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Compliance of Sharia Audit in Banks and Islamic Financial Institutions in Palestine: A Literature Review

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Abstract

Sharia audits are required to make sure that Islamic financial institutions adhere to Islamic sharia standards in their financial and operational activities, and that the goods and services they provide to international financial institutions do not contravene any Islamic laws. This study aims to accomplish its objectives and provide answers to its questions. To accomplish the primary objective of this research, a systematic literature review, content analysis, and descriptive techniques were employed. This study used a systematic literature review methodology to locate, evaluate, and consolidate the extant literature on the analytical topic. This study analyses the differences in the roles of internal and external auditors between (IFIs) and (IBs) while considering the subject matter of internal sharia audits and the credentials of sharia auditors. This analysis is conducted through a literature review and examination of the existing literature on sharia audit compliance and governance. Consequently, the advantages of sharia compliance audits will be increased, and upcoming legal amendments will be put in place to minimize or eliminate the danger of sharia's noncompliance. This study provides a literature review and a theoretical and conceptual understanding of sharia audit compliance in Islamic financial institutions and banks. This study proposes a theoretical framework to evaluate the importance of sharia audit governance and identifies the basic elements that affect compliance, quality, and effectiveness in Islamic banks and financial institutions in Palestine. Compliance with the Islamic sharia audit can lead to optimal benefits, and future legislative changes can be implemented to minimize or eliminate the dangers of non-compliance with sharia.

Keywords: Auditors; Islamic Banks; Islamic Financial Institutions; Sharia Compliance Audit

INTRODUCTION

Increasing at a pace of 11 percent to 17 percent annually, Islamic Banks (IBs) and Islamic Financial Institutions (IFIs) are outpacing all other industries in terms of growth and are now recognised internationally as a viable and thriving part of the global financial system. sharia audits are necessary to ensure that the IFIs' products and services do not violate any Islamic laws and to ensure that the IFIs follow the rules of sharia in both their financial and operational operations. Any organization that promises to provide services that comply with sharia must ensure that all procedures and actions required for its daily operations accomplish the goal of Islamic law, *maqasid sharia*.

The Palestine Monetary Authority mandated the performance of a sharia audit function in Islamic financial institutions through the issuance of the sharia Governance Framework in 2015, which also required sharia research, review, and risk management. (PMA, 2019; Iriqat & Khalaf, 2018; Khalid, 2019). Let us consider the case of Palestine as an example: Systems, goods, personnel, the environment, and society are a few examples of situations in which the idea of sharia auditing is used. The audit function has been suggested as the best way to achieve this goal (Ali et al., 2020; Rashid & Ghazi, 2021). A strong monitoring system would increase and maintain the public's trust in the sector’s operations and activities.

Islamic countries, including Palestine, have two main types of banking system. The first is the conventional banking system, which relies on interest or usury and charges additional interest on top of a loan's principal amount. The second system is the Islamic banking system, which strictly adheres to Islamic principles based on the Qur'an and Hadith. This system differs from the conventional system in that it places special emphasis on sharing earnings and losses. Islamic banking, particularly in the financial sector and with regard to sharia audit compliance, can be viewed as a progressive expansion of the Islamic economy. It was developed in response to the needs of Muslim bankers and economists who wanted to satisfy many stakeholders' expectations (Iriqat & Khalaf, 2018).

Islamic financial institutions are explicitly created in most Islamic nations to offer alternative financial solutions in compliance with the sharia standards. They provide several financial solutions that steer clear conventional banking interests. Islamic banks are financial organizations that raise money, invest in it, and use it for further Islamic cooperation and economic expansion. While attempting to best serve the interests of its clients, these tasks include cooperative insurance, establishing zakat, complying with the sharia audit, and researching the most significant elements affecting it. Zakat is a required Islamic act of charity, in which Muslims give a portion of their money to those in need and the less fortunate (Iriqat & Khalaf, 2018; Khalid, 2019).

According to Khalid et al. (2018), substantial financial transactions are conducted by the Islamic finance industry in both Arab and Western countries. The Islamic Finance Development Index (IFDI) reported a remarkable 17 percent increase in total assets, reaching approximately US US$4.0 trillion in 2021, indicating significant growth in the industry. Furthermore, the worldwide net income of Islamic financial institutions tripled compared to 2020, demonstrating a significant improvement, particularly for Islamic banks. Notably, there are no specific laws governing Islamic transactions in Palestine, and the Palestine Monetary Authority does not issue any directives to regulate its operations.

Commercial banks operating in Palestine are mandated by the Palestine Monetary Authority to adhere to the regulatory capital requirements outlined in Basel III as per Instruction No. 8 of 2018. However, Islamic banks are exempted from this requirement as per the same instructions. Instead, Islamic banks must comply with capital adequacy criteria that align with the standards set by the Board for Islamic Financial Services as per Instruction No. 9 of 2018. This ensures that these banks follow the guidelines established by Islamic financial organizations. It is important to verify that standard contracts produced by Islamic banks comply with sharia audit requirements and the norms of decency and civility, as outlined by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). The AAOIFI Standards prohibit any agreements or contractual clauses that contradict both the standards and tenets of Islamic law, as per Rajgopal et al. (2020), Khalid et al. (2019), and Aliyu et al. (2017).

