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يُؤْتِيهِمُ اللَّهُ مِنْ فَضْلِهِ يُغْنِيهِمْ

**THE RESPONSIBILITY AND INDEPENDENCE
OF *SHARĪ'AH* ADVISORS AND THE *SHARĪ'AH*
REVIEW PROCESS IN THE INDONESIAN
ISLAMIC BANKS**

BY

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ABSTRACT

The Islamic bank (IB) requires an independent and credible body which ensures that all of the IB's activities and transactions are in accordance with *Shari'ah* principles. Despite the present rules and guidelines developed by National *Shari'ah* Council-Indonesian 'Ulamā Council (NSC-IUC) and Bank Indonesia, there is a lack of sufficient guidelines related to the existence of *Shari'ah* Advisors (SAs) in Islamic banks (IBs) in Indonesia. Therefore, this study is designed to examine the perceptions of IBs managers and SAs of IBs in Indonesia on the responsibility and independence of SAs; and the *Shari'ah* review process. The study utilizes questionnaires to obtain the perceptions of IB managers while it uses interview to obtain the perceptions of SAs of IBs in Indonesia. There are 67 IB managers and 5 SAs of IBs in Indonesia who are actively involved as the respondents of the study. The study shows that the respondents perceived that the SAs are responsible for ensuring that the products, contracts and transactions of IBs are in compliance with *Shari'ah* principles. In order to improve the independence of SAs, the respondents viewed that the SAs should be prohibited from becoming consultants and majority shareholders of the IBs for the same IBs in which they act as SAs. The respondents also perceived that the SAs should conduct a *Shari'ah* review based on a sampling method. After conducting a *Shari'ah* review, the respondents were of the opinion that SAs should prepare a *Shari'ah* review report published in the annual report for the shareholders. In addition the respondents also viewed that SAs should prepare a special *Shari'ah* review report for the directors, regulators (e.g. Bank Indonesia) and the NSC-IUC. Furthermore, the study indicates that there are some significant differences between the perceptions of Islamic Commercial Bank (ICB) and Conventional Bank that offers an Islamic banking scheme (CBI) on certain aspects related to the responsibility and independence of SAs and the *Shari'ah* review process in the IBs in Indonesia.

ملخص البحث

يتطلب من البنوك الإسلامية وجود هيئة تتمتع بالاستقلالية والمصداقية يكون من مهامها التأكد من أن أوجه النشاط والمعاملات المصرفية للبنك متوافقة مع مبادئ الشريعة الإسلامية. ويغض النظر عن القواعد والإرشادات الحالية التي تم تطويرها بواسطة مجلس الشريعة الوطني لعلماء أندونيسيا والبنك المركزي الأندونيسي، إلا أنه مازال هناك قصوراً وعدم كفاية في الإرشادات المتعلقة بوجود هيئة مستشاري الرقابة الشرعية في البنوك الإسلامية في أندونيسيا. لذلك فإنه تم القيام بالدراسة الحالية من أجل التعرف على تصور المدراء و أعضاء هيئة مستشاري الرقابة الشرعية في البنوك الإسلامية في أندونيسيا حول مسؤولية وإستقلالية هذه الهيئة وإجراءات الرقابة و المراجعة الشرعية التي يجب القيام بها في البنوك الإسلامية. وقد إستخدمت الدراسة أسلوب الإستبيان للحصول على تصور مدراء البنوك، في حين تم إستخدام أسلوب المقابلة الشخصية للحصول على تصور أعضاء هيئة مستشاري الرقابة الشرعية. وقد إشملت عينة الدراسة على سبعة و ستون مديراً من المدراء و خمسة أعضاء من أعضاء هيئة مستشاري الرقابة الشرعية في البنوك الإسلامية في أندونيسيا. وقد أظهرت نتائج الدراسة أن هيئة مستشاري الرقابة الشرعية مسؤولة عن التأكد من أن أوجه النشاط والمعاملات المصرفية للبنك الإسلامي متوافقة مع مبادئ الشريعة الإسلامية. كما أشارت النتائج الى أنه من أجل تعزيز إستقلالية هيئة مستشاري الرقابة الشرعية، فإنه يجب على أعضاء الهيئة عدم مزوالة أعمال إستشارية او أن يصبحوا أغلبية المساهمين في نفس البنوك الإسلامية التي يعملون فيها كأعضاء لهيئة مستشاري الرقابة الشرعية. كما توصلت الدراسة الى أنه يجب على هيئة مستشاري الرقابة الشرعية مزوالة إجراءات الرقابة و المراجعة الشرعية لأوجه نشاط ومعاملات البنك بحسب نظام العينة الإحصائية. كما أوضحت النتائج أيضاً، أنه وبعد القيام بعملية المراجعة لأوجه النشاط والمعاملات يجب على هيئة مستشاري الرقابة الشرعية إعداد تقرير المراجعة ونشره على المساهمين ضمن التقرير السنوي للبنك. كما أشارت النتائج إلى أنه يجب على الهيئة أيضاً إعداد تقرير مراجعة خاص للمدارء، الأطر التنظيمية (مثل البنك المركزي الأندونيسي) و مجلس الشريعة الوطني لعلماء أندونيسيا. بالإضافة إلى ذلك، فإن الدراسة توصلت إلى أنه يوجد إختلاف في التصور بين البنوك الإسلامية والبنوك التجارية التي توفر المعاملات المصرفية الإسلامية حول بعض المظاهر المرتبطة بمسؤولية وإستقلالية هيئة مستشاري الرقابة الشرعية وإجراءات الرقابة والمراجعة الشرعية في البنوك الإسلامية في أندونيسيا.

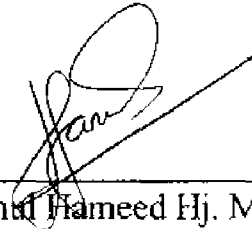
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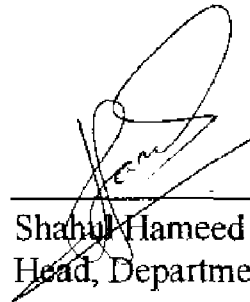
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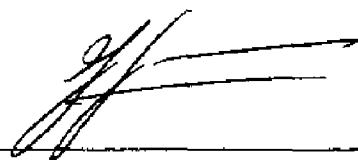
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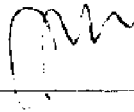
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DECLARATION

I hereby declare that this thesis is the result of my own investigations, except where otherwise stated. Other sources are acknowledged by footnotes giving explicit references and a bibliography is appended.

Name: ADE WIRMAN SYAFEI

Signature



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PROCESS IN THE INDONESIAN ISLAMIC BANKS**

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TABLE OF CONTENTS

Abstract (English Version).....	ii
Abstract (Arabic Version)	iii
Approval Page.....	iv
Declaration.....	v
Copyright	vi
Acknowledgements.....	vii
Table of Contents.....	ix
List of Tables.....	xi
List of Figures.....	xiii
List of Abbreviations.....	xiv
CHAPTER 1 : INTRODUCTION	
1.1 Introduction.....	1
1.2 Background and Motivation of the Study.....	2
1.3 Objectives of the Study.....	5
1.4 Significance of the Study.....	6
1.5 Organisation of the Thesis.....	7
CHAPTER 2 : THE DEVELOPMENT OF ISLAMIC BANKING IN INDONESIA	
2.1 Introduction.....	9
2.2 Objectives and Characteristics of the Islamic Banks....	10
2.3 History of the Establishment of the Islamic Banks in Indonesia.....	15
2.4 Development of the Islamic Banks in Indonesia.....	19
2.5 Blueprint of the Development of the Islamic Banks in Indonesia.....	23
2.6 <i>Shari'ah</i> Advisory Council of the Islamic Bank in Indonesia.....	25
CHAPTER 3 : THE ROLE AND FUNCTIONS OF THE SHARI'AH ADVISORY COUNCIL	
3.1 Introduction.....	28
3.2 Definition of <i>Shari'ah</i> Advisory Council.....	28
3.3 Role of the <i>Shari'ah</i> Advisory Council.....	30
3.4 Appointment and Composition of the <i>Shari'ah</i> Advisory Council.....	32
3.5 Independence of the <i>Shari'ah</i> Advisory Council.....	34
3.6 The <i>Shari'ah</i> Review Process.....	37
CHAPTER 4 : RESEARCH DESIGN AND METHODOLOGY	
4.1 Introduction.....	41
4.2 Research Objectives.....	42
4.3 Research Design.....	52

TABLE OF CONTENTS (Continued)

CHAPTER 4 : RESEARCH DESIGN AND METHODOLOGY		
4.4	Respondents' Background and Sample Selection	53
4.5	Research Instruments.....	55
4.6	Questionnaires and Interview Questions Design.....	57
4.7	Translation of the Questionnaire	60
4.8	Pilot Testing	62
4.9	Data Collection Procedure	63
4.10	Data Analysis	64
 CHAPTER 5 : DATA ANALYSES AND RESEARCH FINDINGS		
5.1	Introduction.....	66
5.2	Response Rate.....	66
5.3	Demographic Analysis.....	69
5.4	Reliability Test.....	73
5.5	Statistical Analyses for Each of the Research Objectives and Research Questions.....	75
5.5.1	<i>Research Objective No. 1</i>	75
5.5.2	<i>Research Objective No. 2</i>	86
5.5.3	<i>Research Objective No. 3</i>	99
5.5.4	<i>Research Objective No. 4</i>	111
 CHAPTER 6 : CONCLUSIONS		
6.1	Introduction	120
6.2	Conclusion for Each of the Research Objectives.....	120
6.2.1	The Importance of the SAC of IB in Indonesia.....	121
6.2.2	The Responsibility of the SAs of IBs in Indonesia.....	122
6.2.3	The Independence of SAs of IBs in Indonesia.....	123
6.2.4	The <i>Shari'ah</i> Review Process in IBs in Indonesia.....	124
6.3	Limitations of the Study.....	125
6.4	Contribution of the Study.....	126
6.5	Suggestions for Further Research.....	127
BIBLIOGRAPHY.....		129
APPENDIX I.....		136
APPENDIX II.....		138
APPENDIX III.....		146
APPENDIX IV.....		153
APPENDIX V.....		155
APPENDIX VI.....		157

LIST OF TABLES

Table No.		Page
2.1	Number of Indonesian Islamic Banks' Networks in 1999	20
2.2	Number of Islamic Banks' Networks in 2004	21
2.3	Some Financial Indicators of Islamic Banks in Indonesia	23
2.4	Growth of Islamic Banks' Share to All of National Banks	23
4.1	Summary of Research Objectives and Research Questions	50
4.2	Number of Islamic Bank Managers and <i>Shari'ah</i> Advisors Selected for Each Islamic Commercial Bank and Conventional Bank that offers an Islamic banking scheme	54
5.1	Overall Response Rate	67
5.2	Type of Islamic Bank	69
5.3	Respondents' Gender	69
5.4	Respondents' Age and Occupation	70
5.5	Respondents' Working Experience	70
5.6	Respondents' Educational Background and Specialization	72
5.7	Research Questions Emerging from Research Objective No. 1	76
5.8	Benefits Derived from the Existence of <i>Shari'ah</i> Advisory Council	76
5.9	Characteristics of <i>Shari'ah</i> Advisors of Islamic Banks	80
5.10	Research Questions Emerging from Research Objective No. 2	86
5.11	Responsibilities of <i>Shari'ah</i> Advisors of Islamic Banks	87
5.12	Views about to Whom <i>Shari'ah</i> Advisors of Islamic Banks Should be Legally, Religiously and Socially Responsible	91
5.13	Research Questions Emerging from Research Objective No. 3	99
5.14	Factors that may Improve the Independence of <i>Shari'ah</i> Advisors	100
5.15	Who Should Appoint <i>Shari'ah</i> Advisors in order to Remain Independent	104
5.16	Appointment of <i>Shari'ah</i> Advisors of Islamic Banks in Indonesia	105
5.17	Research Questions Emerging from Research Objective No. 4	111
5.18	<i>Procedures that Shari'ah</i> Advisors Should Conduct in order to Properly Execute <i>Shari'ah</i> Review	112

LIST OF TABLES (Continued)

Table No.		Page
5.19	To Whom Should <i>Shari'ah</i> Advisors Issue a <i>Shari'ah</i> Review Report Published in the Annual Report	115
5.20	To Whom Should <i>Shari'ah</i> Advisors Issue a Special <i>Shari'ah</i> Review Report	116

LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
BI	Bank Indonesia
BII	Bank International Indonesia
BMI	Bank Muamalat Indonesia
BNI	Bank Negara Indonesia
BNM	Bank Negara Malaysia
BPRS	<i>Bank Perkreditan Rakyat Syari'ah</i>
BRI	Bank Rakyat Indonesia
BSM	Bank Syari'ah Mandiri
BSMI	Bank Syari'ah Mega Indonesia
CB(s)I	Conventional Bank(s) that offer Islamic banking scheme(s)
e.g.	<i>exempligratia</i> : for example
et al.	<i>et alia</i> : and others
etc.	<i>et cetera</i> : and so forth
IAI	<i>Ikatan Akuntan Indonesia</i> -Indonesian Accountant Association
IB(s)	Islamic Bank(s)
ICB(s)	Islamic Commercial Bank(s)
IFI(s)	Islamic Financial Institution(s)
IIIT	International Institute of Islamic Thought
IUM	International Islamic University of Malaysia
ISEFID	Islamic Economic Forum for Indonesian Development
IRB(s)	Islamic Rural Bank(s)
IUC	Indonesian ' <i>Ulamā</i> Council- <i>Majelis 'Ulamā Indonesia</i>
JABAR	<i>Jawa Barat</i> -West Java
KENMS	Kulliyah of Economics and Management Sciences
MAS	Management Advisory Services
MBA	Master of Business Administration
NSAC	National <i>Shari'ah</i> Advisory Council
NSC-IUC	National <i>Shari'ah</i> Council-Indonesian ' <i>Ulamā</i> Council

LIST OF ABBREVIATIONS (Continued)

PAKTO	<i>Paket Oktober</i> -October Package
pbuh	peace be upon him
PKTTI	<i>Program Kajian Timur Tengah dan Islam</i> -Program of Islam and Middle East Study
PP	<i>Peraturan Pemerintah</i> -Government Regulation
RSB	Religious Supervisory Board
SAC(s)	<i>Shari'ah</i> Advisory Council(s)
SA(s)	<i>Shari'ah</i> Advisor(s)
SEBI	<i>Shari'ah</i> Economics and Business Institute
SPSS	Statistical Package for Social Sciences
SSB	<i>Shari'ah</i> Supervisory Board
SSCB	<i>Shari'ah</i> Supervisory Control Board
SWT	<i>Subhanallahu Wa Ta'ala</i> -The Almighty

CHAPTER 1

INTRODUCTION

1.1. Introduction

The development of Islamic Banks (IBs) has increased immensely all over the world. Chapra and Ahmed (2002) claim that a large number of IBs have been established around the world over the last 25 years. This is supported by Suleiman (2000) who mentions that the total number of IBs in the whole world was 180 as at 1999. In the case of Indonesia, particularly, the total composition of IBs in 2004 consisted of three Islamic Commercial Banks (ICBs), eight Conventional Banks that offer Islamic banking schemes (CBs) and 89 Islamic rural banks in 2004 (Bank Indonesia, 2004a).

According to Beekun (1997), IBs are considered as Islamic business institutions. Thus, the operations of IBs must be in accordance with *Shari'ah*¹ principles. Moreover, the IBs should participate in activities that achieve the *Maqāsid al-Shari'ah* (the objectives of the *Shari'ah*) which are preservation of religion, self, intellect, progeny and wealth. In order to ensure the IBs comply with the *Shari'ah* requirements, each of the IBs needs to have a *Shari'ah* Supervisory Board (Karim, 1990b; and Abdallah, 1994). Yet, in this study the researcher prefers to use the term

¹ Chapra and Khan (2000) define *Shari'ah* as the divine guidance which is given by the *Qur'an* and the *Sunnah* and which embodies all aspects of the Islamic faith, including beliefs and practices.

“*Shari‘ah* Advisory Council (SAC)” rather than the “*Shari‘ah* Supervisory Board (SSB)”².

This chapter explains a detailed discussion of the background of the study in section 1.2. Subsequently, section 1.3 presents the motivation for the study. The objectives of the study are discussed in section 1.4. Following this, section 1.5 presents the significance of the study. Section 1.6 then ends the chapter by outlining the organisation of the thesis. The thesis comprises six chapters.

1.2. Background and Motivation of the Study

Karim (1990a) and Hameed (2000) are of the view that the objectives of the establishment of the Islamic bank (IB) are mainly to achieve *falāḥ* (the success in this world and in the hereafter). This notion is supported by Mannan (1980) and Sadeque (1980) who both argue that the IB is intended to create a balanced economic society.

Mannan (1980) opines that the conventional bank is intended to earn higher profits rather than rendering services for economic and social development. On the other hand, Mannan (1980) argues that the Islamic bank (IB) is encouraged to earn profits but not to profiteer. He defines further that profiteering is considered as unreasonably high profit and does not conform to the general welfare of the society. Therefore, this particular objective is different from the conventional bank’s objective. As we know,

² The term “*Shari‘ah* Advisor” is used because the term “Religious Auditor” may be mistaken for the (financial) auditing profession. In addition, the term “*Shari‘ah* Advisor” is more appropriate as compared to the term “*Shari‘ah* Supervisor” because the former assists the IBs not only by providing advice but also by performing supervision whereas the latter seems to concentrate only on supervising the IBs.

the objective of the conventional bank is mainly to maximize wealth for its shareholders and depositors.

In order to ensure that the practices and activities of IBs do not contradict the Islamic ethical standards, Briston and El-Ashker (1986), Abdallah (1994) and Bucheery and Hood (1999) argue that the IBs are expected to establish a SAC. According to Karim (1990b) SAC is also involved in the accounting policy pursued by the bank. This is supported by Abdallah (1994) who states that the SAC is responsible for performing the *ex ante* and the *ex post* audit which enables it to justify to what extent the IB's operations comply with *Shari'ah* principles. Hence, Karim (1995) and Abdallah (1994) argue that this particular body should consist of Muslim scholars from three major disciplines such as Islamic jurisprudence, Law and Economics.

The development of IBs in Indonesia has been very rapid since 1998. This is due to the amendment of the Banking Act No.10/1998 which recognizes the dual banking system in Indonesia. The dual banking system is a system in which the Islamic banking system and conventional banking system are applied side by side in fulfilling the needs of banking services of society (Siregar and Ilyas, 2002).

In addition, after the amendment of the Central Banking Act No.23/1999, Bank Indonesia (BI) is responsible not only for regulating the conventional banks but also the IBs. In addition, BI is also responsible for providing the IBs with some monetary financial aids which adhere to the Islamic principles. Realising these new tasks, BI launched the blueprint of the development of IBs in 2002. This blueprint was initiated as guidance in developing IBs in Indonesia until 2011.

Based on the blueprint, BI has determined the objectives of the development of IBs in Indonesia. One of the objectives is focusing on the creation of competitive IBs which are fully adhering to the Islamic principles (Bank Indonesia, 2002a). This particular objective has promoted a greater concern about the issue of the *Shari'ah* supervision of the IBs' activities and transactions in Indonesia. Karim (1990b) argues that the IB's stakeholders really rely on the performance and independence of the SAC in conducting supervision of IB's activities and transactions.

One of the stakeholders of IB who should be concerned with the issue of IB's *Shari'ah* compliance is the manager of the IB. The IB managers must be responsible for the performance of IB in following *Shari'ah* principles. In addition, the IB managers must manage the IB based on the guidance and *fatwa(s)* issued by the SAC (Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) Governance Standard, 2002b).

Realising the importance of the achievement of *Shari'ah* compliance in all IB's transactions, there must be an adequate standard and a regulation which spotlight the *responsibility and independence of the SAC and the Shari'ah review process* conducted by the SAC. Unfortunately, there are no such comprehensive standards and regulations implemented in Indonesia which focus on those particular issues, although the Indonesian Accountants Association (Ikatan Akuntan Indonesia-IAI) recently launched the accounting standard for IBs in 2003. Nevertheless, there is no doubt that there is an International standard which focuses on and discusses the responsibility, independence of *Shari'ah* Advisors (SAs) and the *Shari'ah* review process which is known as the AAOIFI Governance Standard (2002b&c).

