to explore the answers to the research questions. The method of selecting respondents, their backgrounds, and the design of the research questionnaire are highlighted and discussed. Additionally, the chapter addresses construct measurements and the software used for data analysis. It explains and justifies the techniques adopted in analyzing the collected data. Finally, the chapter outlines the unit of analysis and provides a comprehensive overview of the research approach.

Chapter four presents, analyzes, and discusses the results of the study. It provides a detailed overview of the findings obtained from the data analysis process. The chapter discusses the outcomes in relation to the research objectives and hypotheses. Additionally, it includes visual representations such as tables, figures, and charts to facilitate the interpretation of the results. Overall, Chapter four serves as a critical component of the research, offering insights and conclusions drawn from the empirical data.

Chapter five encapsulates the summary, conclusion, recommendations, and suggestions for further research based on the findings of the study. It begins with a concise summary of the research objectives, and key findings. The chapter then

proceeds to draw conclusions based on the results obtained, addressing the research questions and hypotheses. Recommendations are provided based on the conclusions drawn, offering practical suggestions for stakeholders, policymakers, and practitioners in the field. Finally, the chapter outlines potential avenues for future research, identifying areas that warrant further investigation to advance knowledge in the field. Overall, Chapter five serves as a culmination of the study, providing insights, implications, and directions for future inquiry. Figure 1.1 provides an illustration of how this study was organized.

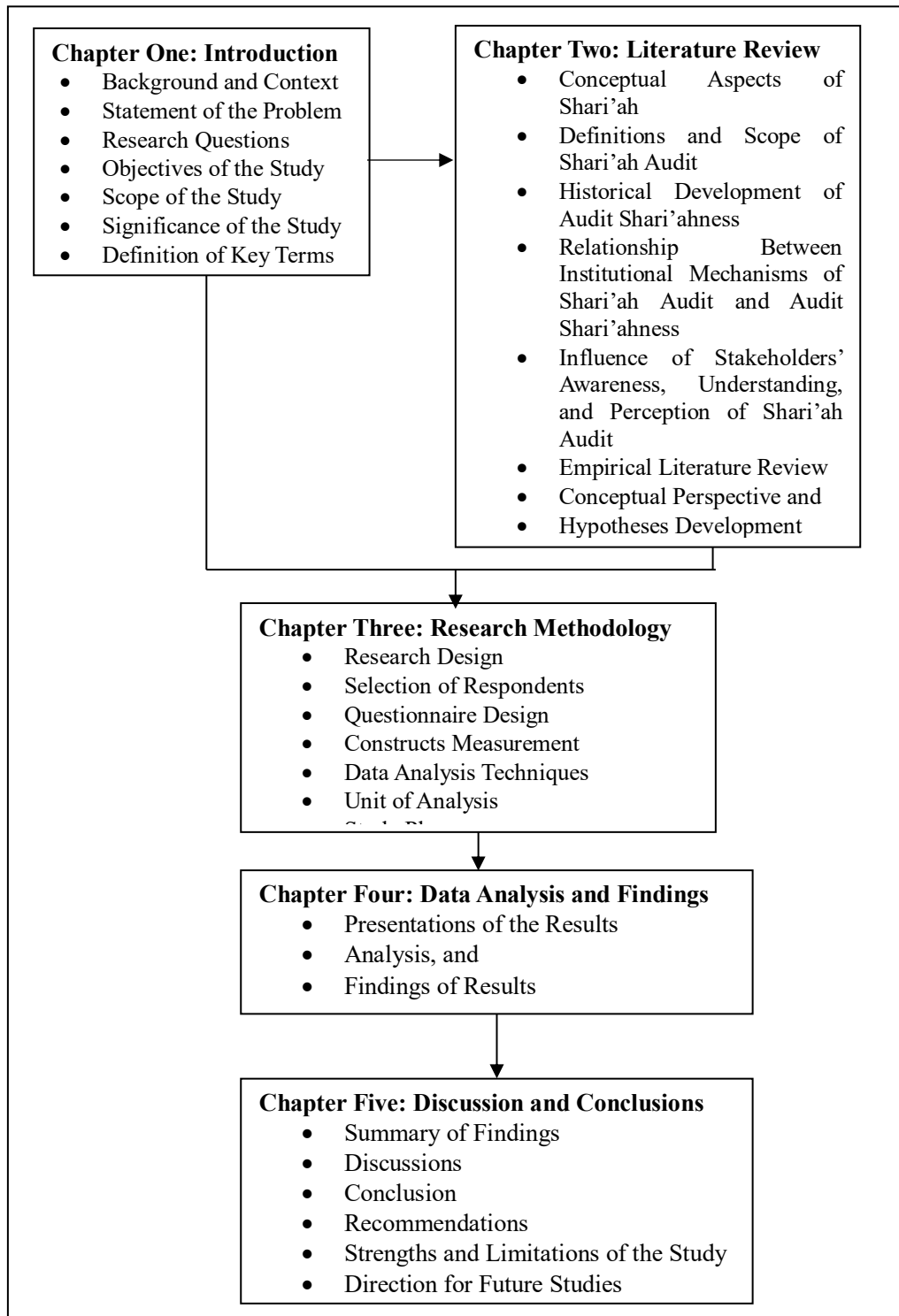


Figure 1.1 Organization of the Study

Sources: Developed by the Researchers