The Palestine Monetary Authority issued Resolution No. 15 in 2019, granting the Supreme sharia Supervisory Board the power to oversee transactions conducted by Islamic banks to ensure that they align with sharia standards and are provided by banks in Palestine (PMA, 2019). This measure aims to guarantee compliance with the requirements established by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). This decision fully conforms to Article 20 of Law No. 9 of 2010, which governs banks in Palestine and mandates that Islamic banks conduct all their operations by Islamic sharia law (Mnif Sellami, 2017; Hassan & Haridan, 2019; Algabry et al., 2020).

All practices and beliefs that God has prescribed are referred to as adhering to the sharia. The Palestine Monetary Authority formed a sharia Supervisory Board to guarantee the institution's conformity with Islamic sharia because these institutions are required to follow its rules (Iriqat & Khalaf, 2018). The sharia Supervisory Board's experts issue fatwas, which are legal judgments based on the “Qur'an and Sunnah,” the two fundamental sources of sharia. If there is an Islamic law-based judgment known as a fatwa that forbids engaging in usury, then adhering to this ruling ought to automatically be in line with the objectives of Islamic finance. Among non-profit organizations worldwide that play a crucial role in supporting Islamic financial institutions, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) holds a significant place. Founded in 1991, AAOIFI was headquartered in Bahrain (Raja 2021).

To successfully achieve its objectives, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) established 100 jurisprudential norms that govern Islamic financial operations. Over forty-five Islamic countries, including Palestine, have adopted these guidelines. Given that 90 percent of Islamic banks and financial institutions worldwide conform to these norms, adhering to them is a crucial component of any Islamic bank's commitment to operate by Islamic principles. It is important to note that AAOIFI was created to supplement the ((IFRS) by offering an additional framework that bridges the gap between Islamic and conventional financial operations. Primary Islamic standards bodies include the International Islamic Financial Market (IIFM), AAOIFI, and Islamic sharia audit committees, all of which encourage and influence adherence to Islamic financial practices and principles. As a result, the current edition of AAOIFI (2020) comprises a comprehensive set of 103 standards. These standards are created and assessed using a meticulous five-stage process that begins with the creation of an agenda, continues with preliminary research and discussion drafts, produces exposure drafts, and ends with the creation of a final edition. This procedure involves the formation of a special committee composed of board members and the participation of outside consultants to guarantee inclusivity and expertise. In developing and putting into practice the standards of the (AAOIFI), several steps are followed to ensure quality, effectiveness, and conformity to Islamic financial principles (Hassan & Haridan, 2019; El-Halaby et al., 2021).

The Islamic financial industry needs supplementary criteria to control its operations, such as compliance with Islamic sharia audits, given the different approaches to commercial transactions used by conventional Islamic financial systems and those governed by sharia. These requirements are taken from the law of transactions, which establishes regulations governing financial transactions. To maintain compatibility and consistency, it is crucial to carefully analyze international norms before developing and adopting Islamic financial rules. The (AAOIFI) rules on sharia auditing and compliance have not been the subject of many national studies (Raja, 2021). Isa et al. (2020) investigated the degree of Islamic sharia auditing compliance among modern Islamic banks in Palestine regarding the sharia standard of the (AAOIFI) and the general legal principles governing contracts. The goal of this study is to help the Palestinian Islamic banking sector close the gap between the (AAOIFI) sharia standards for sharia auditing and compliance with those standards, and perhaps even reduce or eliminate those contradictions (El-Halaby & Hussainey, 2016).

The objective of this study is to carry out a comprehensive review of existing literature, with a particular emphasis on the following objectives: assessing the level of adherence and compliance of audit committees with Islamic sharia auditing principles, which are overseen by the Palestinian Monetary Authority (PMA) and specialized committees of Palestinian Islamic banks, following the most recent directives issued by the PMA and the standards set out by the Standing Board of Palestine (SBP) in 2018 and the PMA in 2019). Exploring the key elements influencing Islamic sharia auditing and its adherence Verifying that Islamic sharia audit committees adhere to the prescribed laws, principles, and principles that, due to laxness or non-compliance, are likely to violate the standards of the (AAOIFI). Then, make changes to guarantee adherence to Islamic principles and pertinent national laws (Fowzia 2010).

This study aims to fill the gap in specialized legal research on compliance with sharia audits and enhance their effectiveness by offering guidance to Palestinian

Islamic banks to improve their practices by the principles of sharia contained in the Holy Qur'an, the Sunnah of the Prophet, and legal requirements. By doing so, this study provides valuable insights into the fields of Islamic institutions, banking, and finance. Additionally, the challenges faced by Islamic institutions and banks when implementing the requirements of the Accounting and Auditing Organization for Islamic Financial Institutions in the context of compliance with the sharia audit and its effectiveness via compliance, as stated in Islamic principles of sharia, were thoroughly examined in earlier parts of this research paper.

LITERATURE REVIEW

The sharia audit has been explored from a variety of angles in the literature, including the determination of the *maqasid sharia* auditing process (Rashid et al., 2017), problems and obstacles, and the future of the sharia audit labor market (Shafii et al., 2014). However, there is little research on sharia audit quality (Yazid & Suryanto, 2016), which is the only study we can locate, and it only covers a small number of variables. On the other hand, there is a wealth of studies on traditional audit quality.