To implement the AAOIFI Governance Standard (2002b&c) in Islamic banking practices in Indonesia, there is a lot of work to be done; the first and foremost task is to ascertain whether the AAOIFI Governance Standard (2002b&c) are appropriate for the perceptions of IBs' stakeholders in Indonesia. Since the IB managers are the ones who are involved in the day-to-day operations of the IBs, the IB managers are the most appropriate party to provide their opinions on the responsibility and independence of the SAs of IBs in Indonesia; and the *Shari'ah* review process as conducted in IBs in Indonesia. In addition, since SAs are the ones who conduct the *Shari'ah* review process in the IBs, it is also required to obtain their perceptions on those three issues related to the SAs of IBs in Indonesia.

1.3. The Objectives of the Study

Basically, there are three main objectives in this current study. First, the current study aims to generate the perceptions of the IB managers on the responsibility and independence of the SAs of IBs in Indonesia and the *Shari'ah* review process conducted in the IBs in Indonesia. Second, the current study is designed to generate the perceptions of SAs on those three issues related with the SAs of IBs in Indonesia. Last but not least, this study is also aims to examine whether the significant difference in those three issues related with the SAs of Islamic banks in Indonesia exists between the perceptions of IB managers who work at the ICB and those who work at the CBI.

1.4. Significance of the Study

Since there are no comprehensive rules and standards which cover the three issues related with the SAs of IBs in Indonesia as mentioned above, this study is an explanatory study designed to obtain the perceptions of the IB managers as well as the SAs of IBs in Indonesia.

Obtaining the perceptions of IB managers may be useful to improve the quality and accountability of the SAs as the bank managers are directly related to the SAs whereby the IB managers rely on the SAs' guidance and supervision to ensure that the operations of the IBs are in compliance with *Shari'ah* principles. It will be very relevant if the SAs of IBs in Indonesia are also asked to express their perceptions since currently the SAs are the ones who supervise the operations of IBs specifically on the issues of *Shari'ah* compliance.

Hence, the current study is expected to produce some insights for regulators (e.g. Bank Indonesia and the National *Shari'ah* Council-Indonesian 'Ulamā Council (NSC-IUC)) and accounting standard setter (e.g. IAI) on the three main issues related to the performance of the SAs of IBs in Indonesia. Furthermore, the regulators can utilise the results of this current study to develop more comprehensive regulations on the three aspects discussed. In addition, since this current study can be considered as preliminary empirical evidence, it is hoped that the accounting standard setter and regulators (e.g. Bank Indonesia and the NSC-IUC) have the willingness to promulgate the governance standard of the IB in Indonesia. Furthermore, this current study is very important in supporting BI to achieve the objectives of the development of IBs in

Indonesia. Last but not least, the findings obtained from this study are expected to contribute towards a better understanding of Islamic banking practices in Indonesia.

1.5.Organisation of the Thesis

The thesis is organised into six chapters. The first chapter introduces the background, objectives and the significance of the study. It gives a brief description of the study and provides the foundation for the remaining parts of the thesis.

The second chapter discusses the development of IBs. This chapter is initiated by presenting the objectives and characteristics of IBs. Since the study will be conducted in Indonesia, this chapter also touches on the history of the establishment of IB in Indonesia. It is followed with a discussion of the development of IBs in Indonesia. In addition, this chapter discusses the blueprint for IBs in Indonesia released by BI (2002a). Finally, this chapter closes with a discussion on the SAC of IBs in Indonesia.

The third chapter focuses on the role and functions of the SAC. This chapter is initiated with the definition of the SAC. It is followed by a sub topic which focuses on the role and responsibility of SAC. Next, this chapter covers the issue of the appointment and composition of the SAC. In addition, this chapter also discusses the independence of the SAC. Lastly, this chapter touches on the issue of how the *Shari'ah* review process is conducted in the IBs.

The fourth chapter describes the research design and methodology of the study. This chapter highlights the objectives of the current study. It is followed with a discussion

of the process of research design of, the respondents' background of and the sample selection of this current study. This chapter also highlights the research instruments used in this current study. Next, this chapter touches on the process of designing the questionnaire and the interview questions used to obtain the data and on the steps taken in translating the questionnaire from English into Bahasa Indonesia. Following this section, another section discusses the data collection procedure of this current study. Finally, the last section ends this chapter with a discussion of the data analyses.

The fifth chapter presents the discussion of the analyses of the statistical tests performed in this current study. Furthermore, this chapter also provides a detailed discussion of the possible interpretations of the results of the current study.

Finally, the sixth chapter presents the conclusions which may be drawn from the results of the study. This chapter will demonstrate the general conclusions of the current study and the original contribution of this study. In addition, this final chapter also presents some limitations of the study and offers suggestions for future research.

CHAPTER 2

THE DEVELOPMENT OF ISLAMIC BANKING IN INDONESIA

2.1. Introduction

Beekun (1997) claims IB as an Islamic business institution, thus, all of the IB's operations have to follow the code of Islamic ethics. Therefore, the IB aims to create a balanced society rather than to prosper the shareholders *per se*. In addition, the IB cannot conduct activities which are considered as *ḥarām* (forbidden) by Islamic jurisprudence such as *ribā* (usury), *gharar* (uncertainty) and *maysir* (gambling). The objectives and characteristics of IB are discussed in detail in section 2.2.

The remainder of the present chapter is structured as follows. Section 2.3 discusses the history of the establishment of IBs in Indonesia. The establishment of the first IB in Indonesia was quite unique since it was established in the absence of any regulations which regulated the operation of IBs' activities and transactions. However, after the amendment of Banking Act and Central Bank Act in 1998 and 1999 respectively, the development of IBs in Indonesia has been very rapid. The discussion of this development is presented in section 2.4. This is followed by section 2.5 which discusses the blueprint of the development of IBs in Indonesia. Finally, this chapter ends with section 2.6 which examines the SAC of IB in Indonesia.

2.2 Objectives and Characteristics of Islamic Bank

According to Karim (1990a) and Hameed (2000), the objective of the establishment of the IB is to achieve *falāh* (the success in this world and in the hereafter). This is supported by Mannan (1980) who argues that the IB is intended to create a balanced society. Therefore, the IB's objectives are different from the conventional bank's objectives. As we know, the objectives of the conventional bank are mainly to maximize profits.

Mannan (1980) opines that the conventional bank plans and formulates policies to earn higher profits rather than rendering services for economic and social development. Furthermore, he argues that an IB is encouraged to earn profits but not to profiteer. He defines further that profiteering is considered as unreasonably high profit and does not conform to the general welfare of the society. In Islam, according to El-Ashker (1987) as quoted by Hameed (2000), profit is deemed legitimate and is one of the major objectives of Islamic Business. However, he states that profit maximization is not identified in the Islamic model.

As mentioned earlier, IB has different objectives from the conventional one. Sadeque (1980) claims that the IB is a financial institution whose statutes, rules and procedures expressly state its commitment to the principles of the Islamic *Shari'ah* and to the banning of the receipt and payment of interest on any of its operation. Thus, the IB must be based on the Islamic faith and must stay within the limits of the *Shari'ah* in all of its actions and deeds (Suleiman, 2000).

Furthermore, Sulaiman (2000) points out the following four rules, which govern the IB's investment behaviour:

a. The absence of interest-based (*ribā*) transactions

Perhaps the most far-reaching of these rules is the prohibition of interest (*ribā*)³. The payment and receipt of *ribā* as occur in a conventional banking system are explicitly prohibited by the *Qur'ān* (2:278-279, 3:130). Therefore, investors must be compensated by other means. Technically, *ribā* refers to the addition in the amount of the principal of a loan according to the time for which it is loaned and the amount of the loan.

Although there was a huge debate as to whether *ribā* relates to interest or usury, there now appears to be a consensus of opinion among Islamic scholars that the term extends to all forms of interest (Chapra, 1992). In banning *ribā*, Islam seeks to establish a society based upon fairness and justice (Qur'an, 2:239). A loan provides the lender with a fixed return irrespective of the outcome of the borrower's venture. It is much fairer to have a sharing of the profits and losses. Fairness in this context has two dimensions: the supplier of capital possesses a right to reward, but this reward should be commensurate with the risk and effort involved and thus be governed by the return on the individual project for which funds are supplied.

³ *Ribā* means any form of taking advantage of the poor and the ignorant (Gambling and Karim, 1986). However, in this study, *ribā* specifically means interest.

b. The avoidance of economic activities involving speculation (*gharar*)

Another feature condemned by Islam is economic transactions involving elements of speculation (*gharar*⁴). This prohibition requires the parties, who agree to have a trading, to possess perfect knowledge of the object intended to be exchanged. El-Gamal (2000) argues that the financial transactions which involve with financial derivatives are prohibited. El-Gamal (2000), further, explains that this is because when the financial derivatives transactions are executed the object of the sale may not exist.

c. The introduction of the religious levy (*zakāt*)

Clark et al. (1996) argue that *zakāt*, as a mechanism for the redistribution of income and wealth, is inherent in Islam. Moreover, they opine that *zakāt* is the most important instrument for the redistribution of wealth. This tax is a compulsory levy; one of the five basic tenets of Islam. According to Qaradhawi (1999), the generally accepted amount of *zakāt* is one fortieth (2.5 per cent) of a Muslim's annual income in cash or kind from all forms of assessed wealth exceeding *niṣāb*⁵.

The AAOIFI Standard (2002a) states that the IB is obliged to establish a *zakāt* fund for collecting the tax and distributing it exclusively to the poor directly or through other religious institutions. In addition, Abdul Rahman (2002) points out that there are several methods of imposing *zakāt* on

⁴ Mustafa Al-Zarqa as quoted by El-Gamal (2000) defines *gharar* as “the sale of probable items whose existence or characteristics are uncertain due to the risky nature which makes the trade similar to gambling”.

⁵ Qaradhawi (1999) defines *niṣāb* as the minimum amount of wealth that subjects a person to *zakāt*. For example, *niṣāb* for gold is 85 grams.

Islamic business institutions i.e. net current assets, the net owner's equity method and the net growing capital method.

Probable

- d. **The discouragement of the production of goods and services which contradict the value pattern of Islam (*ḥarām*)**

According to Sulaiman (2000), the IB has to operate under a strict code of ethical investment. Hence it is forbidden for IB to finance activities or items forbidden in Islam, such as trade in alcoholic beverages and pork (Karim, 1995). Furthermore, Sulaiman (2000) argues, as the fulfilment of material needs assures religious freedom for Muslims, the IB is required to give priority to the production of essential goods which satisfy the needs of the majority of the Muslim community, while the production and marketing of luxury activities (*isrāf wa tarāf*) is considered as unacceptable from a religious viewpoint.

In order to ensure that the practices and activities of IB do not contradict the Islamic ethical standards, IB is expected to establish a SAC (Abdallah, 1994). This particular body is responsible for performing the *ex ante* and the *ex post* audit which enable it to justify to what extent the IB's operations comply with *Sharī'ah* precepts. Hence, Karim (1995) and Abdallah (1994) argue that the body should consist of Muslims from the three major disciplines of Islamic jurisprudence, Law and Economics.

As mentioned earlier, the IB's objectives are mainly to achieve *falāh*. Hence, this will define the variety of IB's activities. According to Siddiqi (1980), the IB's activities may be classified into three categories as follows:

a. Charged Services

The IB is encouraged to earn profit. It may be achieved by giving some services, which the bank renders, on a fee, commission, or on fixed charge basis. In addition, the IB may meet important social needs, in particular the needs of commerce. Hence, there is no reason for the IB to discontinue these particular services since they are rendered based on a fee, commission or fixed charges, but without interest.

b. *Mudārabah* (partnership) Investment

Since interest is prohibited in Islam, an IB has a different relationship with its investors or creditors as compared to the conventional bank. The relationship between the IB and its investors or creditors is of a partnership relationship rather than a creditor-debtor relationship.

According to Abdallah (1994), the *mudārabah* principle identifies two parties, which are *rabb al-māl* (capital owner) and *mudārib* (entrepreneur). Thus, the IB acts as *mudārib* when it accepts funds from investors. On the other hand, it plays the role as *rabb al-māl* when it invests the funds. Abdallah (1994) argues further that both parties have an agreement to run the business together.

However, Hameed (2000) states that under *mudārabah* investment, the *rabb al-māl* puts himself as a silent party. This means that he cannot interfere in the business run by the *mudārib*. Moreover, if the investment makes a loss, the *rabb al-māl* must bear the loss as long as it is not caused by the *mudārib*'s negligence. On the other hand, if the investment makes a

profit, it must be shared between both parties based on the sharing ratio as agreed before.

c. Interest free loans

The bank will advance short-term loans to business parties and not receive remuneration for this service. Yet, the borrower should guarantee repayment of the loan within the scheduled period. The AAOIFI Standard (2002a) states that interest free loans, known as *qard hasan* financing, is the obligation of the IB toward the enhancement of the *ummah's* welfare. Although the IB will not be able to receive any remuneration from borrowers, society will benefit from such an important service. Hence, the IB will be rewarded indirectly. However, Hameed et al. (2004) argue that the IB should not pay attention solely on increasing the shareholders' wealth but also consider the organization's treatment of its employees, the extent to which the business keeps its promises and fulfils its contracts, the impact of the business on its environment, the extent to which the business adheres to the Islamic code of business ethics while dealing with customers, competitors, government and other agencies.

2.3. History of the Establishment of Islamic Banks in Indonesia

The establishment of the IBs in Indonesia was quite unique since it was primarily supported by the political will of some of the Indonesian political elites rather than by any Islamic banking regulations (Harahap and Basri, 2003). However, Arifin (2002) states that the idea of establishing an IB in Indonesia was actually encouraged by the

October Packet (PAKTO 1988) launched by the Government of Indonesia in October 1988. Based on this policy, the Conventional commercial banks were allowed to impose 0 % interest on amounts of money lent to creditors. This particular idea became more realistic as the IUC held a symposium on “Interest and Banking” on August 18th-20th, 1990. According to Siregar and Ilyas (2002), although this symposium could not bring all of the participants to have one opinion as to the classification interest as *ribā*, they realized that there are some Muslims communities who do not want to use any services provided by the Conventional commercial banks based on interest instruments. Considering this fact, the IUC launched the blueprint for the establishment of Bank Muamalat Indonesia (BMI) through its 4th congress on August 22nd-25th, 1990.

According to Somantri (2002), the history of modern Islamic banking in Indonesia began when BMI as the first IB in Indonesia was founded in November 1991 and was officially launched by the Ministry of Finance of Indonesia on May 1st, 1992 (Harahap, 2003). The presence of BMI was followed by the establishment of the other two Islamic Rural Banks (IRBs) (Bank Perkreditan Rakyat Syariah-BPRS)⁶, namely “BPRS Dana *Mardatillah*” and “BPRS *Berkah Amal Sejahtera*” by the Institute for *Shari’ah* Economic Development (ISED) in July 1992. The establishment of IB forced the Government of Indonesia to amend the Banking Act No.14/1967 to be a new Banking Act No.7/1992. Although, this new Banking Act No. 7/1992 did not clearly acknowledge the Islamic banking practices, it recognized the bank’s activities based on profit sharing instruments which are mentioned in more detail in the Government

⁶ The Islamic Rural Bank is a type of bank which offers limited banking services and products based on Islamic principles and which is established on the basis of a provincial decree (Banking Act No.10/1998).

Regulation (*Peraturan Pemerintah-PP*) No.72/1992 (Somantri, 2002). Thus, as far as the Indonesian banking system is concerned, it recognized an IB which operates merely based on the profit sharing mechanism, while most of the IBs' activities were still regulated by the Conventional banking's regulations.

Since the IBs' activities were regulated based on the Banking Act No.7/1992, the management of IBs simply adopted the products offered by the Conventional banks after making some changes to fit the *Shari'ah* requirements (Somantri, 2002). Consequently, the IBs' products became less competitive as compared to products offered by the conventional banks. Even worse, the IBs did not have any alternative instruments which adhere to *Shari'ah* principles when it faced any liquidity problems. This happened because BI, as the Central Bank, failed to provide special central bank facilities such as central bank credit facilities, which comply with Islamic tenets (Siregar and Ilyas, 2002).

In addition, the Government Regulation No.72/1992 also dictated that any commercial banks or rural banks which operate based on profit sharing instruments are not allowed to conduct any kind of activities based on other instruments, and vice versa. In other words, no conventional banks are allowed to offer Islamic banking instruments/services. This particular regulation resulted in the very slow development of the IBs in Indonesia, as the expansion of the IBs' networks could only be expected either from the launching of new branches of the established IBs or from the launching of a new IB, which requires a large amount of initial investment. As a consequence, during the period from 1992 to 1998, BMI was the only IB in the market. However, due to a relatively high demand for Islamic banking services in

certain parts of Indonesia, some investors were motivated to establish the IRB. As a result, there were 76 IRBs in 1998 (Bank Indonesia, 2002b).

Later, the Government of Indonesia realized the condition and problems faced by the IB during the period from 1992 to 1998. Thus, they took the initiative to revise the banking act with the new Banking Act No.10/1998. The new banking act adopts the dual banking system which recognizes the existence of the conventional banking system as well as the Islamic Banking system side by side to grow together in serving the economy. Many authors agree that the new banking act provides a wider opportunity and stronger legal foundation for the IBs' operations (e.g. Siregar and Ilyas, 2002; Somantri, 2002 and Harahap and Basri, 2003).

Based on the new bank act, BI has the right to issue licenses to any parties who have the intention to provide Islamic Banking services through at least three optional methods, either (1) establishing a new Islamic Commercial/Rural Bank (ICB/IRB), or (2) converting the existing Conventional Commercial/Rural Bank to be an ICB or IRB, or (3) establishing an Islamic banking unit within the conventional bank through some optional techniques; (i) launching a new IB branch, or (ii) converting an existing conventional branch into an Islamic branch, or (iii) convert and upgrade the conventional sub branch to be an Islamic branch.

In addition, the Government of Indonesia had also amended the Central Bank Act to be the new Central Bank Act No. 23/1999. This new acts enables BI, as the Central Bank in Indonesia, to regulate and to monitor the conventional banks and IBs.

Moreover, BI is able to regulate and monitor the monetary stability using instruments based on Islamic principles.

2.4. Development of Islamic Banks in Indonesia

Harahap and Basri (2003) argue that although the establishment of IB in Indonesia came later than in other Muslim countries, for example Malaysia, which established its first IB in 1983, the development of IBs has been spectacular. Basically, based on the amendment of Banking Act, the development of IBs in Indonesia can be divided into two periods of time; first, from 1992 until 1998; and second, after 1998.

During the period 1992 until 1998, the IB did not seem to have any significant development, due to several factors which contribute to the creation of that particular condition as discussed earlier. As a result, during this particular period, Indonesia only had one ICB with ten branch offices (Bank Indonesia, 2002b). Nevertheless, the IRBs had developed much better as compared to the development of the ICB. There were only 7 IRBs in 1992, but this rose to 76 IRBs in 1998 (Bank Indonesia, 2002b). The reason which encouraged investors to develop IRBs rather than ICB was that in establishing an IRB, the investors did not have to provide a huge amount of funds as it was required to establish an ICB (Somantri, 2002).

However, after the amendment of the Banking Act and Central Banking Act in 1998 and 1999⁷ respectively, the IBs have developed rapidly. This amendment of the acts

⁷ The Government of Indonesia revised the Central Banking Act No. 13/1968 to be No.23/1999 in 1999. According to the revised Central Banking Act, BI is responsible for regulating and monitoring not only conventional banks but also IBs and, furthermore, providing the IBs with some *Shari'ah* compliant monetary and financial aids.

encouraged the establishment of a new ICB which was named as Bank Syari'ah Mandiri (BSM) in 1999. Hence, in terms of network, there were 2 ICBs with 13 branches and 7 sub-branches; one CBI with one branch and 78 IRBs in the whole country.

Table 2.1 Number of Indonesian IBs' Networks in 1999

No	Group of Banks	Head Office	Branch Office	Sub Branch Office
1	Islamic Commercial Bank (ICB)	2	13	7
	a. Bank Muamalat Indonesia	1	10	2
	b. Bank Syari'ah Mandiri	1	3	5
2	Conventional Bank that offers an Islamic Banking scheme (CBI)	1	1	0
	a. Bank IFI	1	1	0
3	Islamic Rural Banks (IRBs)	78	0	0
TOTAL		81	14	7

Source: Bank Indonesia, 2002b.

The expansion of IBs in Indonesia has continued improving rapidly until 2004. Since there is a new ICB established in June 2004, the total number of ICB in Indonesia becomes three as at 2004. In addition, the number of branches and sub-branches of this type of IB have rose immensely as there are 87 branches and 30 sub-branches as of August 2004 (Bank Indonesia, 2004a). It shows that the number of ICB's branches and sub-branches have increased by 569.23 % and 328.57 % respectively from 1999 until 2004.

In addition, the number of CBI has risen to 10 head offices with 50 branches. This means that during the period from 1999 until 2004, there have been increases in the number of CBI head offices and branch offices of 900 % and 4,900 % respectively. However, the first sub-branch of CBI was only initiated in 2003; then, it rose to nine

sub-branches in 2004. Thus, the sub-branches of CBI have increased by 800 % in less than one year (Bank Indonesia, 2004a). Furthermore, the number of IRB has also improved as there are 88 IRBs as at 2004. Although the growth of networks IRB seems not so significant as compared to the other two types of IB, it has increased to 12.82 % during the period from 1999 until 2004.

Table 2.2 Number of Indonesian IBs' Networks in 2004

No	Group of Banks	Head Office	Branch Office	Sub Branch Office
1	Islamic Commercial Bank (ICB)	3	87	30
	a. Bank Muamalat Indonesia	1	37	8
	b. Bank Syari'ah Mandiri	1	48	22
	c. Bank Syari'ah Mega Indonesia	1	2	0
2	Conventional Bank that offers an Islamic Banking scheme (CBI)⁸	10	50	9
	a. Bank IFI	1	1	0
	b. Bank Negara Indonesia	1	14	8
	c. Bank Jawa Barat (JABAR)	1	4	0
	d. Bank Rakyat Indonesia	1	16	1
	e. Bank Danamon	1	7	0
	f. Bank Bukopin	1	2	0
	g. Bank International Indonesia	1	3	0
	h. Bank DKI	1	1	0
	i. BPD Riau	1	1	0
	j. BPD Kalimantan Selatan	1	1	0
3	Islamic Rural Bank (IRB)	88	0	0
TOTAL		101	137	39

Source: Bank of Indonesia, 2004a.

⁸ In the present study, Bank JABAR and Bank DKI are excluded from the list of CBI since these banks are still assumed having Local bank characteristics whereas BPD Riau and BPD Kalimantan Selatan are still considered as Local development banks.

The development of IBs can be also observed through some financial indicators. In 1992, the assets, financing and deposits of IBs were only about US \$15.11, US \$4.07 and US \$2.60 million respectively (Harahap and Basri, 2003). Although, during the period from 1992 until 1998, the operation of IBs had not been well supported by regulations, yet, each of these particular financial indicators had still shown excellent growth. The assets, financing and deposits of IBs in 1998 were US \$ 59.90, 39.63 and 48.99 million respectively. Thus, during the period from 1992 until 1998, the assets had increased by 296.46 %. For the same period of time, the financing of IBs had shown an incredible growth as it had risen by 873.71 %. In addition, the deposits of IBs had also increased very rapidly as it had a growth of 1,784.23 % during the period from 1992 until 1998.

During the period from 1999 until 2004, the development of IBs has still grown remarkably. This proves that the amendments to the Banking Act and Central Bank Act had a strong influence in the development of IBs. The assets of IBs were only around US\$ 86.66 million in 1999. Yet, this has improved spectacularly to US\$ 1,094.70 million as at 2004. In addition, there has been an improvement in the people's participation in the development of IBs as the deposits of IBs have been increasing from US\$ 66.01 million to US\$ 827.87 million between 1999 and 2004. During the same period of time, the financing of IBs also improved immensely. In 1999, it was about US \$ 42.82 million but it rose to US\$ 732.56 million in 2004. Hence, these three financial indicators have a growth of 1,163.21 %, 1,154.16 % and 1,610.79 % respectively (Harahap and Basri, 2003; Bank Indonesia, 2004a).

Table 2.3 Some Financial Indicators of IBs in Indonesia (US \$ Million)

Year	Assets	Financing	Deposits
1992	15.11	4.07	2.60
1998	59.90	39.63	48.99
1999	86.66	42.82	66.01
2004	1,094.70	732.56	827.87

Sources: Harahap and Basri, 2003 and Bank Indonesia, 2004a.

Note: US \$ 1 = Rp. 8,000.-

Although the growth in IBs' development has been very tremendous, the penetration of IBs share to all of national banks is still very low. It can be observed through some indicators. In 2003, the IBs' share to all of national banks in terms of assets, financing and deposits was only 0.74 %, 0.64 % and 1.16 % respectively (Bank Indonesia, 2004a). However, the trend of the IBs' share to all of national banks has been increasing for the last four years.

Table 2.4 Growth of IBs' Share to All of National Banks

Items	2000	2001	2002	2003
Assets	0.17 %	0.25 %	0.36 %	0.74 %
Financing	0.40 %	0.57 %	0.80 %	1.16 %
Deposits	0.15 %	0.23 %	0.35 %	0.64 %

Source: Bank Indonesia, 2004a

2.5. Blueprint of the Development of Islamic Banks in Indonesia

BI has completed guidelines and general plan for developing the IBs up to 2011 which is considered as a blueprint. The vision of the Central Bank of Indonesia in promoting the development of the IBs is in order to achieve a competitive, efficient and prudent Islamic Banking system (Bank Indonesia, 2002a). Furthermore, the development of the IBs in Indonesia focuses on four fields, such as total compliance of banking operations to *Shari'ah* principles, the application of prudent banking principles, the

creation of competitive, efficient Islamic banking system and the creation of systematic stability and social welfare. Thus, in 2011, BI (2004a) expects that the penetration of IBs' share to all of national banks will be achieving 5 %.

According to Siregar and Ilyas (2002), in order to achieve these visions and objectives as mentioned above, there are three tasks that BI needs to perform. First, BI is responsible for creating a supportive environment for the development of the IBs that commit to *Shari'ah* principles and to perform a great contribution for the real sector. Second, BI needs to publicise an integrative Islamic Banking concept to the public through training, seminars and others. At the same time, BI is responsible for improving the standard of professionalism, integrity, prudence etc. of the IBs' human resources by conducting various training sessions and courses. Lastly, BI must take an active role in establishing a better international Islamic finance community and the necessary international institutions and infrastructures.

BI has also developed some paradigms in order to achieve those visions and objectives (Siregar and Ilyas, 2002). There are four paradigms to be implemented by BI such as (1) the market driven approach in network and product development; (2) no infant industry approach which creates a fair treatment between Conventional banks and IBs; (3) gradual and sustainable development of regulation and infrastructure; and lastly (4) giving high and serious attention to the issue of *Shari'ah* compliance in regulation design and development initiatives.

Furthermore, BI has prepared detailed long-term planning which will be implemented until 2011 (Bank Indonesia, 2002a). This particular long-term planning is divided into

three stages. The first stage is a stage whereby BI will be laying a strong foundation for the development of IB. This stage is elaborated into the three actions such as (i) completing specific regulation suitable for IBs, (ii) improving awareness and knowledge of the target market, and (iii) increasing penetration of IBs' network coverage. The second stage aims to strengthen the role of IBs in improving the real sector. In order to conduct this particular stage, BI has to complete and strengthen the Islamic banking infrastructure, build the institutional capacity of the players, and improve the financial intermediaries' function efficiency. Last but not least, the third stage is meant to create Islamic banking as a world-class industry through three policies of bringing the performance of the IBs on par with the international players, increasing competitiveness among the industry, and shifting dominance of trade-related financing modes toward the Profit Loss Sharing (PLS) scheme.

2.6. *Shari'ah* Advisory Council of Islamic Bank in Indonesia

Antonio (2000) states that the IUC has established a body, named as the National *Shari'ah* Council (NSC), which is intended to consolidate any *fatwa(s)* or opinion(s) issued by different SAC of Islamic financial institutions (IFIs) in 1999. According to IUC (1999), the composition of NSC members should consist of '*Ulamā* and the other experts on various fields related with economic activities and transactions from the Islamic perspective. IUC (1999) also dictates that in order to perform its role, NSC is assisted by a daily working committee whereby the NSC has a full power to appoint and terminate the members of this particular committee.

In conjunction with the above, IUC (1999) outlines that the NSC has several functions: first, the NSC is the sole body which enables the launch of any *fatwa(s)* related with the Islamic financial products and transactions. These *fatwa(s)* issued by NSC are binding on all of the IFIs. Second, the NSC is given the right to recommend or to revoke any names given by the management of the IBs to be the members of SACs. Third, the NSC enables the issuance of *fatwa(s)* which are used as the legal foundation by the regulators in order to launch any regulations for the IFIs. Fourth, the NSC is obliged to warn any IFIs which operate not based on the *fatwa(s)* issued by the NSC. Lastly, the NSC has a right to push the regulators (e.g. Bank Indonesia) to take legal action to punish the IFIs which insist on conducting their activities and ignoring the warnings given by the NSC.

The existence of SAC of IB in Indonesia, at first, was not recognized in the Banking Act No.7/1992. However, with the amendment of the Banking Act No.10/1998, every IB is now obliged to have a SAC. Based on this new banking act, finally, BI has provided a more detailed regulation related to the existence of SAC, known as the BI rule No. 6/24/PBI/2004. Nonetheless, before BI released this rule, the existence of SACs was also governed by the NSC-IUC Decree No.02/2000.

According to BI (2004b), the members of the SAC of IB range from two to five people. NSC-IUC (2000) and BI (2004b) hold a common view that members of SAC must have high integrity and good competency, knowledge and experience in *fiqh al-mu'āmalah* as well as financial activities and transactions. BI (2004b) also dictates that members of SAC should have a good financial reputation such as: (1) whether they have ever had any non performing loan; and (2) whether they have ever been

determined insolvent or they had become member of board of director who had been proven guilty of making a company bankrupt at least within the last five years before they were nominated to be members of SAC. In addition, BI (2004b) mentions that the members of SAC are allowed to be members of SAC in only two IBs and two other IFIs at the same time. Finally, BI (2004b) states that at most two members of SAC in each IB can act as members of NSC-IUC at the same time.

According to the NSC-IUC (2000) and BI (2004b), members of SAC are nominated by the management of the IB. Certainly, the management of IB needs to make sure that those nominated people that they have chosen are able to meet the requirements to be SAC members. The NSC-IUC and BI will evaluate whether those nominated people have sufficient requirements to be members of the SAC. If NSC-IUC and BI conclude that the nominated people have fulfilled the requirements of SAs, NSC-IUC and BI will approve that nominated people to be members of SAC of IB in Indonesia.

The NSC-IUC (2000) and BI (2004b) state that the SAs of IBs in Indonesia should perform their responsibilities based on the *fatwa(s)* and guidance issued by NSC-IUC. In addition, SAs are also obliged to propose ideas for the development of the particular IBs to the management and the NSC-IUC. Moreover, SAs should provide the directors of IBs with advice and suggestion on the adherence to Islamic principles. Lastly, SAs need to submit a report on their supervision of the IBs' activities and transactions to the directors of the IBs, BI and the NSC-IUC regularly a minimum of twice a year.

CHAPTER 3

THE ROLE AND FUNCTIONS OF THE *SHARĪ'AH* ADVISORY COUNCIL

3.1 Introduction

The Previous chapter has discussed that all of the IB's actions and deeds must be in accordance with *Sharī'ah* principles. In order to ensure that all of the IB's activities and transactions are in accordance with *Sharī'ah* principles, many authors (e.g. Briston and El-Ashker, 1986; Abu Moamer 1989; Karim, 1990b; Abdallah, 1994; Banaga et al. 1994; Bucheery and Hood, 1999; Bakar, 2002 and AAOIFI Governance Standard, 2002b) dictate that each IB must have a SAC. Section 3.2 presents the definition of SAC proposed by different authors. Subsequently, section 3.3 discusses the role of SAC. The SAC has a very important role since the uniqueness of IB lies in the *Sharī'ah* compliance of its activities and transactions. This is followed by section 3.4 which discusses the appointment and composition of the SAC. Next, section 3.5 discusses the independence of the SAC. Lastly, this chapter ends with section 3.6 which presents the *Sharī'ah* review process.

3.2. Definition of *Sharī'ah* Advisory Council

Although many scholars (e.g. Briston and El-Ashker, 1986; Abu Moamer 1989; Karim, 1990b; Abdallah, 1994; Bucheery and Hood, 1999; Bakar, 2002, AAOIFI Governance Standard, 2002b) strongly agree that all of the activities of the IB must be

supervised by a certain body with regards to *Shari'ah* compliance, there are some inconsistencies in the literature in using terminology in labelling the body which is responsible for ensuring the IB's *Shari'ah* compliance. Abu Moamer (1989) tends to use the term "*Shari'ah* Supervisory Control Board (SSCB)" but some other authors prefer to use the term "Religious Supervisory Board (RSB)" (Briston and El-Ashker, 1986; Bucheery and Hood 1999) whereas there are some other authors (Karim, 1990b; Abdallah, 1994; Banaga et al. 1994; Bakar (2002); AAOIFI Governance Standard, 2002b) who prefer to use the term "*Shari'ah* Supervisory Board (SSB)".

According to Abu Moamer (1989, p.138), SSCB is defined as

"a body which is used to assure that the IB is working within the limitation of Islamic law and to know the framework and the limitations of Shari'ah and to invest or to increase the capital within these limitations."

Meanwhile, AAOIFI Governance Standard (2002b, pp.5) defines SSB as:

"an independent body of specialized jurists in fiqh al-mu'āmalah (Islamic commercial jurisprudence). However, the SSB may include a member other than those specialized in fiqh al-mu'āmalah but who should be an expert in the field of IFIs and with knowledge of fiqh al-mu'āmalah. The SSB are entrusted to ensure that the IB is in compliance with Islamic rules and principles."

Briston and El-Ashker (1986) and Bucheery and Hood (1999) use the term "RSB" as the body which ensures that all of the IB's activities are inline with Islamic principles. However, in this current study the researcher prefers to use the term 'SAC' because the term "RSB" may be mistaken for the (financial) auditor profession. In addition, in my opinion, the term "SAC" is more appropriate as compared to the term "SSCB and

SSB” because the former helps the IBs not only by providing advice but also by performing a supervisory role whereas the latter two terms seem to concentrate only on supervising the IBs. Thus, in this study, the use of the term “SAC” will cover the two other terms mentioned above.

3.3. Role of the *Shari’ah* Advisory Council

According to Briston and El-Ashker (1986), the SAC is intended as a control mechanism in order to monitor the IB’s performance merely with regard to the *Shari’ah* compliance issues. In addition, the SAC is aimed at ensuring that all contracts, procedures and transactions performed by the IB are in conformity with the Islamic code. Moreover, the SAC is also expected to assure that the IB has performed its *zakāt* obligations.

Similarly, Abu Moamer (1989) claims that the SAC is intended to ensure that the IB’s activities are conducted within the limits of the *Shari’ah*. More specifically, Abu Moamer (1989) states that the SAC is expected to assure that the IB is free from transaction based on interest, gambling and speculation activities and trade in prohibited products i.e. pork and alcoholic products. Abu Moamer (1989) also argues that the SAC is expected to force the management of IB to disclose and dispense revenue from any unlawful transactions for charity and donations. In addition, Abu Moamer (1989) holds a view that the SAC must perform an audit on the IB’s *zakāt* fund whereby it enables to ensure a proper calculation of the IB’s *zakāt* liabilities, a proper *zakāt* administration, and a fair distribution of *zakāt* amounts to the eight groups of beneficiaries as mentioned in *Qur’an*.

Abdallah (1994) argues that the SAC is responsible for performing the *ex ante* and the *ex post* audit which enables it to justify to what extent the IB's operation comply with *Sharī'ah* principles. It means that the SAC is obliged to perform an inclusive audit which covers the development of IB's products and contracts and the execution as well as the follow up of the implementation of the agreements and requirements of the contracts until liquidation. The SAC is also responsible for setting the accounting policies which are adopted by the IB, e.g. accounting treatment of the Islamic modes of investment (Abdallah, 1994).

Furthermore, Abdallah (1994) dictates that the SAC has to perform four special examinations of the financial statements of the IBs. First, the SAC assures that the formula which is used in allocating profits between shareholders and investment account holders is fair and in line with any recommendations made by the SAC. Second, the SAC confirms that all of the IB's revenues are derived from lawful transactions. If the IB generates revenue from unlawful transactions, the SAC suggests that this particular revenue should not be included to the profits allocated between shareholders and investment account holders. Third, SAC has to ensure that *zakāt* fund has been properly calculated, well disclosed on financial statements and equitably distributed to the *zakāt* recipients. Fourth, SAC is responsible for expressing an opinion whether or not the IB has properly performed its social role in the community.

In addition, Banaga et al. (1994) indicate that the SAC is also responsible for answering enquiries that come from the community at large; issuing formal legal opinions according to the Islamic law and enquiries submitted by the management of

IB or any other interested party; reviewing and revising all the dealings and transactions which the bank enters into with clients; and ensuring that those particular dealings and transactions are in compliance with Islamic rulings and principles.

According to the AAOIFI Governance Standard (2002c), SAC must perform *Shari'ah* review in order to examine the extent to which the IB's activities comply with *Shari'ah* rules and principles. Thus, the SAC can ensure that the IB is in compliance with *Shari'ah* rules and principles as reflected in the *fatwa(s)*, rulings and guidelines issued by the SAC. Therefore, the SAC have made a great contribution to the success of the Islamic banking industry as it has succeeded in getting the shareholders and the publics' confidence with regards to the IB's *Shari'ah* compliance (Bakar, 2002). In addition, Bakar (2002) argues that the SAC has successfully innovated and developed various new products of IB which do not only fully comply with Islamic principles but which also suit with the modern and prudent banking activities.

3.4. Appointment and Composition of the *Shari'ah* Advisory Council

According to the AAOIFI Governance Standard (2002b), members of SAC are appointed by the shareholders of the bank in the annual general meeting upon the recommendation of management. In addition, the IB's shareholders have a legal right to dismiss all or any members of the SAC. Thus, the SAC would be able to perform their tasks well without any unwarranted influence from management since members of SAC are not appointed by the management (Bakar, 2002).

As mentioned in the previous section, the SAC must be responsible to the shareholders for the IB's *Shari'ah* performance. This is supported by Abdul Rahman et al.'s study (2004) in which they found that the IB managers in Malaysia perceived that SAs have a legal, religious and social responsibility to five groups of stakeholders namely the customers, depositors, regulatory agencies and the Muslim public. This result is expected as these stakeholders are external parties that have a direct interest in the business of the bank. In addition, the IB managers are also normally concerned with these five external stakeholders, in their daily dealings.

With regard to the composition of the SAC, the AAOIFI Governance Standard (2002b) outlines that a SAC should consist of three members, who have expertise and knowledge in business, economics, law, accounting and others. This is supported by Karim (1990b) and Abdallah (1994) as they argue that the members of SAC should be people who are expert in *Shari'ah*, law and economics. In addition, Banaga et al.(1994) emphasize that SAC usually include distinguished scholars with a *Shari'ah* background who are regarded in the community for their integrity and honesty, and respected for their competence and experience in related *Shari'ah* knowledge.

The International Institute of Islamic Thought (IIIT) (1996) have conducted a survey in more than 60 IFIs in all over the world. They found that 19.69 % of IFIs have only one SA, 3.32 % of the IFIs have two SAs, 71.6 % of the IFIs have three or more than three SAs and 5 % of the IFIs have no specific number of SAs. Abu Moamer (1989) opines that the different numbers of SAs implies the different scope of the SAC in performing their duties in each of the IBs. For instance, the appointment only one SA would be acceptable particularly in the case of an Islamic window or Islamic counter

(Bakar, 2002). Further, Bakar (2002) argues that in the case of Malaysia, the SA in every Islamic counter must refer to *fatwa(s)* issued by National *Shari'ah* Advisory Council (NSAC) which is established in the Central Bank. Accordingly, there is no such obligation to have three SAs in an Islamic counter.