An examination of the pertinent literature demonstrates that there is no universally accepted definition of audit quality. Despite numerous efforts over the past few decades to reach an agreement on how to define and evaluate audit quality, no consensus has been reached (IOSCO, 2010). Due to the uncertainty surrounding audit quality, there are two primary issues: (a) it is challenging to pinpoint the factors that impact audit quality and (b) it is impossible to accurately measure audit quality. Regulators, standard-setting organizations, auditors, and other stakeholders are still debating the issue in an attempt to reach consensus (FRC, 2006; IOSCO, 2010). For example, the International Auditing and Assurance Standards Board has acknowledged that "Audit Performance is a complex subject, and no description or evaluation of it has gained global acceptance" (IAASB, 2014). As a result, the current literature does not include all features of the concept in its definitions (Raak & Thürheimer, 2016).

After reviewing the current literature, various interested parties have established and presented diverse opinions on audit standards. The first is the viewpoint of the general population or consumers, who judge the accuracy of an audit based on how it affects their company's choices and investment decisions (Holt and DeZoort, 2009; Ianniello and Galloppo, 2015). In light of this, it may be said that the standard of the audit is attained if the auditor discloses any substantial misstatement (DeAngelo, 1981).

Auditing is structured work completed through a methodological procedure. Therefore, satisfying an efficient audit plan’s requirement is sufficient to achieve high audit quality (Christensen et al., 2015). This viewpoint holds that even if substantial misrepresentation is not discovered throughout the auditing procedure, the standard of excellence is still reached if the auditor correctly follows the audit plan, risk assessment methods, and auditing methods (Al-Khazaleh & Badwan, 2023). Auditors have asserted that audit assignments offer a reasonable degree of confidence based on sufficient audit proof rather than absolute assurance (IAASB, 2014). The third viewpoint is the audit company's point of view. They believe that an audit's integrity can be attained if it can be effectively represented in court against legal action or malpractice claims. According to Franz et al. (1998), lawsuits are indicators of poor audit quality. To prevent adverse results, auditors act more carefully when there is significant danger to lawsuits (Sun & Liu, 2011).

Many people and associations of professionals have developed and put forward various frameworks as an alternative to judge the audit's general quality to overcome the difficulty of describing the quality of audits. In this context, the Financial Reporting Council (FRC) took the initiative and published a discussion study titled "'promoting audit quality' in 2006. This endeavor started the discussion on the subject, and other approaches have been developed since then. A structure titled 'The Audit Quality Framework' was provided by the FRC itself in 2008 (FRC, 2008).

The International Auditing and Assurance Standard Board published "A Structure for Auditing Quality: Important Features that Develop Conditions for Auditing the Quality' (IAASB, 2016-17a, b, c), which is similar to the aforementioned publications. Various others have provided regulations on audit quality (DeFond and Zhang, 2014). Contributions, procedure, output, and context refer to how the structures have commonly classified the aspects that impact audit quality. The inputs are the qualities auditors possess, such as expertise, competent judgment, and sector expertise. Audit organizing, risk evaluation, collection, review of evidence from the audit, and other steps are all included in the audit procedure. Auditing findings and data sent to users were considered as the output. Context refers to the circumstances in which the audit is conducted, including regulations or guidelines, audit fees, audit employment, and non-audit fees (Huang et al., 2016; Hassan & Haridan, 2019).

The next topic covered in the available literature is how to assess audit quality. This problem has been the subject of several studies. Nevertheless, no study (Raak & Thürheimer, 2016; Ramamoorti et al., 2017; Rajgopal et al., 2020) offers a definite resolution to this problem. The absence of an expression that is broadly recognized as appropriate is a clear cause of this inadequacy. Consequently, it is impossible to evaluate and assess the precision and effectiveness of an audit without a commonly accepted standard. As previously noted, assessing audit quality is a difficult task with many facets, both theoretically and practically. Professionals' organizations and individuals constructed their structures by classifying the characteristics of audit quality in terms of components, procedures, outcomes, and contexts. There is a wealth of research on the variables that influence audit quality, and whether they affect it either separately or cumulatively.

Several research studies that examine the influence of auditors' expertise and knowledge in specific sectors have revealed that they have a favorable relationship with audit quality (Carcello et al., 1992). One of the causes is that by performing the same job, auditors acquire particular to an industry's ability (Frederick & Libby, 1986), which enhances their performance. Additionally, this expertise improves their capacity to spot errors and fraud (Sarwokoa & Agoes, 2014) as well as vulnerabilities in internal controls. An identical principle can be applied to the sharia auditors. A sharia auditor cannot evaluate the adequacy, efficacy, and effectiveness of sharia safeguards at divide and operating divisions without a thorough understanding of the dynamics of sharia non-compliance risk. Nevertheless, one of the major issues facing the sector is the lack of sharia auditors and compliance assessment employees (Ali & Kasim, 2019; Rashid & Ghazi, 2021).

Scholars have also discovered a link between auditor expert judgments and audit accuracy. Nevertheless, other studies contend that a variety of prejudices, including the effect of recency, the impact of framing or framing prejudice (Emby & Finley, 1997), and the consequences of dilution (Hoffman & Patton, 1997), might occasionally influence assessment. Moreover, expertise and innate skepticism (Koch et al., 2016) may reduce the auditor's prejudice. Some of the key elements that influence the standard of an audit are the auditor's impartiality. Several studies have considered several factors that may have an impact on the auditor's impartiality, including the significance of the customer, the length of service of the auditor, non-audit fees (Koch et al., 2016), atypical audit fees (Hribar et al., 2014), and the size and diversity of the auditing market (Huang et al., 2016).

Greater audit fees (Blay & Geiger, 2013) and lower audit fees compared to standard fees (Ettredge et al., 2014) are both viewed as threats to the auditor's impartiality, which may result in subpar audit quality. Many studies have examined the determinants and factors of the audit process, such as risk evaluation and management procedures (Zaiceanu et al., 2015), analytical evaluations and procedures (Glover et al., 2015), sampling audit quality and effectiveness (Hoogduin et al., 2015), and documentation of audit effectiveness. Several studies have been conducted to determine the nature of the relationship between various factors related to regular auditing companies, legitimacy, audit quality, and effectiveness. Furthermore, the Public Company Accounting Oversight Board (PCAOB) (2011) reported that audit firm rotation enhances audit quality and effectiveness. This is because internal and external auditors may form personal relationships with clients or stakeholders, which can negatively impact audit quality and effectiveness (Carey and Simnett, 2006).

Sharia Enterprise Theories

Sharia Enterprise Theory (SET) is a theoretical framework that merges enterprise theory with Islamic principles of value. As stated by Novikova and Kharisova (2019), the concept of wealth or value creation extends beyond parties directly involved in or contributing to cooperatives and companies, such as shareholders, creditors, employees, and the government, but also includes other parties who are not directly related to the business operations of the company, or those who provide financial and skills support.

According to Meldona et al. (2019), the SET framework is built on the premise that humans act as Khalifat Allah to create and distribute welfare for both humans and the environment. This framework emphasizes fairness in both human beings and the natural world, and benefits all parties involved, including both the vertical (ALLAH) and horizontal (human and natural environment) aspects. The ultimate goal of SET is to fulfill the purpose of God in creating humans as Khalifat Allah, which is not addressed by existing entity theories (Hassan Haridan, 2019; Sri & Lilik, 2019; Retnasih, 2023). This idea is based on the belief that humans are Khalifat Allah and responsible for generating and disseminating welfare for all people and nature. To be considered sharia compliant, a business must follow Islamic regulations. These regulations are based on the Qur'an, the Sunnah, and Ijtihad, which are collectively referred to as "the sharia." In modern times, this equates to the decisions and viewpoints of qualified scholars who focus on the investigation and interpretation of Islamic law in contemporary settings (OICU-IOSCO, 2004).

Enterprises that want to be labelled as "sharia compliant" must abide by the limitations set by Islamic law in addition to any secular national legislation that may be in effect where the business is located. Businesses who choose not to be deemed are solely subject to secular national legislation (Suganda & Humaemah, 2023). The key limitations imposed by the sharia law are described here to illustrate how these limitations could impact and distinguish the target cash holdings of sharia-compliant and non-sharia-compliant enterprises. The first limitation on businesses operating in accordance with sharia relates to routine daily operations. Only acceptable (halal) goods and services can be traded by businesses. This prevents the manufacturing of weapons, wine, pork, pornography, and gambling, among other goods and services. Financial services that entail speculation are included in gambling (El-Gamal 2000). Second, the use of interest (Riba) in fundraising or financing is prohibited for sharia-compliant businesses.

Sharia-compliant businesses have access to various unconventional funding options, such as debt-based contracts like "Murabaha" and "Tawarruq" and trade partnership-based contracts like "Musharaka" and "Mudaraba." These contracts are commonly used in Islamic finance, with trade-based contracts comprising the majority of Islamic financial assets. However, trade partnership arrangements are relatively uncommon because of their complexity and high risk, as noted by Suzuki and Uddin (2016). Despite this, the value of "Murabaha" contracts in GCC countries has increased from US$120 billion in 2006 to over US$720 billion in 2016, as reported by Alandejani and Asutay (2017). However, it's important to note that Murabaha contracts can be more expensive than standard loans due to the additional steps involved in their completion, which raises the cost of debt for businesses that adhere to sharia law, as pointed out by Alandejani and Asutay (2017).

As a result, sukuk is a less desirable way for businesses that adhere to the sharia to raise finance. Risk management is the final challenge that sharia-compliant businesses must overcome. Companies that adhere to the sharia regulations are required to manage and safeguard themselves against various risks, including those related to liquidity, foreign exchange, interest rates, credit risk, and operational hazards. However, the majority of risk management tools currently used in traditional financial markets are based on Riba, Maysir, and Gharar, which are prohibited under sharia law for Muslims (Alam et al., 2017; Standard & Poor, 2017; Ma'ruf & Fikri, 2023). Consequently, companies that comply with sharia regulations often face difficulties in managing their risks and may encounter more challenges than non-compliant companies.

Identifying the Elements that Determine the Quality of a sharia Audit

The study categorizes the elements influencing sharia audits in accordance with the three elements of the Audit Risk framework: risks of inherent, risks of control, and risks of detection.

Risks of Inherent

In the context of a sharia audit, there are several facets of inherent danger. The standard of the sharia audit may be impacted by the substance's effectiveness, the good's supervisor's background and expertise, the financial institution's size and age, and other factors. Nevertheless, the quality of the audit topic will ultimately determine all hazards categorized as inherent dangers. The sharia audit's subject matter is encapsulated in the terminology of "financial arrangements," "contracts," "operations," "measures and procedures," "accounting and IT systems," "transaction procedure flows," and related terms (SBP, 2018).