3.5. Independence of the *Shari'ah* Advisory Council

The concept of independence is considered as the fundamental principle of audit. Karim (1990b) argues that if auditors expect to maintain their credibility in performing their role, they need to be independent. According to Moizer (1986), “..an auditor is useless as an auditor if he is not independence.” In addition, being independent is not applicable only to the external auditors but to internal auditors as well (Abu Moamer, 1989).

According to Konrath (2002), the auditor needs to be independent of the interest of different parties in the company. Konrath (2002) also argues that since different parties have different interests, it may create conflict in the company. Hence, this situation leads to the need for the auditor to be independent and impartial in performing his/her role. In the case of the SAC, it should be similar. Although the SAC are considered as internal religious Advisors (Karim, 1990b), the SAC still need to be independent as the SAC should be representing the stakeholders, especially the depositors of the IBs, particularly in ensuring that the IBs activities and transactions are in compliance with *Shari'ah* principles. Furthermore, Karim (1990b) claims that if the SAC fails to keep their independence, it will induce the depositors to withdraw

their fund from the IB. This is supported by Abu Moamer (1989) whereby he states that both of the internal and external auditors should maintain independence.

Mautz and Sharf (1961) indicate that, in general, there are two types of independence which are (1) practitioner independence and (2) professional independence. Mautz and Sharf (1961) define practitioner independence as meaning that the auditors need to maintain the proper attitude of their planning, performance and report in conducting an audit. Furthermore, this particular independence demonstrates the ability of auditors to make objective and unbiased audit decisions (Dykhhoorn and Sinning, 1982). On the other hand, professional independence means that the auditors need to avoid any appearance which reduces the independence of auditors. Hence, the auditors must consider the public's and other's perceptions of their independence. Messier and Boh (2002) argue that to be perceived as independent, the auditor should demonstrate that there is no threat to his or her independence such that an outsider would not doubt the auditor's objectivity.

Considering the concept of practitioner independence, the AAOIFI Governance Standard (2002b) dictates that the SAC members must be appointed by the shareholders in the annual general meeting. Thus, the SAC members will be able to perform their role well since they are given a legitimate right by the shareholders to supervise the IB's activities and transactions in relation to adherence to *Shari'ah* principles. However, the Bank Indonesia (2004b) states that the SAC members should be appointed by the Central Bank. Being appointed by the Central Bank, the SAC members will be enabled to be above all the IB's stakeholders' interests. Hence, the SAC members may be enabled to be really representing the interest of all of the IB's

stakeholders, particularly in ensuring that the IB's operations are in accordance with *Shari'ah* principles.

The concept of professional independence means that the SAC members need to be independent in appearance. Hence, the SAC members have to avoid any actions which may reduce the perceptions of the IBs' stakeholders of their independence although, as stated by Karim (1990b), the SAC members are guided by their moral beliefs and obligations to their religious peers and the community. The SAC members must maintain their position neutral from any of the IB's stakeholders. According to Al-Qattan (2003), to be perceived independent, the SAC members must avoid any influence or pressure from any of the IB's stakeholders in performing their role. Hence, the members of SAC are prohibited to be either the employee or on the board of directors of IB. Similarly, the AAOIFI Governance Standard (2002b) states that the members of SAC should not be as the directors or significant shareholders of the IB.

However, Al-Ba'li (1990) views otherwise as he argues that the independence of the SAC members is not affected if they become members of the board of directors of the IB. On the other hand, by joining the board of directors, the SAC members will be able to influence the board of directors' decision making process; and even more, the SAC members may express the religious legal opinion on the matter being discussed and ensure its implementation. Further more, according to Tulbah (1996), the SAC members should not be prohibited from having shares on the IB while at the same time acting as the SAC members. Tulbah (1996) argues that by becoming shareholders, the SAC members will be more careful in supervising that particular IB.

3.6. The *Shari'ah* Review Process

Karim (1990b) claims that the SAC carries out its role guided by religious tenets prescribed in the *Qur'an*, *Sunnah* and *Ijmā'*⁹ which would be more valued than any legal rules and professional codes of ethics. According to Banaga et al. (1994), the SAC is expected to receive enquiries from the management or others and present them to the Board of Directors. In addition, the SAC is required normally to prepare drafts of opinions delivering them to all those who are concerned. In some circumstances, the SAC prepares contracts in collaboration with the legal advisor of the bank. The SAC normally participates in the preparation of decrees, decisions and orders presented by the bank, preparing explanatory notes and preparing the studies and research required to direct the *zakāt* resources towards the deserving parties. Furthermore, the SAC also carries out technical review to make sure that the *Shari'ah* controls are implemented by the bank, its branches and its affiliates.

However there are several different methods used by the SAC in performing its duties (Bakar, 2002). This is supported by research conducted by the IIFT in 1996¹⁰ on the methods used by the SAC to perform their duties whereby they found that 10.8 % of the respondents claim that they have established a permanent office of *Shari'ah* supervision at the bank which is responsible for vetting all products and related documentation, 48.5 % of the respondents have adopted a method whereby the SAC conduct periodical meetings with management to discuss and respond to any issues

⁹ Hasan (1978) defines *Qur'an* as "the word of God which is revealed through Prophet Muhammad, pbuh for the Muslim *ummah*". Hasan (1978) also defines the *Sunnah* as the sayings and the deeds of Prophet Muhammad, pbuh and his companions which explain and comment on the practice of *Qur'an*. In addition, Hasan (1978) defines *Ijmā'* as the agreement of those who are legally responsible ('*Ulamā*) and belong to the community of Prophet Muhammad, pbuh in a certain age, on a rule about a certain incident

¹⁰ This is quoted from Bakar, M.D (2002), the *Shari'ah* Supervisory Board and issues of *Shari'ah* rulings and their harmonisation. Ins. *Islamic banking and finance*, pp.80.

raised by management, 6.2 % of the respondents have subscribed a method whereby the SAC fulfil their duties based on samples of the IB's documentation and other relevant information, and the other 27 % of the respondents have adopted another method to determine issues faced by the management.

Further, Bakar (2002) argues there are two possible reasons which stimulate most of the respondents to prefer to have a periodical meeting between the SAC and management, such as: first, management only shortlists any issues related to *Shari'ah* principles which need to be discussed with the SAC; second, the SAC performs its duties on a part-time basis. However, this method may create a problem in which management fails to disclose any issues which are considered *Shari'ah* compliant. Thus, Bakar (2002) argues that ideally the SAC should perform its duties on a full-time basis so that it is able to fully supervise the IB's activities which regard to *Shari'ah* compliance issues and to take action quickly if it needs to do so.

The AAOIFI Governance Standard (2002c) outlines that the SAC must conduct at least three stages in performing their tasks, such as: planning review procedures, executing *Shari'ah* review procedures and documenting conclusions and report. During the planning stage, the SAC is intended to have complete understanding of the IB's activities, products and transactions with regard to *Shari'ah* compliance issues. In addition, the SAC must make a proper sample selection criterion and sizes based on the complexity and frequency of the transactions.

After making proper planning, the SAC needs to execute the *Shari'ah* review procedures. The SAC performs this particular stage based on a sample of the IB's

transactions. It is supported by Karim (1990b) who argues that it is impossible for the SAC to review all of the IB's transactions. During this stage, the SAC is expected to obtain a clear understanding of the management's performance particularly that is related to *Shari'ah* compliance issues. Thus, the SAC encompasses several activities such as reviewing the contracts, agreements, reports and other documents; determining that all transactions conducted by the bank are based on products approved by the SAC; having consultation and or coordination with external auditors; and discussing findings with the bank's management.

The third stage is documenting conclusions and reports. The SAC is obliged to prepare proper documents containing its conclusions on the IB's performance related to adherence to *Shari'ah* principles which will be given to the IB's shareholders. The AAOIFI Governance Standard (2002b) states that this *Shari'ah* review report is published in the annual report of the IB. In addition, the SAC is also required to read this particular report at the annual general meeting. Moreover, the SAC should also issue a special *Shari'ah* review report, which is more detailed as compared to the report given to the shareholders, to the management of IB when it is necessary.

Based on the methods of SAC in performing their duties, it seems that the AAOIFI Governance Standard (2002c) agrees with Bakar's (2002) opinion that SAC should conduct an investigation on the IB's forms, documents, contracts, agreements, policies and products on a full-time basis. Nevertheless, the AAOIFI Governance Standard (2002c) suggests that SAC is still able to perform its duties on a part-time basis since it is assisted by an internal *Shari'ah* department held by the management of the IB. According to AAOIFI Governance Standard (2002d), the internal *Shari'ah* review can

be performed by an independent department or part of the internal audit department depending on the size of the IB. This particular department is intended to ensure that the management of IB fulfils its responsibility in operating the transactions and activities based on the Islamic principles. Therefore, the internal *Shari'ah* review department is given unlimited access to the IB's documents, reports etc. In addition, to maintain this particular department's objectivity and independence, the head of the internal *Shari'ah* department is directly responsible to the board of directors.

CHAPTER 4

RESEARCH DESIGN AND METHODOLOGY

4.1. Introduction

This chapter will discuss in detail the research methodology for the present study. The discussion will focus on the research objectives and design, sample selection, development of the questionnaire, data collection and data analysis procedures. The present research is an exploratory study that involves the administration of a questionnaire survey to examine managers' perceptions of the responsibility and independence of *Shari'ah* Advisors (SAs) in Islamic Bank (IBs); and the *Shari'ah* review process in Indonesia.

Section 4.2 describes the research objectives of the current study. It is followed by section 4.3 which focuses on the research design. Next, in section 4.4, the discussion is with regard to the respondents' background and sample selection. Following this, section 4.5 discusses the research instruments used in the present study. The discussion on the process of the questionnaires and interview questions design is covered on section 4.6. The translation process of the questionnaires from the original English into Bahasa Indonesia is presented on section 4.7. Section 4.8 highlights the pilot testing process of the questionnaires. In addition, section 4.9 touches the data collection process of this study. Finally, this chapter closes with section 4.10 which discuss the data analyses in this study. There are some statistical analyses conducted in analysing the data whereby those analyses are conducted using SPSS 11.0 for Windows.

4.2. Research Objectives

The review of the literature in the previous chapter has shown that the IB must conduct its activities and transactions in accordance with *Sharī'ah* principles. Sulaiman (2000) argues that the IB must refrain from activities and transactions which involve *riba*, *gharar* and *mayshir*. In addition, Siddīqi (1998) argues that the activities and transactions of IB can be divided into three main transactions, such as (1) *ḥiwālah* (fee based) transactions (2) *muḍārabah/mushārah* (profit loss sharing) transactions (3) *qard ḥasan* (benevolent) transactions.

Karim (1995) argues that the uniqueness of the IB lies in the Islamic principles which govern its transactions and activities. Thus, the IB is expected to run its activities in accordance with the *Sharī'ah* principles. This is supported by Haron et al.'s study (1994) in which they found that 39 % of the Muslim respondents prefer to join the IBs since the banks are run in accordance with *Sharī'ah* principles. BI also conducted a study on Muslims' perceptions of IB whereby they found that 45% of Muslim respondents who live in Java Island (excluded DKI Jakarta province) believe that interest is *riba* and, thus, they prefer to use IB (Bank Indonesia, 2000). Therefore, BI (2002a) states that the main objective of the development of the IBs in Indonesia is to achieve the full *Sharī'ah* compliance of IBs' activities and transactions.

This current study is aimed at discussing the practices of the SACs of IBs in Indonesia particularly in terms of the responsibility and the independence of SAs and the *Sharī'ah* review process conducted by the SAs of IBs in Indonesia. In addition, the study is designed to compare the perceptions of the IB managers who work at the ICB

with those who work at the CBI on those three issues related to the SAs of IBs as mentioned before.

Hence, the researcher obtains the perceptions of managers who work at the ICB as well as those who work at the CBI in Indonesia. The reason for having the IB managers' perceptions is because the managers are the parties who are involved in the day-to-day operations of IBs, thus it will be very relevant to seek their perceptions as to the credibility of SAs may depend, among others, on the perceptions and confidence of the bank managers (Abdul Rahman et al. 2004). This is supported by Bucheery and Hood (1999) who argue that the IB managers are the best respondents to seek the views on the responsibility and independence of SAs as they represent the group that have an interest in making sure that services provided to customers, depositors and others are adherent to Islamic principles.

The Banking Act No. 10/1998 has recognised the dual banking system whereby the Conventional and the Islamic banking systems are used in parallel at the same time. This act has encouraged the Conventional banks to offer Islamic banking schemes in a special Islamic branch. Hence, there are three types of Islamic bank in Indonesia; namely as Islamic Commercial Bank (ICB), Conventional Bank that offers an Islamic banking scheme (CBI) and Islamic Rural Bank (IRB)¹¹.

This is known that the first ICB was established in 1991 whereas the second one was formed in 1999. On the other hand, there was only one CBI in 1999, meanwhile the other seven CBsI were launched during period from 1999 to 2004 (Bank Indonesia,

¹¹ The managers who work at the Islamic Rural Bank (IRB) are not considered as the respondents of this study since the IRB is a local bank which is established on the basis of provincial decree.

2004a). Hence, it can be assumed that the managers who work at the ICB have a longer working experience in the Islamic banking industry as compared to their counterparts at the CBI. In addition, this current study assumes that IB managers who work at the ICB have different perceptions on the role and independence of SAs and *Shari'ah* review process as compared to those who work at the CBI.

Based on the perceptions of IB managers in Indonesia, the first research objective is:

Research Objective No.1:

To examine the importance of SAC of IB in Indonesia.

Three research questions emerge from this objective. These are:

Research Question No.1:

What are the benefits of the existence of SAC?

Research Question No.2:

What are the characteristics of SAs of IBs in Indonesia?

Research Question No.3

Are there any significant differences between the perceptions of ICB's and CBI's respondents on the importance of the SAC of IB in Indonesia?

The second research question has been raised in order to obtain the IB managers' perceptions of the characteristics of the SAC. As mentioned earlier, there are various characteristics of the SAC proposed by many authors (e.g. Briston and El-Ashker, 1986; Karim, 1990b; Banaga et al. 1994; Bakar, 2002; and AAOIFI Governance Standard, 2002b)¹². In addition, the third research question is intended to examine

¹² Please refer to Section 3.4, Appointment and Composition of the SAC.

whether there are significant differences in the importance of SAs between the perceptions of the ICB's managers and their counterparts who work at the CBI.

The first main issue highlighted in the literature is related to the responsibility of the SAs of IBs. According to Briston and El-Ashker (1986) and Abdallah (1994), the SAs need to conduct an *ex ante* and an *ex post audit* which will enable them to justify to what extent the operations of the IBs' comply with *Shari'ah* principles. Hence, it seems that all of the authors (Briston and El-Ashker, 1986; Karim, 1990b; Abdallah, 1994; Banaga et al. 1994; Bakar, 2002; and AAOIFI Governance Standard, 2002b) are in of the view that the SAs are responsible for examining the extent to which IBs' activities and transactions conform to *Shari'ah* principles.

However, regarding to whom the SAs need to be responsible, some authors have different views (e.g. Banaga et al.1994; Bakar, 2002; and AAOIFI Governance Standard, 2002). According to the AAOIFI Governance Standard (2002b), the SAs should be responsible to the shareholders in monitoring the IBs' activities through a report which is published in the annual report. Meanwhile, Bakar (2002) argues that the SAs need to be responsible not only to the shareholders but to the public as well. This is supported by Banaga et al. (1994) who argue that the SAs should also be responsible to the Muslim community at large.

Following this line of discussion, the study is aimed at determining the responsibilities of the SAs of IBs in Indonesia and the parties to who the SAs need to be responsible. Hence, there are four research questions which emerge from this particular objective. These are (1) what are the responsibilities of SAs?; and (2) to whom should the SAs

be legally responsible?; (3) to whom should the SAs be religiously/socially responsible?; and (4) are there significant differences between the perceptions of ICB and CBI respondents on the responsibility of the SAs?.

Specifically, the second research objective is:

Research Objective No. 2:

To examine the legal and religious/social responsibilities of SAs of IBs in Indonesia.

The research questions that relate to this objective are:

Research Questions No. 4:

What are the responsibilities of SAs of IBs in Indonesia?

Research Questions No. 5:

To whom should the SAs of IBs in Indonesia be legally responsible?

Research Questions No. 6:

To whom should the SAs of IBs in Indonesia be religiously/socially responsible?

Research Question No. 7

Are there any significant differences between the perceptions of ICB's and CBI's respondents on the responsibilities of SAs of IBs in Indonesia?

The second main issue discussed in the literature is the independence of SAs of IBs. According to Karim (1990b), the (financial) auditors need to be independent in order to maintain their credibility. In addition, Abu Moamer (1989) argues that it is not only the external auditors but also the internal auditors who need to maintain their independence in performing their tasks. This is supported by Karim (1990b) as he states that although the SAs are considered as internal auditors, they need to keep their independence to ensure that the IBs' activities and transactions are in compliance with *Shari'ah* principles.

Mautz and Sharf (1961) claim that there are two types of independence, such as: (1) practitioner independence, (2) and professional independence. The practitioner independence induces the auditors to refrain from any activities which may reduce their independence. Meanwhile, the professional independence means that the auditors need to be free from any appearances which reduce their independence. Based on this discussion on the independence of SAs, the current study is also aimed at determining the factors which enable SAs of IBs in Indonesia to maintain and to improve their independence.

Therefore, three research questions are raised from this particular objective. These are; (1) what are the factors which maintain and improve the independence of SAs?; (2) who should appoint SAs in order to maintain their independence?; and (3) are there any differences between the perceptions of ICB and CBI respondents as to the independence of the SAs of IBs in Indonesia?.

Specifically, the research objective and the research questions are as follows:

Research Objective No. 3:

To examine the factors that may influence the independence of the SAs of IBs in Indonesia.

Research questions that relate to this objective are:

Research Question No. 8:

What are the factors that may improve the independence of SAs of IBs in Indonesia?

Research Questions No.9:

Who should appoint SAs in order to improve the independence of SAs of IBs in Indonesia?

Research Question No. 10:

Are there any significant differences between the perceptions of ICB's and CBI's respondents on the independence of SAs of IBs in Indonesia?

The last main issue reviewed in the literature concerns the *Shari'ah* review process conducted by the SAs in ensuring that all of the IBs' activities and transactions are in accordance with *Shari'ah* principles. According to the AAOIFI Governance Standard (2002c), the SAC must at least conduct three stages in performing their tasks, such as: (1) planning review procedures, (2) executing *Shari'ah* review procedures and (3), lastly, documenting conclusions and report.

During the planning stage, the SAs are intended to obtain a complete understanding of the IBs' activities, products and transactions which regard to *Shari'ah* compliance issues. In addition, the SAs must make a proper sample criterion and sizes based on the complexity and frequency of the transactions.

After making a proper planning, the SAs need to execute the *Shari'ah* review procedures based on a sample of the IBs' transactions. In this stage, the SAs are expected to get a clear understanding on the managements performance particularly related with *Shari'ah* compliant issues. Thus, the SAs encompass several activities such as reviewing the contracts, agreements, reports and other documents; determining that all transactions conducted by the IBs are based on products approved by the SAs; having consultation and or coordination with external auditors; and discussing findings with the IBs' management.

The last stage is documenting conclusions and reports. The SAs are obliged to prepare proper document containing their conclusion on the bank's performance related to the adherence to *Shari'ah* principles which will be given to the IBs' shareholders and this particular report is to be read at the annual general meeting. In addition, this *Shari'ah* review report is usually published in the annual report of the IB (AAOIFI, 2002b). Furthermore, the SAs should also issue a special *Shari'ah* review report, which is a more detailed report as compared to the report given to the shareholders, to the IBs' management when it is necessary.

Therefore, following the literature, the research objective and the research questions are as follows:

Research Objective No. 4:

To examine the Shari'ah review procedures as conducted by the SAs of IBs in Indonesia.