Risks of Control

Controlling risk is a crucial aspect of an audit risk framework. The management team is expected to develop and establish appropriate processes and controls in the form of an Internal sharia Control System (ISCS) in collaboration with the sharia board and other sharia governance framework authorities to foster a strict sharia compliance environment within the bank (Eriqat & Al-Khazaleh, 2024). (ISCS) refers to the policies and practices created, put into place, and upheld by those in the position of oversight, leadership, and other staff in order to give investors a fair level of confidence over the accomplishment of an entity's sharia-related goals. When adequate internal controls to guarantee sharia compliance are not located, it may be misleading to market Islamic financial instruments (IMF 2014). Operations were performed in conformity with the rules of sharia, according to the ISCS. According toIAASB (2019), ISA-315 offers comprehensive instruction to "the auditor in acquiring knowledge of many facets of the company and its surroundings to determine the risk of material misrepresentation". This knowledge gives the auditor the chance to comprehend the entity's operations and dangers connected to insufficient controls. With this knowledge, auditors can choose the best auditing techniques and important processes.

Risks of Detection

The third element of the audit risk framework is risk of detection. This idea has several facets. Failure to recognize a major misrepresentation may be related to security participation, audit companies, and auditors (Faza et al., 2023). The subsequent paragraphs describe the aspects that affect audit quality in relation to the auditor and audit company as audit engagements. One of the crucial elements that impact the sharia audit's effectiveness is the auditor's competence. Understanding sharia law, in addition to conventional security abilities and processes, is a necessary mix of capabilities for evaluating and detecting sharia risk in various financial deals, agreements, and operations (Ali et al., 2020; Khalid, 2020). Therefore, sharia auditors cannot fully recognize sharia non-compliance risk, an intricate issue, without a solid foundation in Islamic banking and auditing, as well as in-depth knowledge of the characteristics, risks, and actual limitations of Islamic financial products.

RESEARCH METHOD

This study is the first to investigate the efficiency of sharia auditing by Islamic institutions and banks in Palestine. It offers realistic advice for best practices to ensure that these transactions comply with laws that must be followed. The degree to which Islamic banks and institutions abide by pertinent legal requirements and sharia principles has not yet been investigated by legal experts (Grais & Pellegrini, 2006). The findings of earlier studies were restricted to a few accounting studies that looked at the extent to which banks and other organizations complied with accounting rules from an accounting perspective.

This study used a systematic literature review (SLR) methodology to locate, evaluate, and consolidate the extant literature pertaining to the analytical topic (Fink, 2005; Okoli, 2015; Ahmad & Omar, 2016). To determine the degree of validity of Palestinian Islamic banks' and institutions' compliance with the sharia audit in line with relevant legal norms and sharia principles, this study adopted a comparative descriptive analytical method. To learn from their experiences, this study analyzed various financial reports and publications from Islamic banks and institutions operating in Arab nations (Palestine Islamic Bank, Arab Islamic Bank, Al-Safa Bank, and Jordan Islamic Bank). This study uses AAOIFI's ratings of Islamic banks from a number of periodic reports published by the organization over the previous eight years. The steps included in the research methodology were literature assessment, comparative review, compliance assessment with Islamic principles and the requirements of the Accounting and Auditing Organization for Islamic Financial Institutions for sharia audits, legislative framework assessment, then practical suggestions were developed based on the research findings.

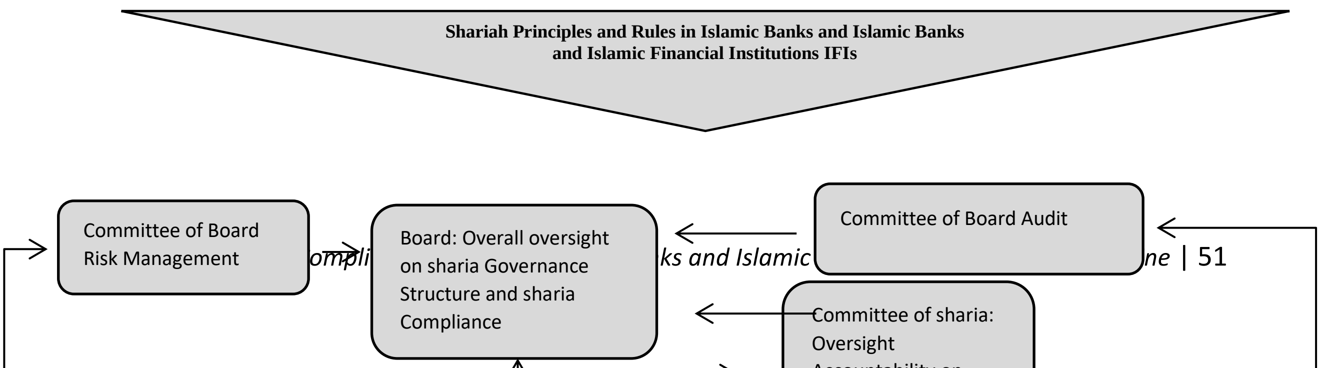

Figure 1. sharia Audit Governance Framework for Islamic Banks and Islamic Financial Institutions IFIs

Source: Authors, 2024

The sharia Committee was responsible for overseeing all sharia-compliant activities on behalf of the multinational financial institutions. They can also be required to perform a sharia audit, in addition to a sharia assessment. At the time, there were no formal rules on sharia governance in international financial institutions. However, there were substantial improvements in sharia concerns in international financial institutions after 2011 with the formation of the Social Security Fund. The Social Security Administration Fund has demonstrated heightened awareness of sharia by implementing four distinct functions commonly utilized in Islamic finance, as depicted in Figure 1. These functions comprise the sharia risk management regulation, overseen by the Risk Management Committee of the Board of Directors, and the administrative and sharia review functions, managed by The sharia Committee.