Research Questions No. 11:

What are the procedures that need to be conducted by the SAs of IBs in Indonesia in order to properly execute the Shari'ah review?

Research Questions No. 12:

To whom should the SAs of IBs in Indonesia make a Shari'ah review report published in the annual report of IBs?

Research Questions No.13:

To whom should the SAs of IBs in Indonesia make a special Shari'ah review report?

Research Questions No.14:

Are there any significant differences between the perceptions of ICB's and CBI's respondents on the Shari'ah review process of IBs in Indonesia?

A summary of each research question together with the research objectives discussed above is presented in Table 4.1 as follows:

Table 4.1 Summary of Research Objectives and Research Questions

Research Objectives	Research Questions	Questionnaires
No.1. <i>To examine the importance of the SAC of IB in Indonesia.</i>	No.1 <i>What are the benefits of the existence of the SAC of IBs in Indonesia?</i>	Section II, part 1
	No. 2 <i>What are the characteristics of the SAs of IBs in Indonesia?</i>	Section II, part 1
	No. 3 <i>Are there any significant differences between the perceptions of ICB's and CBI's respondents on the importance of SAC of IB in Indonesia?</i>	
No.2 <i>To examine the legal and religious/social responsibilities of SAs of IBs in Indonesia.</i>	No.4 <i>What are the responsibilities of the SAs of IBs in Indonesia?</i>	Section III, part 1
	No.5 <i>To whom should the SAs of IBs in Indonesia be legally responsible?</i>	Section III, part 2
	No.6 <i>To whom should the SAs of IBs in Indonesia be religiously/socially responsible?</i>	Section III, part 3
	No.7 <i>Are there any significant differences between the perceptions of ICB's and CBI's respondents on the responsibilities of SAs of IBs in Indonesia?</i>	
No. 3 <i>To examine the factors that may influence the independence of SAs of IBs in Indonesia.</i>	No.8 <i>What are the factors that may improve the independence of SAs of IBs in Indonesia?</i>	Section IV, Part 1
	No. 9 <i>Who should appoint the SAs in order to improve the independence of SAs of IBs in Indonesia?</i>	Section IV, Part 2
	No. 10 <i>Are there any significant differences between the perceptions of ICB's and CBI's respondents on the independence of SAs of IBs in Indonesia?</i>	

Table 4.1 Continued

Research Objectives	Research Questions	Questionnaires
No. 4 <i>To examine the Shari'ah review procedures as conducted by the SAs of IBs in Indonesia.</i>	No. 11 <i>What are the procedures that need to be conducted by the SAs of IBs in Indonesia in order to properly execute the Shari'ah review?</i>	Section V, Part 1
	No. 12 <i>To whom should the SAs of IBs in Indonesia make a Shari'ah review report published in the annual report of IBs?</i>	Section V, Part 2
	No.13 <i>To whom should the SAs of IBs in Indonesia make a special Shari'ah review report?</i>	Section V, Part 3
	No.14 <i>Are there any significant differences between the perceptions of ICB's and CBI's respondents on the Shari'ah review process of IBs in Indonesia?</i>	

Moreover, the researcher also needs to obtain the perceptions of the SAs on those three issues related with the practices of SACs of IBs in Indonesia such as the responsibility and the independence of SAs and the *Shari'ah* review process conducted by the SAs of IBs in Indonesia.

However, instead of using the questionnaires, the researcher conducts an interview. The reason which motivates the researcher to prefer to have interviews rather than use questionnaires is because all of SAs of IBs in Indonesia have conducted their roles as part-time staff of the IBs. Since the SAs are considered as part-time staff, the SAs might have not been always at the office of the IBs. Hence, if the researcher utilises

the questionnaire method to get their perceptions, the response of SAs will be low. Meanwhile, through an interview, the researcher is able to contact the SAs directly and negotiate the time to get their perceptions.

4.3. Research Design

In order to achieve the objectives of this current study, the researcher uses a survey method. According to Janes (1999), the survey method is a good way to obtain a picture of the current state of a community. In addition, Davis (2000) argues that the survey method is designed specifically to obtain a large amount of information from human respondents. Furthermore, the survey method can provide an accurate data through thoughtful design, testing and detailed administration (McClelland, 1994). Since contemporary business research relies much on the use of primary data collection, hence, survey method has become a commonplace research tools (Davis, 2000).

In this current study, the researcher utilizes two types of survey method: the questionnaire and the interview. According to Janes (1999), the survey method is considered as the only one instrument in obtaining a picture which represents the current state of a group, a community or an organization. This study utilises a self-administered questionnaire survey to explore the perceptions of IB managers of the role of SAs in IBs.

Jordan (1998) and Thietart (1999) argue that the questionnaire method is the most efficient method of collecting primary data. The questionnaire method allows the

researcher to collect data quickly and cheaply even though the study covers a large geographical area. In addition, Cooper and Schindler (2003) are of the view that the questionnaire method would be the best approach in gaining opinions or perceptions. They claim that by using questionnaires, information can be gathered more efficiently and economically compared to other types of survey methods. In accordance with the above, due to a relatively large sample which comprises managers of IBs in Indonesia of this current study, the researcher decided to utilise the Survey-questionnaire method.

However, in order to obtain deeper perceptions of SAs of IBs in Indonesia, the researcher utilises the interview method. According to Cooper and Schindler (2003), by using the interview method, the researcher may obtain more in-depth and detailed information from the respondents. This is because the researcher may control the topics and pattern of discussion. As explained earlier, since the SAs of IBs in Indonesia are considered as part-time staff, the use of the questionnaire method may obtain a low response rate.

4.4. Respondents' Background and Sample Selection

The present study has the main objective of discussing the current practices of SACs of IBs in Indonesia particularly in terms of the responsibility and the independence of SAs and the *Shari'ah* review process. To achieve the main objective, the researcher needs to study the perceptions of managers of IBs as well as the SAs on the three issues mentioned before.

In this present study, the researcher focuses on the managers who work only at ICB and CBI. Since the head offices of the ICB and CBI are located in Jakarta, it is assumed that the perceptions of the IB managers who work either in the ICB or CBI head offices represent the perceptions of IBs' managers in Indonesia.

The respondents of the ICB are defined as those who work at ICB and hold at least a diploma degree with a minimum two years of working experience in the Islamic banking industry. On the other hand, since most of CBSI have only recently emerged, the respondents of the CBI are defined as those who work at CBI and hold at least a diploma degree with at least one year working experience in the Islamic banking industry. Therefore, by imposing certain requirements in selecting the respondents, the study is able to obtain valid respondents who are aware with the existence of SAC of IBs in Indonesia.

According to BI (2004a), there are three ICBs and six CBSI in Indonesia. Those three ICBs are (1) Bank Muamalat Indonesia (BMI), (2) Bank Syari'ah Mandiri (BSM), and (3) Bank Syari'ah Mega Indonesia (BSMI). However, BSMI is not considered as a respondent of the study since this particular bank was just officially launched in July 2004. In addition, Table 4.2 also highlights that the CBI in Indonesia consist of (1) Bank Negara Indonesia (BNI), (2) Bank Rakyat Indonesia (BRI), (3) Bank Bukopin, (4) Bank Danamon, (5) Bank IFI, and (6) Bank International Indonesia (BII).

Table 4.2 Number IB Managers and SAs Selected for Each ICB and CBI

No	Name of the Bank	Number Selected	
		IB Managers	SAs
1	Bank Muamalat (BMI)	20	4
2	Bank Syari'ah Mandiri (BSM)	20	4

Table 4.2 Continued

No	Name of the Bank	Number Selected	
		IB Managers	SAs
3	Islamic Banking Unit-Bank Negara Indonesia (BNI)	10	2
4	Islamic Banking Unit-Bank Rakyat Indonesia (BRI)	10	3
5	Islamic Banking Unit-Bank Bukopin	10	3
6	Islamic Banking Unit-Bank Danamon	10	3
7	Islamic Banking Unit-Bank IFI	10	3
8	Islamic Banking Unit-Bank International Indonesia (BII)	10	3
	Total	100	25

The selection of bank managers is carried out at random whereby 20 and 10 IB managers were selected for each of the ICB and CBI respectively. Thus, it is expected that 40 ICB managers and 60 CBI become the respondents of this present study. In addition, an employee from each of ICB as well as CBI is required to distribute and to collect the questionnaires.

In order to support the analysis of the response of IB managers, the researcher conducts an interview with the SAs of IBs in Indonesia. There are twenty five SAs for two ICBs and six CBIs who are considered as the respondents in this current study. However, of the 25 SAs, four SAs are members of SAC in more than one IB¹³. Thus, in the end the real number of SAs of IBs included in this current study is reduced to 21.

4.5. Research Instruments

The researcher utilized two survey methods in this current study; a self-administered questionnaire survey and interview survey instruments. The Self-administered

¹³ Please refer to APPENDIX IV, Members of SAC of IBs in Indonesia.

questionnaire survey is an instrument used to obtain the perception of IB managers of the responsibility and independence of the SAs and the *Shari'ah* review process. Meanwhile, interview survey method is used to obtain the perceptions of SAs of IBs of those three issues mentioned above.

McClelland (1994) argues that the self-administered questionnaire instrument is able to be used in obtaining the perceptions of a large population in different geographical locations. The most critical part in using a self-administered questionnaire instrument is the construction of the questionnaire instrument. In this study, most of the questions are self-developed based on AAOIFI Governance Standard (2002b&c) and opinions of several authors (such as Abu Moamer, 1989; Abdallah, 1994; Bakar, 2002 and Al-Qattan, 2003).

The reason for obtaining the perception of the SAs through the interview survey method is because SAs of IBs in Indonesia are not members or staff of the bank. Hence, it seems hard to meet SAs at the IBs. Thus, in this study, the researcher utilised a personal interview method. It is expected that by using the personal interview method, in-depth and detailed information can be obtained from the participants (Cooper and Schindler, 2003). In addition, Cooper and Schindler (2003) argue that the interviewer is able to note the conditions of the interview and, if it is necessary, he/she can add some new questions and obtain additional information from the participants.

4.6. Questionnaires and Interview Questions Design

According to McClelland (1994), there are two types of survey questionnaires: standardised and custom designed (original). The questions in a standardised questionnaire usually have been developed over a period of time and tested in terms of validity and reliability. Thus, the standardised questionnaires are commercially available through a number of training organizations and consultants and developed to address general purposes. On the other hand, custom designed questionnaires are developed to address certain and narrowly defined issues (McClelland, 1994). They are designed to satisfy a specific purpose. Thus, McClelland (1994) claims that this type of questionnaire needs substantial work in designing the questions and testing the validity and reliability of the questions.

This present study employs the custom designed questionnaire. The development of questionnaires was initiated with the discussion of the literature on the responsibility and independence of SAs and the *Shari'ah* review process in IBs. Based on the various literatures, the researcher devised the Research Questions (RQs) for this particular study. The questionnaires are designed to obtain the perceptions of ICB and CBI bank managers on those RQs related to SAs of IBs in Indonesia.

McClelland (1994) argues that there are three types of questions: close-ended, open-ended and a combination of the two. The close-ended question is also known as forced-choice questions since participants need to respond the questions with a predetermined set of answers. In order to obtain more comprehensive response from the participants, a researcher needs to employ open-ended questions.

According to McClelland (1994), the open-ended questions afford the participants a right to write their response into some statements. However, the participants' responses obtained through the use of close-ended questions are much easier to tabulate. Consequently, the researcher will be able to analyse the responses with the assistance of a simple statistical technique. Hence, the researcher utilises a close-ended questions to obtain the IB managers perceptions on those three issues related with the SAs as mentioned before.

The questionnaire used in the current study utilises various measurement scales which include nominal and ordinal scale. According to Cooper and Schindler (2003) nominal scale measurement is used for questions that are non-overlapping, mutually exclusive and collectively exhaustive such as gender, marital status and occupation. In addition, an ordinal scale, on the other hand, is used to categorise the data and rank it according to its order such as opinion or preference scales (Cooper and Schindler, 2003).

The questionnaire also uses a five-point Likert scale measurement that helps to compare one's opinion to another (Cooper and Schindler, 2003). Likert scale measurement is considered highly reliable, particularly when used to gauge people's opinions (Davis, 2000). Furthermore, the questionnaire of this current study is divided into five sections. In addition, it consists of seventy questions. Section one comprises ten questions that are designed to generate the respondents' demographical background. The purpose of gathering demographic information is to investigate whether a relationship exists between IB managers' demographic factors and their perceptions regarding responsibility and independence of SAs and the *Shari'ah* review process. Section two consists of nine questions which are designed to generate the

perceptions of IB managers of the importance of SAs. In the third section, the respondents are asked their views on SAs' responsibility through 21 questions while in the following section, section 4, the respondents need to answer 11 questions to express their views on SAs' independence. Lastly, section 5 which comprises of 19 questions is intended to generate the perceptions of IB managers on the *Shari'ah* review process.

In order to obtain the SAs' perceptions of those three issues mentioned before, the current study utilises open-ended questions. The use of open-ended questions is aimed at gaining insights into opinions or perceptions. Thietart (1999) argues that with open-ended questions, respondents are not influenced by the alternative answers as in closed-ended questions and this, therefore, will provide a rich source of information.

However, at the same time, the use of open-ended questions involves the high subjectivity of the participants in interpreting the questions. Hence, the analysis of participants' responses obtained from the open-ended questions requires a great deal of the researcher's time (McClelland, 1994). Furthermore, the answers to open-ended questions are difficult to interpret (Davis, 2000).

Nevertheless, since it seems very hard to meet SAs of IBs in Indonesia, the researcher employs the open-ended questions during interview with SAs. The questions used in the interview consist of three sections. The first section with six questions is related to the responsibility of SAs of IBs in Indonesia. Next, there are five questions which discuss on the independence of SAs of IBs in Indonesia which are asked to the

interviewee SAs. Lastly, the interviewee SAs are given seven questions on the procedures of *Shari'ah* review in IBs in Indonesia¹⁴.

4.7. Translation of the Questionnaire

Since Bahasa Indonesia is considered as the sole official language, all of the IB managers in Indonesia use Bahasa Indonesia as the medium of communication. Hence, it is necessary to translate the questionnaire into the official language which is Bahasa Indonesia.

According to Sekaran (2003), in translating the questionnaire, the researcher needs to make sure that the local language of the questionnaire matches the original language accurately. Thus, Sekaran (2003) suggest a method which is known as back translation method. There are two steps taken in translating the questionnaire when using the back translation method. First, the researcher requests a local expert to translate the original questionnaire, which is constructed in English, into Bahasa Indonesia. Next, the researcher requests another local expert to translate that local version into English. By performing those two steps, Sekaran (2003) claims that the vocabulary of the translated version is ensured.

However, Sulaiman (1997) has utilized another method proposed by Hofstede (1980) in translating the questionnaire in her study. Hofstede (1980) as cited in Sulaiman (1997) argues that in translating the questionnaire, it is better for a researcher to directly request a translator who is well versed in the issues contained in the study

¹⁴ Please refer to APPENDIX V, Sample Questions for Interview.

rather than using two bilinguals who are not familiar in the area under study. Hence, Sulaiman (1997) employed a Malay teacher majoring in English to translate the questionnaire. In addition, Sulaiman (1997) had the questionnaire translated second time by a final year accounting student.

Since the preservation of the meaning of the questionnaire is more important than its literal meaning, the researcher employs the second method in translating the questionnaires as used by Sulaiman (1997). Hence, the English version of the questionnaire was given to a lecturer from Department of Economics, Kulliyah of Economics and Management Sciences (KENMS), International Islamic University Malaysia (IIUM), who is from Indonesia and one of the experts in the area of Islamic banking and finance. The second version of the questionnaire was given to a final year postgraduate student of the IIUM, majoring in Accounting who is also coming from Indonesia. This particular student is one of the lecturers at *Shari'ah* Economics and Banking Institute (SEBI), Jakarta-Indonesia, who teaches subjects of auditing and accounting for IBs. In addition, SEBI is known as one of the higher institutions which focuses on the area of Economics, Banking and Finance from the Islamic perspective. Thus, both of the translators are proficient in using Bahasa Indonesia and English. In addition, by considering the background of both translators, the researcher believes that both translators have a good knowledge in the area of Islamic banking and finance. Therefore, the researcher believes that by performing the process as mentioned above, the translation process is deemed sufficient.

4.8. Pilot Testing

Prior to the actual survey, a pilot test was conducted in the month of August 2004. The objective of this pilot testing was to ascertain the instrument's understandability and length. Pilot testing was also intended to acquire comments so as to improve the quality of the research instrument, in an effort to achieve a good response rate. Finally, pilot testing was conducted to measure the validity of the questionnaires.

A validity test is conducted to ensure that the instrument is valid, i.e. it measures what it purports to measure (Davis, 2000). According to Cooper and Schindler (2003), there are various approaches used in order to conduct a validity testing such as (1) criterion-related validity, (2) content validity, (3) construct validity, (4) concurrent validity, (5) predictive validity, etc. Furthermore, Cooper and Schindler (2003) claim that the content validity analyses the extent to which the instrument provides sufficient coverage of the investigated questions guiding the study. Thus, this study employs a content validity approach.

Moreover, Davis (2000) indicates that one way of determining content validity is to use a panel of persons to judge the instruments. Thus, the English version of the questionnaire has been evaluated by three students of the Master of Business Administration (MBA) of the IIUM majoring in Islamic banking two of whom have worked as bankers in Malaysia, i.e. a former banker of Malaysian Bank and a Bank Negara Malaysia Officer. Meanwhile, the Bahasa Indonesia version of the questionnaire has been evaluated by four postgraduate students of IIUM with different programmes, i.e. Economics, Accounting and Law. These four students are involved intensively as researchers at the Islamic Economic Forum for Indonesian

Development (ISEFID), a research institution which focuses on the issues on Economics, banking and finance from the Islamic perspective. Based on the person's educational background involved to conduct validity test, it is assumed that the content validity of the questionnaires can be considered as adequate.

The results of the pilot test were generally positive. All of the students were of the opinion that the questionnaire was, on the whole, understandable. They agreed that the format was clear and not confusing. With regard to length, two out of the seven students claimed that the questionnaire was fairly lengthy. However, majority of the participants believed that the length of the questionnaire was reasonable. The questionnaire was developed to be of a certain length so as to capture as much detail as possible to obtain concrete evidence that would support the findings. In terms of the time taken to complete the questionnaire, on average, it was estimated that completion would take approximately twenty minutes.

4.9. Data Collection Procedure

Before distributing the questionnaires, the researcher approached some of the IBs. The researcher requested the Director of the Directorate for Islamic banking-Bank Indonesia to issue a recommendation letter for the current study. The Director agreed to release a recommendation letter sent directly to the targeted IBs¹⁵.

After getting a recommendation letter from Bank Indonesia, the researcher managed to distribute the questionnaires to each of the respondents. In order to improve the

¹⁵ Please refer to the APPENDIX I, Recommendation Letter from Director of the Directorate of Islamic Banking-Bank Indonesia.

response rate, the researcher attached to every questionnaire a cover letter signed by the supervisor which explains the aim of the study and the assurance that the data obtained from the questionnaires would be solely used for research purposes. The researcher also attached to each of the questionnaires a cover letter which gives the researcher's identity and the objectives the study to the respondents. Furthermore, the researcher asked one of either of the ICB's or CBI's employees to distribute and collect the questionnaires.

With regard to the interview survey, the researcher visited the Office of the NSC-IUC, in order to obtain the SAs personal phone numbers/addresses. Then, the researcher contacted the SAs through their personal phone numbers, in order to make appointments for interviews.

4.10. Data Analysis

Basically, there are several statistical analyses used in this current study. The researcher conducted the reliability test to analyse the data. Next, the researcher analysed the demographics of the respondents by using descriptive statistics and measures of central tendency. Then, the responses were tabulated using frequencies and central tendency.

In addition, the researcher compares the responses of the respondents who work at the ICB and CBI. Since there are two independent groups, the appropriate statistical test which is going to be applied in this study is the Mann-Whitney U test. The Mann-Whitney U test is basically an alternative (a non parametric) to the t -test. According to

Davis (2000), the Mann-Whitney U test examines differences between two independent samples if the data at least is ordinal. Cramer and Bryman (2003) argue that this test is intended to calculate differences in the population mean. Further, Cramer and Bryman (2003) dictate that if the z statistic from the Mann-Whitney U test is significant, it indicates that at least one of the group's responses are different from the other.

CHAPTER 5

DATA ANALYSES AND RESEARCH FINDINGS

5.1. Introduction

This chapter presents the data analyses and findings. The chapter is organized in the following sequence. First, it begins with the response rate. Then, the respondents' profiles are highlighted through demographic analysis. This is followed by another section which is the reliability test. Lastly, the statistical analyses are presented for each of the research objectives and research questions which have been formulated in the previous chapter.

5.2. Response Rate

The questionnaires were sent to the IBs' managers in Jakarta. In total, there were 100 questionnaires distributed to two ICBs and six CBsI. In each of the IBs, the researcher asked for one of the bank employees to distribute and collect the questionnaires. In order to have the respondents as required in this current study, the researcher provided the assigned employee with a brief explanation on the characteristics of the respondents¹⁶.

Out of 100 questionnaires distributed, 67 were returned. This has resulted in an overall response rate of 67 %. Although, most of the questionnaires returned were completed,

¹⁶ Please refer to Section 4.4, Respondents' Background and Sample Selection.

there were two incomplete questionnaires. However, the incomplete questionnaires are still considered usable since the uncompleted questions did not affect the overall analysis. Table 5.1 provides a summary of the overall response rate for each of ICB and CBI.

Table.5.1. Overall Response Rate

No	Respondents	Total Distributed		Total Received		Total Used	
		No	%	No	%	No	%
1	Bank Muamalat Indonesia (BMI)	20	20.0	11	16.4	11	16.4
2	Bank Syariah Mandiri (BSM)	20	20.0	9	13.4	9	13.4
3	Islamic Banking Unit-Bank Negara Indonesia (BNI)	10	10.0	8	11.9	8	11.9
4	Islamic Banking Unit-Bank Rakyat Indonesia (BRI)	10	10.0	6	9.0	6	9.0
5	Islamic Banking Unit-Bank Bukopin	10	10.0	9	13.4	9	13.4
6	Islamic Banking Unit-Bank IFI	10	10.0	9	13.4	9	13.4
7	Islamic Banking Unit-Bank International Indonesia (BII)	10	10.0	7	10.6	7	10.6
8	Islamic Banking Unit-Bank Danamon	10	10.0	8	11.9	8	11.9
	TOTAL	100	100.0	67	100.0	67	100.0

Table 5.1 obviously shows that the overall response rate is moderately high as it achieves 67 %. This result was achieved through rigorous follow up procedures and efforts. Before the questionnaires were distributed to each of the ICBs and CBSI, the researcher used a recommendation letter from the Director of the Directorate of Islamic Banking of Bank Indonesia. Then, the recommendation letter was sent directly to each of the IBs.

After having a recommendation letter, the researcher distributed the questionnaires to each of the IBs. The questionnaires were given to one employee in each of the IBs who is responsible for distributing and collecting from the targeted respondents. Most of the respondents promised to return the questionnaires within ten to fifteen days.

Thus, on the agreed day, the researcher collected the questionnaires from the assigned employee in each IB.

Unfortunately, there were still two IBs which still had not returned the questionnaires in the targeted time frame. Then, the researcher made a follow up with the assigned employee of those two IBs. Finally, the researcher managed to obtain the questionnaires from those two IBs in the following week. These procedures in distributing and collecting the questionnaires took about one month.

In addition, as mentioned before, the researcher contacted the SAs through their personal phone numbers, in order to have appointments for the interviews. However, after almost one month, out of twenty-one names of SAs, the researcher could only manage to interview six of them. This is because the difficulty to arrange the time for interviews with most of the SAs since they had many and various activities.

The interview was conducted for 30 minutes to one hour for each of the SAs. Two out six SAs were interviewed in their houses whereas the other four in their offices. Each of the interviews was recorded using a tape recorder. However, since there was one interview which could not be heard clearly, the researcher decided not to use it in this study. Thus, in the end, there are only five SAs who participate in this study¹⁷.

Although there are about nineteen questions on the list, the researcher summarised the questions into thirteen questions. This is because there are some questions which cover similar issues or topics¹⁸.

¹⁷ In this current study, these five interviewee *Shari'ah* Advisors are termed as SA1, SA2, SA3, SA4 and SA5.

¹⁸ Please refer to APPENDIX VI, Interview Summary.

5.3 Demographic Analysis

Since the study is designed to get the overall perception of the IB managers on the responsibility and independence of SAs and the *Shari'ah* review process and also to compare the perceptions of those three issues between the IB managers who work at ICB and those who work at the CBI, the analysis of respondents' background and their characteristics is presented in three different columns; first, the overall respondents; second, the respondents from ICB and three, the respondents from CBI.

It is revealed that in term of type of IB, 29.9 % from the overall respondents work at the ICB while 70.1 % from the overall respondents work at the CBI (please refer to Table 5.2 below).

Table 5.2 Type of Islamic Bank

Type of Islamic Bank	All	
	N	%
Islamic Commercial Bank (ICB)	20	29.9
Conventional Bank that offers an Islamic Banking Scheme (CBI)	47	70.1
Total	67	100.0

In this present study, the respondents are requested to answer five basic questions regarding sex, age, working experience, occupation and educational background. The analysis of respondents' background and their characteristics is presented as follows:

Table 5.3 Respondents' Gender

Gender	All		ICB		CBI	
	N	%	N	%	N	%
Male	49	73.1	13	65.0	36	76.6
Female	18	26.9	7	35.0	11	23.4
Total	67	100.0	20	100.0	47	100.0

Note: ICB is Islamic Commercial Bank

CBI is Conventional Bank that offers an Islamic Banking Scheme

Table 5.3 shows the majority (73.1 %) of the overall respondents are male whereas 26.9 % are female. The gender composition of the ICBs' and CBI's respondents is similar to the gender composition of the overall respondents. Hence, the majority of the respondents in this study are male.

The respondents' age, occupation, educational background and working experience are provided in Tables 5.4 and 5.5 below:

Table 5.4 Respondents' Age and Occupation

	All		ICB		CBI	
	N	%	N	%	N	%
Age Group						
20-29	12	17.9	3	15.0	9	19.1
30-39	29	43.3	8	40.0	21	44.7
40-49	22	32.8	8	40.0	14	29.8
50-59	4	6.0	1	5.0	3	6.4
Total	67	100.0	20	100.0	47	100.0
Occupation						
Director/Deputy Director	5	7.5	4	20.0	1	2.1
Head of Division/Unit	16	23.9	6	30.0	10	21.3
Bank Manager	8	11.9	1	5.0	7	14.9
Bank Officer	27	40.3	7	35.0	20	42.6
Others	3	4.5	0	0.0	3	6.4
N/A	8	11.9	2	10.0	6	12.8
Total	67	100.0	20	100.0	47	100.0

Note: ICB is Islamic Commercial Bank

CBI is Conventional Bank that offers an Islamic banking scheme

Table 5.5 Respondents' Working Experience

	All		ICB		CBI	
	N	Mean	N	Mean	N	Mean
Working Experience						
Current Position	63	2.0963	19	2.7937	44	1.7952
Working Experience in IB	63	3.6654	19	5.5426	44	2.8548
Total Working Experience in Banking	65	10.8931	20	11.7820	45	10.4980

Note: ICB is Islamic Commercial Bank

CBI is Conventional Bank that offers an Islamic banking scheme

Table 5.4 shows that 43.3 % of the total overall respondents are between 30 and 39 years old while 32.8 % are within a range of 40-49 years old. Furthermore, it is found that the age composition of the ICB's and the CBI's respondents seems to be similar to the age composition of the overall respondents.

Furthermore, Table 5.4 also provides information on the respondents' occupation. It shows that 40.3 % of the overall respondents act as bank officers while the other 31.4 % act as heads of division/unit and directors/deputy directors. Although, there are a few of the overall respondents (4.5 %) who have an occupation named as others and some of the overall respondents who did not response the question on occupation (11.9%), the majority of the overall respondents are assumed to be closely involved with the operation of the IBs.

Table 5.5 provides the information of the respondents' working experience. It shows that that the overall respondents have worked in the banking industry on average for around 10.89 years whereas the average working experiences of overall respondents in the Islamic banking industry is about 3.66 years. In addition, the average total working experience of the ICB's respondents (5.54 years) in the Islamic banking industry is slightly longer compared to the CBI's respondents (2.85 years). This finding is just as expected since most of the CBsI were established after 1999.

Since the current study is intended to obtain the respondents' perceptions, the analysis of the respondents' educational background and specialization is quite important. Table 5.6 shows that 61.2 % of the overall respondents hold a bachelor's degree whereas the other 28.4 % hold a master's degree. It is also revealed that 45 % ICB's

respondents hold a master's degree whereas only 21.3 % of CBI's respondents who hold a master's degree. However, the majority of the respondents of ICB and CBI hold a bachelor's degree (50.0 % and 68.1% respectively).

Table 5.6 Respondents' Educational Background and Specialization

	All		ICB		CBI	
	N	%	N	%	N	%
EDUCATIONAL BACKGROUND						
Diploma	5	7.5	0	0.0	5	10.6
Bachelor Degree	42	62.7	10	50.0	32	68.1
Master Degree	19	28.3	9	45.0	10	21.3
Not Available	1	1.5	1	5.0	0	0.0
Total	67	100.0	20	100.0	47	100.0
SPECIALIZATION						
BACHELOR DEGREE						
Accounting	12	28.6	3	30.0	9	28.1
Islamic Study	1	2.4	1	10.0	0	0.0
Marketing	3	7.1	2	20.0	1	3.1
Economics	4	9.5	0	0.0	4	12.5
Finance	4	9.5	0	0.0	4	12.5
Law	7	16.7	1	10.0	6	18.8
Others (e.g. Agribusiness, Engineering, Fishery)	11	26.2	3	30.0	8	25.0
Total	42	100.0	10	100.0	32	100.0
MASTER DEGREE						
Marketing	4	21.1	1	11.1	3	30.0
Finance	6	31.6	4	44.4	2	20.0
Business Administration	6	31.6	3	33.3	3	30.0
Islamic Economics and Finance	2	10.5	1	11.1	1	10.0
Others (e.g. Industrial Engineering)	1	5.3	0	0.0	1	10.0
Total	19	100.0	9	100.0	10	100.0

Note: ICB is Islamic Commercial Bank

CBI is Conventional Bank that offers an Islamic Banking Scheme

Table 5.6 shows that the overall respondents have different specializations either at the bachelor's degree or master's degree level. 28.6 % of the overall respondents hold a bachelor's degree specialized in accounting, whereas the other 16.7 % specialized in law. It is also found that 26.2 % of the overall respondents have a bachelor's degree specialized in Agribusiness, Engineering and Fishery. Unfortunately, there are only 2.4 % of the overall respondents with a bachelor's degree specialized in Islamic Studies. However, 10.5 % of the overall respondents have a master's degree with a

specialization in Islamic economics and finance, whilst the other 63.2 % specialized in Finance and Business administration.

The respondents were also asked whether they are aware with the existence of SAs of IB in Indonesia, it appears that all respondents are aware with the existence of SAs. Further, based on the analyses on the respondents' age, occupation, working experience, educational background and specialization, it is concluded that the respondents are considered suitable to give their views on the responsibility and independence of SAs and the *Shari'ah* review process of IB in Indonesia.

5.4 Reliability Test

According to Davis (2000) a reliability test is performed to ensure that the responses obtained are reliable. This current study has adopted an internal reliability method using Cronbach's Alpha. According to Sekaran (2003), Cronbach's Alpha within 0.7 is acceptable and those over 0.8 are considered good. As shown in Figure 5.1, an internal reliability test was conducted for Section 3.1 of the questionnaire on Responsibility of SAs of IBs in Indonesia.

Reliability tests were carried out for Section 3.1 of the questionnaire on responsibility of SAs of IBs in Indonesia. The result of reliability test is presented below:

Figure 5.1 Reliability Test for Section 3.1 of the Questionnaire on Responsibility of SAs of IBs in Indonesia

R E L I A B I L I T Y A N A L Y S I S - S C A L E (A L P H A)	
Reliability Coefficients	
N of Cases =	67.0
N of Items =	2
Alpha =	.9134

The reliability test was conducted on statement No. 1 and 2 of Section 3.1 of the questionnaire. This is because the statement No. 1 and 2 have a quite similar issue. It is known that the reliability value between statement No 1 and 2 is significantly high as the reliability value is 0.9134. This means all of the respondents' responses are consistent. For example, if a respondent agrees with statement No. 1, he/she should also agree with statement No.2 and vice versa. As result, the reliability value of the section 3.1 of the questionnaire on responsibility of IBs in Indonesia indicates that all of the respondents understand all of the statements.

The reliability test is also carried for Section 5.1 of the questionnaire on procedures of *Shari'ah* review that need to be taken by the SAs in order to conduct a proper *Shari'ah* review. The result of reliability test is presented below:

Figure 5.2 Reliability Test for Section 5.1 of the Questionnaire on Procedures of *Shari'ah* Review

R E L I A B I L I T Y A N A L Y S I S - S C A L E (A L P H A)	
Reliability Coefficients	
N of Cases =	66.0
N of Items =	2
Alpha =	.8721

The reliability test was conducted on statement No.2 and 3 of Section 5.1 of the questionnaire. This is because the statement No. 2 and 3 have a quite similar issue. It is found that the reliability value between statements no 2 and 3 is significantly high as the reliability value is 0.8721. This means that all of the respondents' responses are consistent. For example, if a respondent agrees with statement no. 2, he/she should also agree with statement no.3 and vice versa. Therefore, the reliability value of the Section 5.1 of the questionnaire on procedures of *Shari'ah* review that need to be taken by the SAs in order to conduct a proper *Shari'ah* review of IBs in Indonesia indicates that all of the respondents understand all of the statements. As a result, with reference to Davis (2000), all of the respondents' responses can be considered as very reliable.

5.5. Statistical Analyses for Each of the Research Objectives and Research Questions

5.5.1. Research Objective No. 1

The first research objective in this current study is to examine the importance of the SAC of IBs in Indonesia. As mentioned before, there are three research questions emerging from this first objective as follows:

Table 5.7 Research Questions Emerging from Research Objective No.1

Research Questions
No.1 <i>What are the benefits of the existence of SAC?</i>
No. 2 <i>What are the characteristics of SAs of IBs in Indonesia?</i>
No. 3 <i>Are there any significant differences between the perceptions of ICB's respondents and CBI's respondents on the importance of SAC of IB in Indonesia?</i>

The view of the respondents on Research Question No.1 (RQ1) can be scrutinized from their responses to the statements contained in the Section 2.1 of the questionnaire on benefits that can be derived from the existence of SAC.

Table 5.8 Benefits Derived from the Existence of SAC

Statement	All		ICB		CBI		p Value
	N	Mean	N	Mean	N	Mean	
1 To provide the Islamic banks' and Islamic banking scheme's banks' stakeholders a credible and reliable body which ensures that all activities and transactions of the banks are in compliance with the <i>Shari'ah</i> principles.	67	4.55	20	4.65	47	4.51	.071
2 To provide guidance such as fatwa and rulings which are related with the <i>Shari'ah</i> compliance of Islamic banks' and Islamic banking scheme's banks' activities and transactions.	67	4.45	20	4.35	47	4.49	.489
3 To provide advices which are related with the <i>Shari'ah</i> compliance of Islamic banks' and Islamic banking scheme's banks' activities and transactions.	67	4.64	20	4.80	47	4.57	.139

Table 5.8 Continued

Statement	All		ICB		CBI		p Value
	N	Mean	N	Mean	N	Mean	
4 To provide and perform trainings which are related with the <i>Shari'ah</i> compliance of Islamic banks' and Islamic banking scheme's banks' activities and transactions.	65	3.58	19	3.58	46	3.59	.977

Note: ICB is Islamic Commercial Bank

CBI is Conventional Bank that offers an Islamic banking scheme

The results presented in Table 5.8 show that the mean scores of the overall respondents on three benefits are moderately high. These benefits are (1) to provide the IB's stakeholders with a credible and reliable body which ensures that all of the IB's transactions and activities are in compliance with *Shari'ah* principles (4.55); (2) to provide the IB with *fatwa(s)* and guidelines (4.45); and (3) to provide the IB with advice which is related with the *Shari'ah* compliance of IB's activities and transactions (4.64).

The mean scores of these three benefits indicate that the overall respondents perceived that the existence of SAC in IB will ensure the IB's stakeholders that the operations of IB are in compliance with *Shari'ah* principles. In addition, the overall respondents perceived that the existence of SAC is expected to provide the IB with *fatwa(s)* and guidelines as well as advices. These perceptions support the view of Banaga et al. (1994) who argue that the SAs are responsible to answer enquiries to issue formal legal opinions according to the Islamic law and enquiries submitted by the management of IBs or any other interested party; to review and to revise all the dealings and transactions which the bank enters into with clients; and to ensure that

those particular dealings and transactions are in compliance with Islamic rulings and principles.

These results seem to be against the current Islamic banking practices in Indonesia. IUC (1999) clearly states that the right to release and provide *fatwa(s)* for IBs is that of the NSC-IUC. In addition, the NSC-IUC (2000) states that SAs are not allowed to provide any guidelines for the IBs. This means that the SAs are prohibited from issuing any *fatwa(s)* and guidelines for the IBs. Nonetheless, the NSC-IUC (2000) still allows the SAs to provide the IBs with advice.

However, in certain cases, some IBs' transactions are still not clearly covered by any *fatwa(s)* provided by the NSC-IUC. According to SA no 4 (SA4) and SA no. 5 (SA5)¹⁹, in order to solve that problem, the management of IBs usually request the SAs' opinions on those particular transactions. If the SAs conclude those particular transactions do not contradict with *Shari'ah* principles, the management of the IBs will directly execute the transaction without waiting for a formal *fatwa(s)* issued by the NSC-IUC. This current situation has possibly affected the perceptions of IB managers on the benefits derived from the existence of SAC. Therefore, the overall respondents perceived strongly that the existence of SAC is expected to provide the IB not only with advice but also with *fatwa(s)* and guidelines.

Based on the mean score, Table 5.8 also shows that the overall respondents (3.58) tend to agree if the existence of SAC provides the IB with training related with the *Shari'ah* compliance of the IB's activities and transactions. According to a survey

¹⁹ Please refer to the APPENDIX VI Section A, Responsibility of SAs

study on the educational background of human resources of IBs in Indonesia conducted by the University of Indonesia (2003), it is found that most of the IBs' employees in Indonesia do not have any formal educational background either in Islamic studies or Islamic banking and finance. This survey is supported with the educational backgrounds of the overall respondents in this present study as it is found that only 2.4 % and 10.5 % of the respondents who have a bachelor's and master's degree specialised in Islamic studies.

Therefore, as soon they were recruited, the IBs required all of their employees to undertake a short training course in Islamic studies and Islamic banking and finance held by a private consultant. In this short training course, the new employees are usually taught about the nature and operations of IB. However, this short training course does not seem to be sufficient for the IB managers. Thus, the overall respondents tend to agree that the existence of SAC can provide the IB with training related with the *Shari'ah* compliance of IBs' activities and transactions.

In addition, the RQ2 basically aimed at obtaining the overall respondents' views on the characteristics of SAs of IBs in Indonesia. The overall respondents were asked to give their responses to statements included in Section 2.2 of the questionnaire.