Furthermore, the administration views the sharia audit function as subordinate to the authority of the committee. Generally, the sharia risk function is executed by collaboration between finance and sharia executives, who are typically undergraduate students specializing in finance or sharia. On the other hand, the sharia audit function is performed by sharia authorities who are undergraduate students specializing in sharia at the IB in question. Currently, IBs' internal auditors are implementing this process without any established criteria for selecting the most qualified expert to serve as the sharia auditor for Islamic Banking institutions.

RESULTS AND DISCUSSION

Sharia Compliance Audit in the Palestinian Context

Palestine's financial system, which follows Islamic principles, includes Islamic banks, Takaful operators, Development Financial Institutions, and Islamic capital markets. The Palestinian Monetary Authority (PMA) oversees the regulation of Islamic banks, Takaful operators, and development financial organizations while also governing the capital market's regulation. Palestine has a two-tier sharia governance system that consists of an internal sharia Committee established in each Islamic Financial Institution (IFI) and a central sharia advisory body at the bank. This structure is essential for ensuring the compliance of Islamic financial institutions with the sharia principles (Alam et al., 2020).

The sharia Advisory Council (SAC) of the Ministry of Awqaf and Religious Affairs was created under Section 42 of the PMA Act 2016. It has established itself as the highest authority for determining Islamic laws for Islamic financial businesses. The SAC's responsibilities include ascertaining relevant Islamic law on financial matters and providing a ruling upon request as well as advising the PMA and the Islamic Financial Institution (IFI) on sharia issues related to their operations, activities, or transactions.

The Guidelines on the Governance of sharia Committee for Islamic Financial Institutions issued in 2015 further outline the duties and responsibilities of the internal sharia Committee in advising the respective IFIs on sharia matters. These guidelines have been updated to reflect new developments in Islamic finance and the increased expectations of IFI's key stakeholders regarding the sharia compliance process (Khalid, 2020). The (PMA) in collaboration with the Ministry of Awqaf and Religious Affairs (MARA), formulated a sharia governance framework for Islamic Financial Institutions (IFIs) with the primary objective of strengthening the role of the board, the sharia Committee, and management in matters related to sharia, including enhancing the capabilities of the relevant key organs responsible for executing sharia compliance and research functions. The ultimate aim was to establish a sharia-compliant operating environment (PMA 2019; Puad et al. 2020).

The sharia Governance Framework for International Financial Institutions (IFIs) (hereafter referred to as the sharia Framework) is designed to achieve the following objectives: first, it sets out the expectations of the Primary Market Auction (PMA) with respect to the sharia governance structures, processes, and arrangements of IFIs to ensure that all their operations and business activities are in accordance with sharia principles; second, it provides comprehensive guidance to the board, sharia Committee, and management of IFIs in discharging their duties in matters related to sharia; and third, it outlines the functions related to sharia review, sharia audit, sharia risk management, and sharia research. Three factors directly or indirectly impact the sharia compliance auditing of IFIs: cooperation between internal and external auditors, the scope of internal sharia audits, and the qualifications of sharia auditors.

Interaction between Palestinian Internal and External Auditors

Internal and external auditors from traditional financial institutions collaborate to increase audit efficiency and effectiveness. This collaboration is crucial, because internal audits provide an impartial evaluation of risk management, control, and governance systems. As Arwani (2018) highlights, creating a sharia audit framework is essential for achieving sharia compliance goals in IFIs, which can positively impact society or "The Ummah." The external audit function also works with the internal audit function to offer an objective review of the correctness and fairness of financial statements to shareholders. This collaboration allows the internal audit function to contribute to the overall risk assessment by learning about the organization's internal control systems and gathering relevant data, as mentioned by Khalid and Sarea (2021).

The governing body can benefit from a comprehensive understanding of the organization's operations and risks as well as the elimination of potential redundancy in audit jobs through a good working relationship and cooperation between internal and external audit functions (Alqudah et al., 2019; Abd Rahman et al., 2020). Puad et al. (2020) emphasize the importance of frequent communication between internal auditors and external auditors in areas of mutual interest, as well as close collaboration with management. Internal and external auditors must communicate well with each other to ensure the effective governance of the organizations they serve. This is supported by Khelil's (2022) study, which highlights the importance of sharing knowledge, viewpoints, and reports to conduct high-quality audits. While previous research has focused primarily on internal and external audit functions in the banking industry, there is a lack of detailed studies on internal sharia audits in Islamic Financial Institutions (IFIs), particularly in the context of Palestinian practice (Khalid et al., 2018; Algabry et al., 2020).