Table 5.9 Characteristics of SAs of IBs

Statement	All		ICB		CBI		p Value
	N	Mean	N	Mean	N	Mean	
1 <i>Shari'ah</i> Advisory Council of Islamic banks and Islamic banking scheme banks should consist of <u>at least</u> three members.	67	4.06	20	4.20	47	4.00	.930
2 Members of <i>Shari'ah</i> Advisory Council of Islamic banks and Islamic banking scheme banks should have good expertise and knowledge on <i>Shari'ah</i> rulings and fiqh muamalah.	67	4.78	20	4.95	47	4.70	.111
3 Members of <i>Shari'ah</i> Advisory Council of Islamic banks and Islamic banking scheme banks should have a formal religious (<i>Shari'ah</i> and fiqh muamalah) degree.	67	4.18	20	4.55	47	4.02	.074
4 Members of <i>Shari'ah</i> Advisory Council of Islamic banks and Islamic banking scheme banks should have enough experiences on Islamic banking activities and transactions.	67	4.63	20	4.85	47	4.53	.207
5 Ideally, members of <i>Shari'ah</i> Advisory Council of Islamic banks and Islamic banking scheme banks should have at least three different educational backgrounds such as <i>Shari'ah</i> (fiqh Muamalah), economic and law (positive law).	67	4.46	20	4.70	47	4.36	.118

Note: ICB is Islamic Commercial Bank
 CBI is Conventional Bank that offers an Islamic banking scheme

Table 5.9 shows that the overall respondents agreed with all of the statements considered as the characteristics of SAs of IBs in Indonesia. Furthermore, there are at least three characteristics which the overall respondents perceived as the most important characteristics of SAs (the mean scores are above 4.5). These characteristics are (1) SAs must have a good knowledge and skills in *Shari'ah* (*fiqh al-mu'āmalah*); (2) SAs must have a good knowledge about the IBs' transactions and activities; and (3) Ideally, SAs should have at least three different educational backgrounds.

The first-two findings indicate that the overall respondents expected that the SAs who are expert in *Shari'ah (fiqh al-mu'amalah)* and Islamic banking transactions and activities are able to guide and supervise the IBs in following *Shari'ah* principles. This perception of the overall respondents is in parallel with the opinions of SAs of IBs in Indonesia. All of the Shari'ah Advisors involved in the interview (to be termed as SA1, SA2, SA3, SA4 and SA5)²⁰ fully supported the idea that the SAs of IBs should have expertise in *Shari'ah (fiqh al-mu'amalah)* and Islamic banking transactions. Accordingly, a fully *Shari'ah* compliant IB as one of the objectives stated in the blueprint of development of IBs in Indonesia can be achieved.

In addition, the first-two findings are in parallel with the definition of SAC proposed by the AAOIFI Governance Standard (2002b). However, the AAOIFI Governance Standard (2002b) claims that it is difficult to find a person who is an expert in *Shari'ah* as well as in economics and finance. Thus, AAOIFI Governance Standard (2002b) allows the appointment of a person who is not expert in *Shari'ah (fiqh al-mu'amalah)* but he/she must be an expert in the field of IFIs.

According to Abdallah (2002), the appointment of an Islamic jurist as a SA of an IB who is not properly qualified in Islamic commercial law is allowed during the early stage of the development of the IBs. Nevertheless, as the IBs have developed rapidly, the demand for a SA who is an expert in Islamic commercial law becomes significantly higher. This is because such a SA is deemed to be more able to apply the *Shari'ah* principles in the modern banking practices (Abdallah, 2000).

²⁰ Please refer to APPENDIX 8 Section B, Characteristics of SAs.

Given this circumstance whereby it is difficult to have a person who is an expert in *Shari'ah (fiqh al-mu'amalah)* as well as in Islamic finance, BI (2004b) has allowed a person who has knowledge in *Shari'ah (fiqh al-mu'amalah)* and banking activities to be a SA of an IB. This is supported by the NSC-IUC (2000) which suggests that members of SAC can be selected either from Islamic jurist or practitioners in Islamic banking and finance.

Since it is very difficult to have a person who is an expert in *Shari'ah (fiqh al-mu'amalah)* and Islamic banking operations in Islamic banking practices in Indonesia, therefore, the overall respondents strongly perceived that, as the mean score is 4.46, the SAs' educational backgrounds should consist of three different areas of knowledge such as *Shari'ah*, Law (positive law) and Economics. However, Bakar (2002) argues that the idea that SAs' educational backgrounds should consist of three different areas of knowledge is considered as a short term solution to solve the difficulty to have a SA who is an expert in *Shari'ah* as well as in Islamic banking transactions. This means that the requirement to have a person who is an expert in *Shari'ah* as well as in Islamic banking and finance in the long term is unavoidable.

Realising this situation, some higher institutions (e.g. TAZKIA Institute, SEBI, PKTTI-University of Indonesia, etc.) in Indonesia have started to offer a programme which integrates the *Shari'ah* and economics. Therefore, it is expected that this programme will produce a person who is an expert in *Shari'ah* as well as in economics (banking and finance).

In general, these three perceptions of the overall respondents show that the SAs are expected to perform not only the *ex ante* audit but also the *ex post* audit. Consequently, the SAs should be able to read/understand the IBs' financial reports. This is because in many cases, issues related with the *Shari'ah*, law and economics are overlapping (Bakar 2002). Similarly, SA4 and SA5 stated that the SAs should also understand the accounting aspects of Islamic banking activities and transactions.

There are two other characteristics of SAC mentioned in Table 5.9, such as the number of SAC members and the formal educational degree of SAC members of IBs. Although, the mean scores of these two characteristics are considered high (the mean score is 4.06 and 4.18 respectively), they are still lower than the mean scores of the other three characteristics as discussed earlier.

The mean score on the number of SAC members shows that the overall respondents perceived that the minimum number of SAC members should be three. This finding is a little bit different from the current situation as the number of SAC of IBs in Indonesia varies from two to four members²¹. Nevertheless, it is obviously known that most of the IBs in Indonesia have at least three SAs. This particular situation is in line with a survey conducted on more than 60 IFIs in all over the world by the IIT (1996) as they found that more than 70 % of IFIs have three SAs.

However, SA4 and SA5 argue that number of SAs depends on the size of that particular IB. Further, SA4 and SA5 are of the opinion that minimum number of SAs for each IB (either ICB or CBI) is three. This is because, in certain cases, the SAs

²¹ Please refer to APPENDIX VI Section C, Number of SAs.

need to conduct voting in the event of a dispute of *Sharī'ah* matters. The need to have at least three members of SAs is also urged by a spirit that SAs are not only responsible to advise the management of IBs but also to supervise the IBs' transactions in compliance with the *Sharī'ah* (*fatwa(s)*) issued by NSC-IUC (NSC-IUC Decree No. 02/2000). This finding departs from Bakar's (2002) opinion who argues that in the case of Malaysia, the Islamic window just need to have one SA since he/she must refer to the *fatwa* released by the National *Sharī'ah* Advisory Council of Bank Negara Malaysia (NSAC-BNM). Therefore, Bakar (2002) claims that there is no urgent need to have three SAs in an Islamic window.

The overall respondents also perceived that the SAs should have at least a bachelor's degree in *Sharī'ah* (*fiqh al-mu'āmalah*). This result supports Bakar's (2002) opinion as he argues that it is a must for a person who is appointed as a SA to have a certain degree of knowledge in Islamic commercial law. The overall respondents believed that by having a bachelor degree in *Sharī'ah*, it can be safely assumed that the SAs have a good expertise in *Sharī'ah* (*fiqh al-mu'āmalah*).

This finding implies that every SAs of IBs in Indonesia should have sufficient knowledge and skills in *Sharī'ah* (*fiqh al-mu'āmalah*) although he/she is considered as a scholar in general knowledge of Islam. Nonetheless, the researcher views that the requirement to have at least bachelor degree (S-1) in *Sharī'ah* (*fiqh al-mu'āmalah*) for a person to be appointed as a SA is not sufficient to determine that he/she has a sufficient knowledge and skills in *Sharī'ah* (*fiqh al-mu'āmalah*). Therefore, all of the SA nominees should be subject to the fit and proper test (through interview) conducted jointly by the NSC-IUC and BI.

Furthermore, another research question (RQ3) aimed to test whether there are any significant differences between the perceptions of ICB's and CBI's respondents on the importance of SAC of IB in Indonesia. The study compares the mean score of each group of respondent and conducts a non parametric statistical test which is known as the Mann-Whitney *U* test. The Mann-Whitney *U* test is required because the distribution of data in each group of respondents is not normal.

The Mann-Whitney *U* test revealed that the differences of the mean score between the perceptions of ICB's and CBI's respondents on three benefits derived from the existence of SAC are not significant at 10 % level. These three benefits are (1) to provide the IB with *fatwa(s)* and guidelines; (2) to provide the IB with advice and (3) to provide the IB with training related to the *Sharī'ah* compliance of IB's transactions. Similarly, it is also discovered that the differences of the mean score between the perceptions of ICB's and CBI's respondents on four characteristics of SAs are not significant at level 10 %. These four characteristics are (1) the minimum number of SAs in an IB is three; (2) SAs must have a good knowledge of and skills in *Sharī'ah*; (3) SAs must have a good knowledge about IBs' transactions and activities; and (4) the SAs' educational backgrounds consist of three different areas of knowledge.

Nonetheless, the differences of the mean scores between the perceptions of ICB's (4.65 and 4.55) and CBI's respondents (4.51 and 4.02) on (1) the benefit derived from the existence of SAC where the SAC is expected to provide the IB with a credible and reliable body which ensures that the IB's activities and transactions are in compliance with *Sharī'ah* principles; and (2) the characteristics of SAs whereby the SAs must have at least a bachelor's degree in *Sharī'ah (fiqh al-mu'āmalah)* are significantly

different at 10 % level. Therefore, these findings indicate that ICB's respondents are more concerned than CBI's respondents on the issue of *Shari'ah* compliance in all of IB's transactions.

There are two possible reasons to rationalise this finding. First, ICB's respondents wish to maintain the corporate image as the bank whose transactions and activities must be in compliance with *Shari'ah* principles. Second, the average working experience in the Islamic banking industry of ICB's respondents is longer than that of the CBI's respondents'. Thus, ICB's respondents are better informed about the Islamic financing modes and knowledge as compared to their counterparts in CBI. As a result, the ICB's respondents may have a better understanding of the operations of IB than the CBI's respondents.

5.5.2 Research Objective No.2

The second research objective explores issues related to the responsibility of the SAs of IBs. In addition, this research objective is meant to examine the legal and religious/social responsibility of the SAs. There are four research questions emerged from this objective as follows:

Table 5.10 Research Questions Emerging from Research Objective No.2

Research Questions
No.4 <i>What are the responsibilities of the SAs of IBs in Indonesia?</i>
No. 5 <i>To whom should the SAs of IBs in Indonesia be legally responsible?</i>
No. 6 <i>To whom should the SAs of IBs in Indonesia be religiously/socially responsible?</i>

Table 5.10 Continued

Research Questions
No.7 <i>Are there any significant differences between the perceptions of ICB's respondents and CBI's respondents on the responsibilities of SAs of IBs in Indonesia?</i>

The view of the respondents on Research Questions No.4 (RQ4) can be analysed from their responses on statements contained in section 3.1 of the questionnaires.

Table 5.11 Responsibilities of SAs of IBs

Statement	All		ICB		CBI		p Value
	N	Mean	N	Mean	N	Mean	
1 To monitor and confirm that all the Islamic banks' and Islamic banking scheme's banks' <u>activities</u> and <u>transactions</u> are in conformity with Islamic <i>Shari'ah</i> principles.	67	4.72	20	4.65	47	4.74	.700
2 To monitor and confirm that all the Islamic banks' and Islamic banking scheme's banks' <u>products</u> are compatible with Islamic <i>Shari'ah</i> .	67	4.78	20	4.75	47	4.79	.350
3 To monitor and confirm that the Islamic banks' and Islamic banking scheme's banks' transactions are in conformity with Islamic <i>Shari'ah</i> principles on the basis of sample.	67	4.28	20	4.40	47	4.23	.400
4 To monitor and confirm that all the Islamic banks' and Islamic banking scheme's banks' products are compatible with Islamic <i>Shari'ah</i> on the basis of sample.	67	4.13	20	3.90	47	4.23	.701
5 To examine the appropriateness of the <i>Shari'ah</i> basis of allocation of profit between the equity holders and the investment account holders.	67	4.52	20	4.70	47	4.45	.023
6 To ensure that all of earnings generated by the Islamic banks are in accordance with <i>Shari'ah</i> principles.	67	4.75	20	4.95	47	4.66	.020
7 To examine whether calculation of the Islamic banks' and Islamic banking scheme's banks' <i>zakāt</i> obligation is in compliance with Islamic principles	67	4.51	20	4.75	47	4.40	.093

Note: ICB is Islamic Commercial Bank
CBI is Conventional Bank that offers an Islamic banking scheme

Based on the mean scores of those responsibilities of SAs of IBs in Indonesia (all of them are above 4.00), the overall respondents perceived that the SAs must perform all of responsibilities as presented in Table 5.11. However, the mean score for the five responsibilities are significantly high, such as: (1) to monitor and ensure all of IB transactions and activities are in line with the *Shari'ah* (4.72); (2) to monitor and ensure all of IB products are in line with the *Shari'ah* (4.78); (3) to evaluate whether the profit sharing methods are in line with the *Shari'ah* (4.52); (4) to ensure that all of IB revenues are in line with the *Shari'ah* (4.75); and (5) to evaluate whether the zakāt calculation of IB are in line with the *Shari'ah* (4.51). Therefore, these findings are in accordance with the responsibilities of SAs as proposed by some scholars (such as Abu Moamer, 1989; Abdallah, 1994; Banaga et al. 1994; AAOIFI Governance Standard, 2002b; and Bakar, 2002)²².

However, in the case of Indonesia, the NSC-IUC (2000) states that the SAs are responsible for supervising the IBs' products and transactions in following *fatwa(s)* issued by the NSC-IUC. Thus, the scope of SAs' responsibility as defined by the NSC-IUC focuses solely on whether *'aqd* and products offered by IBs are in compliance with *fatwa(s)* issued by the NSC-IUC. On the other hand, BI (2004b) states that the SAs should be responsible for ensuring not only the accordance of the IBs' products but also the accordance of IBs' activities and transactions with *Shari'ah* principles.

As for the views of the overall respondents as to whom SAs should be legally responsible (RQ5), the mean scores for four groups are relatively low. Table 5.12

²² Please refer to Section 3.3, Role of the SAC.

shows that the mean scores for these five groups are as follows: (1) depositors (2.66), (2) customers' financing (2.99), (3) directors (3.22), and (4) shareholders (3.26).

Although, the depositors and customers financing are also considered as the most important stakeholders, the depositors and customers financing usually do not have a direct legal relationship with SAs. Furthermore, the depositors group is not homogenous and there is no formal agreement that institutionalises the depositors through a body recognised by the banking law of the country. As for the directors, the SAs have a direct advisory capacity to advise the management of IBs on *Shari'ah* matters while it is similar for the shareholders where SAs always have a regular meeting with the board commissioners (who represent the shareholders) to discuss issues related with the *Shari'ah* compliance in all of IBs' activities and transactions²³, the overall respondents viewed that this responsibility as internal matter and understood within organizational structure and accountability of IBs. Therefore, the overall respondents perceived that the SAs should not be legally responsible to depositors, customers financing, directors and shareholders.

Table 5.12 also shows that the mean scores of overall respondents on the other three parties to whom SAs of IBs in Indonesia should be legally responsible are moderately high. These three parties are (1) Muslim society (3.74), (2) regulators (e.g. Bank Indonesia) (3.98) and (3) the NSC-IUC (4.55). As for the Muslim society, the overall respondents believed that IBs really rely on the confidence of the external stakeholders on the Islamic banking activities. Based on the mean score of overall

²³ SA1, SA2 and SA3 opine that if the SAs of IBs in Indonesia find that the management keep performing unlawful transactions although SAs have written a memo to remind the management, SAs will meet the board of commissioners to discuss about this particular issue. Please refer to APPENDIX VI Section M, Procedures Taken by SAs if They Found the IBs Break the *Shari'ah*.

respondents for Muslim society, therefore, the overall respondent might have viewed that the Muslim society could be assumed to represent the external stakeholders of IBs in Indonesia.

As for the NSC-IUC and BI, the existence of SAs has a legal relationship with the NSC-IUC and BI. According to the NSC-IUC (2000) SAs are the representatives of NSC-IUC at the IBs. Thus, SAs are required to submit a report on the products and transactions of the IBs that they supervise to the NSC-IUC at least once a year. Therefore, the overall respondents perceived strongly that the SAs should be legally responsible to the NSC-IUC. At the same time, the overall respondents realised that as the Central Bank, BI is the single authoritative body which is responsible for monitoring and supervising the operations all of banks in Indonesia. Therefore, the overall respondents tend to agree that the SAs of IBs in Indonesia should be legally responsible to BI.

Table 5.12 also shows that the overall respondents' mean score for BI is moderately lower as compared to the mean score for the NSC-IUC. After the amendment of the Banking Act in 1998, a new ICB and some CBI were established²⁴. Since each of the IBs (ICB or CBI) has a SAC, IUC has established a NSC in 1999. According to Suma (2002) NSC-IUC is intended to harmonise the *Shari'ah* matters related to the operations of IBs in Indonesia. Since the NSC-IUC claims that the existence of SAC represents the NSC-IUC, furthermore, the NSC-IUC requires the SAs of IBs in Indonesia to submit a report to the NSC-IUC at least once a year (NSC-IUC Decree No. 2/2000).

²⁴ Please refer to Section 2.4, Development of Islamic Banks in Indonesia.

Table 5.12 Views about to Whom SAs Should be Legally, Religiously and Socially Responsible

Statement	Legally						p Value	Religiously/Socially						p Value
	All		ICB		CBI			All		ICB		CBI		
	N	Mean	N	Mean	N	Mean		N	Mean	N	Mean	N	Mean	
1 Depositors (e.g. <i>Wadhī'ah</i> and <i>Mudārabah</i>)	67	2.66 (7)	20	2.20 (7)	47	2.85 (7)	.031	66	4.35 (3)	20	4.35 (3)	46	4.35 (4)	.156
2 Shareholders	67	3.26 (4)	20	2.70 (4)	46	3.50 (5)	.021	66	4.26 (6)	20	4.05 (5)	46	4.35 (5)	.994
3 Directors	67	3.22 (5)	20	2.55 (5)	45	3.51 (4)	.008	66	4.20 (7)	20	3.90 (7)	46	4.33 (7)	.606
4 Regulators (e.g. Bank Indonesia)	67	3.98 (2)	20	3.55 (3)	46	4.17 (2)	.738	66	4.29 (5)	20	3.95 (6)	46	4.43 (3)	.751
5 National <i>Shari'ah</i> Council-Indonesian <i>Ulamā</i> Council (NSC-IUC)	67	4.55 (1)	20	4.65 (1)	47	4.50 (1)	.355	66	4.61 (2)	20	4.45 (2)	46	4.67 (2)	.700
6 Customer financing	67	2.99 (6)	20	2.50 (6)	47	3.19 (6)	.046	66	4.32 (4)	20	4.25 (4)	46	4.35 (6)	.338
7 Muslim Public	67	3.70 (3)	20	3.60 (2)	47	3.74 (3)	.641	67	4.72 (1)	20	4.80 (1)	47	4.68 (1)	.220

Note: ICB is Islamic Commercial Bank

CBI is Conventional Bank that offers an Islamic banking scheme

Moreover, in the period from 2000 until in the early of 2004, the existence of SAC of IB in Indonesia is exclusively governed by the NSC-IUC Decree No. 02/2000, whilst BI just recently issued a rule No. 6/24/PBI/2004 in October 2004. Since the perceptions were only collected in September 2004, this particular BI rule had not yet been enacted. Therefore, the overall respondents perceived stronger that the SAs should be legally responsible to the NSC-IUC than to BI.

As for the view of the overall respondents as to whom the SAs should be religiously/socially responsible (RQ6), Table 5.12 shows that overall respondents perceived that the SAs should be religiously/socially responsible to all of the parties (the mean score for each of parties is above 4.00). Table 5.12 also shows that the mean scores for two groups are significantly high, such as the NSC-IUC (4.61) and Muslim Society (4.72).