To avoid unnecessary duplication of effort and to achieve high-quality audits, external and internal auditors must collaborate. Omar (2019) suggests that internal auditors work with external auditors in a coordinated manner, as part of the management function, to enhance the effectiveness of internal audits.

Palestine's Internal Sharia Audit's Scope

When conducting daily business operations, Islamic Financial Institutions (IFIs) must adhere to all Islamic laws and standards, making the scope or role of internal sharia audits critical. Although the PMA provides various guidelines and policy papers to stakeholders in the industry, many internal sharia auditors and review officers remain unaware of their tasks, as stated by (Ab Ghani et al. (2019) and Yasoa et al. (2020). Due to a lack of understanding of these distinctions, it is unclear how to operationalize them (Ali et al., 2018; Yazkhiruni et al., 2018).

The roles of an internal auditor and an internal sharia auditor differ significantly in the application of Islamic rules and principles, as seen in conventional practices (Sani & Abubakar, 2020; Rashid & Ghazi, 2021). Internal auditors rely on financial statement analysis and the organization's governance and management controls, whereas internal sharia auditors are responsible for ensuring that all activities, such as transactions, products, policies and procedures, agreements and contracts, financial statements and reports, comply with Islamic standards and principles (Isa et al., 2020; Yasoa et al., 2020). Traditional auditing methodologies in the financial sector have developed from traditional auditing, which focuses on topics such as socioeconomic infrastructure and Islamic social culture (Ab Ghani et al., 2018; Yazkhiruni et al., 2018; Yazkhiruni et al., 2019). Sharia auditing seeks to accomplish objectives comparable to those of traditional financial organizations (Algabry et al., 2020). The fundamental distinction, however, is whether or not (IFIs) adhere to national accounting standards and their guiding principles. Internal sharia auditors have a broader range of responsibilities than conventional internal auditors do while performing daily tasks and operations (Tawfik & Bilal, 2020).

An internal sharia auditor must possess skills and expertise that are primarily focused on the specifics of the business as a whole to provide a view of the current situation regarding conformity with the sharia guidelines and fatwas issued by their sharia committee (Raja, 2020). The necessity of performing a sharia audit by internal auditors with comprehensive knowledge of the sharia regulations applicable to Islamic financial institutions is emphasized by the findings of PMA (2019). It is strongly recommended that any data that may be subject to sharia audit risk, including financial statements, policies, and processes, be audited by a certified auditor to ensure accuracy (Alahmadi et al., 2017; Ab Ghani et al., 2019).

An effective auditing process can be achieved by providing the auditor with sufficient evidence that the business adheres to sharia principles and the fat was issued by its sharia Supervisory Board (SSB). This is crucial for reducing internal or external breaches or risks and for enhancing sharia governance through sharia auditing (Algabry et al., 2020).

Palestinian Sharia Auditor Qualifications

As the Islamic finance sector continues to expand, qualified sharia auditors will increasingly become in demand. To ensure that these auditors can perform their tasks in compliance with the sharia regulations, only competent internal and external auditors with substantial expertise in Islamic finance, sharia, and other relevant subjects should undertake sharia auditing (Yasoa et al., 2020; Sani & Abubakar, 2020).

According to Omar (2019), a shortage of educated sharia board members can harm sharia governance and erode public trust. Therefore, the expertise of sharia Board participants is crucial for ensuring an effective sharia governance process in Islamic Financial Institutions (IFIs). Additionally, the demand for competent sharia auditor specialists ensures that Islamic banks' operations align with their ultimate objective of fulfilling *maqasid sharia* and maintaining significance in the eyes of their stakeholders (Ali et al., 2018).

According to Mohd et al. (2014), professional development programs from reputable organizations such as the Palestinian Association of Certified Public Accountants (PACPA), in-house training, and sharia-certified courses from reliable entities can increase the visibility of sharia auditors. Universities should include Islamic finance and sharia audit courses in their undergraduate programs to better prepare students for careers as sharia auditors. Increasing the number of qualified and experienced sharia auditors can address the sharia agency problem and promote good governance in Islamic financial institutions, as Schneider (2009) and Karim and Shetu (2020) note. Khatib et al. (2022) emphasize that qualified sharia auditors need a specific set of skills, knowledge, and traits in addition to relevant work experience. To maintain a continuous supply of knowledgeable and qualified sharia auditors and to avoid potential negative consequences for sharia-based commerce, coordinated efforts from the government, industry, and academia are essential, as highlighted by Khatib et al. (2022). To address this issue, collaboration among authorities, the government, sharia experts, and, most importantly, the Muslim community is crucial.

The findings of the study point to a specific issue that prevents the PMA decision from being implemented correctly. Examining the compatibility of Islamic banking principles with the fundamental tenets of the sharia compliance law as forth in national legislation is difficult. A major problem is the legal acceptance of unilateral pledges as legitimate sources of legally enforceable duties. Since these guarantees are necessary for sharia compliance, Islamic banks and financial institutions may experience difficulties if they do not have any legal standing under sharia compliance legislation. To align this compliance with Islamic banking principles and regulatory standards, this study thoroughly investigates the ramifications of this difference and considers various remedies.

Sharia audits are very important to Islamic financial institutions and companies that follow Islamic principles and rules. The term "sharia" refers to the body of laws and regulations developed from the Quran, "The Holy Book of Islam and the Hadith" sayings and deeds of Prophet Muhammad." The fundamental purpose of a sharia audit is to ensure that an organization's activities, transactions, and operations adhere to Islamic law. Some major arguments in favor of a sharia audit are as follows. Per Aliyu et al. (2017), Islamic financial institutions, including banks, investment funds, and insurance companies, are required to conduct their operations in accordance with the principles of sharia law. Activities that are forbidden or non-compliant with these principles and rules are prohibited. A sharia audit can help to ensure compliance with the ethical and moral tenets of Islam.

Businesses that adhere to sharia rely significantly on the faith and trust of stakeholders, investors, and clients. These institutions demonstrate their dedication to openness and respect for Islamic values by submitting themselves to periodic sharia audits. As a result, trust increases, and a good reputation is fostered. To find any non-compliance or sharia hazards inside an organization, a sharia audit is essential. By addressing these risks at an early stage, the major consequences that could result from unintended violations of Islamic principles, such as reputational harm or legal problems, can be avoided. Islamic financial firms may suffer severe financial repercussions if they violate sharia standards. sharia boards or regulatory authorities may issue penalties or punishments if an institution functions against Islamic law (Awwad, 2021). Organizations can avoid these penalties by quickly addressing any noncompliance concerns identified by a sharia audit. Islamic financial services and products need to be verified and authorized by qualified sharia scholars to be regarded as sharia compliant. A sharia audit ensures that an organization's goods and services have received this examination and are compliant with Islamic law.

As the global Islamic financial sector continues to expand, there is growing demand for sharia-compliant goods and services. By obtaining sharia audit certifications, organizations can enhance their market competitiveness and attract a broader clientele, including those who prefer to conduct financial transactions in line with their religious beliefs. The sharia audit process typically ensures the integrity, compliance, and ethical standards of both Islamic financial institutions (IFIs) and enterprises, as highlighted by Alkhan (2020). By adhering to sharia rules, these organizations not only fulfil their religious obligations but also contribute to the establishment of a robust and trustworthy Islamic financial environment.

CONCLUSION

This research mainly concentrated on the significance of Islamic banks and organizations in Palestine in compliance with the sharia audit. He discussed a significant obstacle these banks and organizations confront in upholding Resolution No. 15/2019 of the Palestinian Monetary Authority, which intends to implement Islamic principles in their dealings. The research brought to light an important discrepancy between these Islamic norms, which are inspired by modern jurisprudential tendencies, and the writings of “Al-Mujahirah” journal, which adheres to traditional Hanafi jurisprudence. This discrepancy is apparent in the inconsistency between several compliance laws and the Code's provisions, as well as in the standards set by relevant Islamic financial institutions. The findings of this study revealed a significant discrepancy between the rules and regulations set by the Palestine Monetary Authority for banks and Islamic financial institutions in Palestine and the legal standards outlined in the AAOIFI guidelines (El-Halaby et al., 2021). The contractual parties must abide by the regulations and legislation of the Palestine Monetary Authority, which is based on the Islamic sharia and its tenets. (AAOIFI) standards and fundamental legal precepts in Palestine must be adhered to by these standards and legislation. Compliance with sharia principles is essential for the daily operations of Islamic Financial Institutions (IFIs), as it greatly impacts financial practices that violate sharia law. Despite this, there are still issues with sharia compliance auditing, including cooperation between internal and external auditors, scope of internal sharia audits, and qualifications of sharia auditors. It is crucial for all parties involved to take action to bridge this gap, as it will significantly affect stakeholders' confidence in the sharia compliance of IFIs' products and services related to their operations and activities. Scholars have ignored this field of study despite the fact that the quality of the sharia audit is incredibly important in maintaining tight compliance conditions at IBIs. Regarding the sharia auditing standard, the literature is ambiguous. What elements influence sharia audit quality? Therefore, how can it be accurately quantified? To better comprehend the idea and to lay a solid basis for successful and effective decision-making about internal sharia oversight systems in IBIs, it is imperative to explore the factors, parameters, and effects of sharia quality of audits.

In light of these findings, the study suggests that a draft civil code be released in line with modern jurisprudential developments in Islamic jurisprudence. Additionally, the Palestine Monetary Authority advises ordering banks and Islamic financial institutions to comply with all sharia audit regulations and norms. To guarantee that financial institutions and Islamic banks adhere to modern Islamic norms, the Palestine Monetary Authority must examine all sharia audits of these organizations. All substantive requirements for Islamic banks and financial institutions must be met in line with the rules and regulations established in accordance with prescribed sharia principles. Drawing on this conclusion, we can identify several policy implications. First, Islamic Financial Institutions (IFIs) should strive to enhance the existing knowledge base on sharia audit compliance. This study emphasizes the significance of sharia compliance auditing in fulfilling the needs of stakeholders. Furthermore, all relevant parties must take steps to bridge the gap that could negatively impact stakeholders' confidence, particularly regarding the sharia compliance of the products and services provided by IFIs in their operations and activities.

Based on our analysis, we propose that future researchers should explore additional factors related to the current study and compare them with previous findings. This will help to develop new concepts and recommendations that align with sharia compliance auditing. By offering a structure, this study aims to discuss the quality of the sharia audit. The structure thoroughly identifies the aspects that may have an impact on the quality of a sharia audit, including those linked to the audit's topic of study, internal sharia oversight, auditors, audit company, and audit participation.

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