As for the NSC-IUC, the overall respondents considered the NSC-IUC members as a group of pious people who have very good general knowledge of Islam and the *Shari'ah* (*fiqh al-mu'amalah*). Thus, the overall respondent believed that SAs should be religiously responsible to the NSC-IUC as a means of being religiously responsible to *Allah SWT*. As for the Muslim society, the overall respondents assumed that Muslim society represents all of the external stakeholders of IBs. Therefore, the overall respondent perceived stronger that the SAs should be religiously/socially responsible to the NSC-IUC and Muslim society groups as compared to other groups of stakeholders. This is supported by the opinions of SA2, SA3, SA4 and SA5 who opine that the SAs should be religiously/socially responsible to *Allah SWT*, the NSC-

IUC and Muslim society²⁵. The results support the views of Karim (1990b) and Banaga et al.'s (1994) as they argue that the IB managers normally rely on the confidence of the external stakeholders on all of IB's activities and transactions, as otherwise IB's might lose its customers, shareholders, depositors and potential customers from among the Muslim public.

Research Question No.7 (RQ7) examines whether there are significant differences between the perceptions of ICB's and CBI's respondents on the responsibility of the SAs of IBs in Indonesia. The researcher compares the mean scores of each group of respondents on (1) the responsibility of SAs and (2) the parties to whom SAs should be legally and religiously/socially responsible. Since the data of those two groups are not in normal distribution, the study has carried out a non parametric statistical test, the Mann-Whitney *U* test.

Table 5.11 shows that the mean scores for all of the responsibilities of the SAs of both groups of respondents are reasonably high (all of them are above 4.00). Based on the mean scores, there are differences between the perceptions of ICB's and CBI's respondents in all of the responsibilities of SAs. The mean scores of the CBI's respondents on the two general responsibilities of SAs: (1) to monitor and ensure all of IBs' transactions are in line with the *Shari'ah* (4.74) and (2) to monitor and ensure all of IBs products are inline with the *Shari'ah* (4.79) are somewhat higher than the mean scores of ICB's respondents (the mean scores are 4.65 and 4.75 respectively).

²⁵ Please refer to APPENDIX VI Section H, To Whom SAs should be Responsible.

Although after being tested with the Mann-Whitney U test, the differences are not significant at 10 % level, these results imply that the CBI's respondents really expected the SAs to perform those two general responsibilities. These results are possibly because the CBI's respondents realised that CBI are just a special (an Islamic) division (unit) of the Conventional banks. Therefore, the CBI's respondents perceived more strongly on those two general responsibilities of SAs, in order to convince the stakeholders that all of IBs activities and transactions are in accordance with *Shari'ah* principles.

On the other hand, the ICB's respondents perceived more strongly than the CBI's respondents on the three specific responsibilities of SAs. Table 5.11 shows that, the mean scores of ICB's respondents on those three specific responsibilities are as follows: (1) to evaluate whether the profit sharing methods are in line with the *Shari'ah* (4.70); (2) to ensure that all of IBs' revenues are in line with the *Shari'ah* (4.95) and (3) to evaluate whether the *zakāt* calculation of IBs' is in line with the *Shari'ah* (4.75) while the mean scores of CBI's respondents on those three specific are 4.45, 4.66 and 4.40 respectively. After being tested with the Mann-Whitney U test, it is found that the differences of the mean scores of both groups on those three specific responsibilities of SAs are significant at 10 % level.

The results imply that there is a greater expectation that the SAs should perform the specific responsibilities rather than the general responsibilities in order to convince the stakeholders that the operations of ICB are in accordance with *Shari'ah* principles. This is possibly because ICB's respondents assumed ICB's stakeholders have trusted that all of ICB's products and transactions should be in accordance with *Shari'ah*

principles, since the operations of ICB are exclusively governed by *Shari'ah* principles. Thus, the stakeholders of ICB expect that as fully-fledged IBs, ICB have to maintain their Islamic uniqueness in all of their operations and not only in their products and transactions. As a result, the ICB's respondents perceived strongly that the SAs should perform those three specific responsibilities.

Table 5.11 also shows that the mean scores of ICB's and CBI's respondents are different in the other two responsibilities of SAs of IBs in Indonesia, such as (1) to ensure that all of IBs' transactions are in accordance with the *Shari'ah* based on sampling method and (2) to ensure that all of IBs' products are in compliance with the *Shari'ah* based on sampling method. However, after being tested with Mann-Whitney *U* test, however, the differences are not significant at 10 % level.

Based on the mean score, the ICBs respondents (mean score is 4.40) perceived more strongly than the CBI's respondents (mean score is 4.23) on the responsibility of SAs where SAs are responsible for ensuring that all of IBs' transactions are in line with the *Shari'ah* based on the sampling method. This is possibly because the ICB is much bigger than the CBI in terms of networks²⁶, thus the ICB may have a lot of activities and transactions. Therefore, the ICB's respondents perceived strongly that the SAs should ensure that all of IBs' transactions and activities are in accordance with the *Shari'ah* based on the sampling method.

In contrast, based on the mean score, the ICB's respondents registered a slightly lower score (mean score is 3.90) as compared to the mean score of CBI's respondents (mean

²⁶ Please refer to Section 2.4, Development of the Islamic Banks in Indonesia

score is 4.23) on the responsibility of SAs of IBs in Indonesia for ensuring all of IBs' products are in compliance with the *Shari'ah* based on the sampling method. There are some possibilities to explain this result, such as: first, ICB's respondents expect that the SAs to ensure all of the IBs' products since the number of IBs products is relatively small as compared to the number of IBs' transactions and activities. In addition, the ICB's respondents believe that as fully-fledged IBs, ICB should demonstrate to the stakeholders that all of their products are in accordance with the *Shari'ah*. Therefore, the result shows that the ICB's respondents tend not to agree that the SAs of IBs in Indonesia review the products based on the sampling method.

Second, this result may also imply that the CBI respondents are not really concerned with the method (technique) used by the SAs in order to review either the transactions and activities or the products of IBs. This is because the mean scores of CBI's respondents on these two responsibilities of SAs are the same (the mean scores are 4.23). Since CBI is an Islamic unit of the Conventional bank, the CBI's respondents required the SAs in order to ensure the stakeholders that their products are in accordance with *Shari'ah* principles. Therefore, the CBI's respondents are more concerned about the issue that the SAs of IBs in Indonesia are responsible for reviewing the products rather than about the method (technique) used to review the products.

In order to answer RQ7, it is also required to compare the mean scores of ICB's and CBI's respondents as to whom the SAs of IBs in Indonesia should be legally and religiously/socially responsible. The mean scores of ICBs respondents and CBI respondents are different on all of the parties to whom SAs of IBs in Indonesia should

be legally responsible. Table 5.12 shows that the mean scores of ICB's respondents are somewhat lower on those parties such as: depositors (2.20), shareholders (2.70), directors (2.55), regulators (e.g. Bank Indonesia) (3.55), customer financing (2.50) and Muslim society (3.60) as compared to the mean scores of CBI's respondents (the mean scores for those six parties are 2.85, 3.50, 3.51, 4.17, 3.19 and 3.74 respectively). However, after being tested with the Mann-Whitney *U* test, it is revealed that there are significant differences between the mean scores of both groups only on (1) depositors, (2) customer financing (3) shareholders, and (4) directors at 10 % level.

As for the depositors and customers financing, although the differences on the mean scores of both groups are significant at 10 % level, the mean scores of both groups indicate that both groups did not agree that the SAs should be legally responsible to these two groups as deliberated earlier.

As for the shareholders and directors, the CBI's respondents tend to agree that the SAs should be legally responsible to the shareholders and directors. This is possibly because the SAs of CBI could not easily meet the directors and commissioners (who represent the shareholders) in order to discuss issues related with *Shari'ah* matters²⁷, although, the SAC of CBI has an indirect relationship with the directors and board of commissioners (shareholders) as mentioned in the organizational structure of the bank (Bank Danamon, 2003). Thus, the SAs have more and intensive interaction with the head of the Islamic banking division (unit) rather than with the directors and

²⁷ The CBI is only one special (Islamic) division (unit) within the bank where the size of the Islamic banking activities is infinitely smaller than the conventional banking activities.

commissioners²⁸. Therefore, ICBs respondents perceived stronger as compared to the perception of their counterparts in ICBs that SAs of IBs should be legally responsible to the directors and commissioners.

On the other hand, the ICB's viewed otherwise. This is possibly because, as fully-fledged bank, the directors and board of commissioners of ICB view the existence of SAC is very important in order to maintain the stakeholders' reliability on the bank's *Shari'ah* compliance. Thus, the directors and board of commissioners always have an intensive interaction with the members of SAC. In addition, this is also possibly because the SAC has a direct relationship with the directors and board of commissioners as mentioned in the organizational structure of the bank (BMI, 2003). Therefore, the ICB's respondents viewed that the SAs should not be legally responsible to the directors and shareholders.

Following the line of discussion above, it is revealed that the relationship between the SAC and the directors and the board of commissioners still varies in both types of bank (ICB and CBI). The results indicate that there is a need for regulators (e.g. BI and the NSC-IUC) to standardise this relationship since if it varies among the IBs in Indonesia, it may lead to different authorities, roles and functions of the SAC. However, a further study needs to elaborate on this issue.

As for the view of to whom the SAs of IBs in Indonesia should be religiously/socially responsible, Table 5.12 show that there are differences between the mean scores of both groups on all of the parties except on depositors. However, after being tested

²⁸ Please refer to APPENDIX VI Section I, J, L and M.

with the Mann-Whitney U test, the differences are not significant at 10 % level. These results indicate that both groups are of the same view that the SAs should be religiously/socially responsible to all of the stakeholders. Therefore, the IB can always maintain the confidence of the IBs stakeholders that all of IBs activities and transactions are in accordance with *Shari'ah* principles.

5.5.3 Research Objective No. 3

Research Objective No. 3 (RO3) is designed to examine the factors that may influence the independence of SA of IBs in Indonesia. This particular objective is equipped with three Research Questions. These Research Questions are presented in Table 5.13 as follow.

Table 5.13 Research Questions Emerging from Research Objective No. 3

Research Questions
No.8 <i>What are the factors that may improve the independence of the SAs of IBs in Indonesia?</i>
No. 9 <i>Who should appoint the SAs in order to improve the independence of the SAs of IBs in Indonesia?</i>
No. 10 <i>Are there any significant differences between the perceptions of ICB's respondents and CBI's respondents on the independence of the SAs of IBs in Indonesia?</i>

The overall respondents were also asked about factors that may improve the independence of SAs of IBs in Indonesia (RQ8). The perceptions of overall respondents on this particular issue are presented in table 5.14 below.

Table 5.14 Factors that may Improve the Independence of SAs

Statement	All		ICB		CBI		p Value
	N	Mean	N	Mean	N	Mean	
1 To perform their duties on part time basis as part time staff.	66	2.62	20	2.35	46	2.74	.169
2 To receive a remuneration only from Regulatory Body (e.g. Bank Indonesia).	67	3.46	20	3.25	47	3.55	.427
3 To be restricted from becoming member of National <i>Shari'ah</i> Council at the same time.	67	3.67	20	3.25	47	3.85	.263
4 To be restricted from becoming consultant, e.g. consultant for product development, for the Islamic bank or Islamic banking scheme bank whereby he/she acts as a member of <i>Shari'ah</i> advisory council.	67	4.06	20	3.95	47	4.11	.932
5 To be restricted from becoming the major shareholders of the Islamic banks or Islamic banking scheme banks whereby he/she acts as a member of <i>Shari'ah</i> advisory council.	67	4.58	20	4.80	47	4.49	.153

Note: ICB is Islamic Commercial Bank

CBI is Conventional Banks that offers an Islamic banking scheme

Table 5.14 shows that the overall respondents strongly agree (the mean scores are above 4.00) that there are two factors that may improve the independence of SAs of IBs in Indonesia, which are: (1) it is forbidden to be a consultant for the IB where he/she acts as one of the SAC members and (2) it is forbidden to be the major shareholders of IB where he/she acts as one of the SAC members. In addition, the overall respondents tend to agree (the mean scores are above 3.00) with two other factors which may also improve the independence of SAs: (1) to have remuneration only from regulator and (2) it is forbidden to be a NSC-IUC and SAC member of an IB at the same time. Table 5.14 also shows that the overall respondents do not agree

that when SAs are considered as part-time employees, it may improve the independence of SAs (the mean score is 2.62).

As for the view that a SA is prohibited from acting as a consultant for the same IB, the mean score of this factor (4.06) indicates the overall respondents perceived that if a SA is allowed to be a consultant for the same IB, it may reduce his/her apparent independence. This result differs with Gul's study (1989) as he concludes that the Management Advisory Service (MAS) provided by financial auditors increased the financial auditors' independence. However, Gul (1989) adds that it is perhaps the scenario where the MAS was provided by a separate department within the audit firms which contribute to the increase in respondents' perceptions of the auditors' independence.

Meanwhile, if a SA of an IB acts as a consultant for the same IB, he/she would assist the management of the IB in the development of a new product as well as in conducting a review as to whether that new product is in accordance with *Shari'ah* principles (*fatwa(s)* of the NSC-IUC). As a result, this would create a conflict of interest for him/her since he/she has dual functions which are related one to the other. Furthermore, if he/she insists on having these dual functions at the same time, he will possibly lose the confidence of IBs' stakeholders on his/her independence in appearance as a SA. Therefore, the overall respondents perceived that a SA of IB in Indonesia should be prohibited from acting as a consultant for the same IB.

Based on the mean score, the overall respondents also perceived strongly (mean score is 4.58) that a SA should be prohibited from becoming the majority shareholder of the

IB. This is due to the overall respondents' anxiety that if a SA becomes the majority shareholder, he/she would not be able to stand above the interests of all the IB's stakeholders. This result is in parallel with the view of the AAOIFI Governance Standard (2002b) which suggests members of SAC to be prohibited from becoming the majority shareholders since they will be perceived to be not independent (in appearance) by the stakeholders. Therefore, the overall respondents perceived strongly that SAs of IBs in Indonesia should be prohibited from becoming the majority of shareholders.

Table 5.14 also exhibits that, the overall respondents tend to agree (mean score is 3.46) that if SAs receive remuneration exclusively from regulators (e.g. Bank Indonesia), this can improve the independence of the SAs. According to all of the interviewee *Shari'ah* Advisors (SA1, SA2, SA3, SA4 and SA5), basically SAs are not really influenced by the remuneration factor in performing their responsibilities since they claim that as members of the SAC, they have to be responsible for every single action not only to NSC-IUC and BI but also to Allah SWT. However, those SAs also agree that if the SAs of IBs receive remuneration which is distributed by the regulators (e.g. Bank Indonesia), it will improve the independence of SAs of IBs in Indonesia.

Furthermore, According to SA1 and SA5²⁹, there are some SAs who have a significant amount of remuneration given by the IBs. Thus, those SAs might be afraid to lose significant income if they disclose any non-*Shari'ah* compliance activities conducted by the management. As a result, SAs of IBs will lose their independence. Even worse, the IBs stakeholders will reduce their confidence that all of IBs activities are in

²⁹ Please refer to APPENDIX VI Section G, Remuneration of SAs.

accordance with *Shari'ah* principles. However, a more comprehensive study is required to discuss this issue in the future.

In addition, the mean score of the overall respondents on another factor which may improve the independence of SAs of IBs in Indonesia, it is forbidden for SAs to act as one of the NSC-IUC members at the same time, is reasonably high (mean score is 3.67). In the current Islamic banking practices in Indonesia, the NSC-IUC has a right to issue as well as to revoke recommendations given for a person to be a SA (IUC, 1999). The NSC-IUC is also responsible for evaluating the performance of the SAs. Hence, in this case, the SAs are the agents and the NSC-IUC is the principle. If a SA becomes members of NSC-IUC at the same time, he/she will have a conflict of interest because he/she performs two different functions, as a principle and an agent, at the same time. Indeed, it will be very difficult for him/her to maintain his/her independence. Therefore, the overall respondents tend to agree that the SAs should be prohibited from becoming members of NSC-IUC at the same time.

This result departs from BI Rules No. 6/24/PBI/2004. According to BI (2004b), each of the IBs in Indonesia is allowed to have at most two SAs who are also members of NSC-IUC at the same time. This current policy indicates that the independence of SAs will not be influenced even though they become members of the NSC-IUC at the same time. This is possibly because BI (2004b) recognises a principle and agent relationship between BI and SAs. To support this argument, BI has been granted very strong power in the process of appointment the SAs (Bank Indonesia, 2004b). In addition, BI (2004b) also requires all SAs to submit a report on their supervision at least twice a year to BI. In other words, BI (2004b) has implicitly made itself the body which is

also responsible for evaluating the performance of the SAs of IBs in Indonesia. Therefore, this is assumed that the independence of the members of SAC will not be impaired although BI (2004b) allows at most two SAs of each of IBs to be the members of NSC-IUC at the same time.

Research Question No. 9 (RQ9) is designed to obtain the perceptions of overall respondents as to who should appoint SAs in order to remain independent. Table 5.15 shows that the overall respondents perceived strongly that the SAs should be appointed by the NSC-IUC (mean score is 4.43). In addition, the overall respondents tend to agree that SAs of IBs in Indonesia should be appointed by regulators (e.g. Bank Indonesia) (mean score is 3.82).

Table 5.15 Who Should Appoint SAs in order to Remain Independent

Statement		All		ICB		CBI		p Value
		N	Mean	N	Mean	N	Mean	
ID21	Depositors (e.g. <i>Wadhi'ah</i> and <i>Mudārabah</i>)	66	1.80	20	1.70	46	1.85	.481
ID22	Shareholders	66	2.42	20	2.65	46	2.33	.353
ID23	Directors	66	2.05	20	1.50	46	2.28	.023
ID24	Regulators (e.g. Bank Indonesia)	67	3.82	20	3.15	47	4.11	.104
ID25	National <i>Shari'ah</i> Council-Indonesian <i>'Ulamā</i> Council (NSC-IUC)	67	4.43	20	4.90	47	4.23	.002

Note: ICB is Islamic Commercial Bank
CBI is Conventional Bank that offers an Islamic banking scheme

The results are in accordance with the Islamic banking practices in Indonesia where the existence of a SAC in Indonesia was exclusively subject to NSC-IUC Decree No. 02/2000. According to the NSC-IUC (2000), the existence of SAs represents the NSC-

IUC while members of the NSC-IUC are perceived to represent the interest of Muslim society in Indonesia. The overall respondents might have believed that members of NSC-IUC are considered as people who have very good understanding about Islamic teaching and a deep religious commitment. Therefore, the overall respondents perceived strongly that in order to remain independent, the SAs should be appointed by the NSC-IUC.

However, in October 2004, BI issued a rule No. 6/24/PBI/2004 which governs the operations of IBs (either ICB or CBI) in Indonesia. Hence, there are two rules which regulate some issues related with the SAC. With regard to the appointment of the SAs, there are some differences between these two regulations (please refer to Table 5.16 below).

Table 5.16 Appointment of *Shari'ah* Advisors of Islamic Banks in Indonesia

No	Process	NSC-IUC (NSC-IUC Decree No. 02/2000)	BI (BI Rule No. 6/24/PBI/2004)
1	Nomination	<ol style="list-style-type: none"> 1. Management of IB can nominate at least three people to be SAs. 2. Management of IB has submitted the name of these nominees for SAs of IBs in Indonesia to the <u>NSC-IUC</u>. 	<ol style="list-style-type: none"> 1. Management of IB <u>has</u> to nominate people to be SAs. 2. Management of IB has to submit the name of these nominees for SAs to <u>Governor of Bank Indonesia</u> together with all of required documents. 3. In order to determine the people who will be nominated as SAs, the bank is required to have coordination with the NSC-IUC.

Table 5.16 Continued

No	Process	NSC-IUC (NSC-IUC Decree No. 02/2000)	BI (BI Rule No. 6/24/PBI/2004)
2	Endorsement	<ol style="list-style-type: none"> 1. The process is not clear. 2. The NSC-IUC will provide recommendations for those who are eligible to be SAs. 	<ol style="list-style-type: none"> 1. BI will conduct an evaluation of the comprehensiveness and validity of the required documents of each of SA nominees. 2. BI will conduct a fit and proper test (through an interview) for each of the SA nominees. 3. After conducting these two processes, BI will issue an endorsement letter for each of those SA nominees who is considered eligible to be a SA candidate of an IB in Indonesia. 4. The NSC-IUC will issue an approval letter for each of those who have been endorsed by BI to be a SA candidate of an IB in Indonesia. 5. If, within 30 days of the date on the endorsement letter issued by BI, the NSC-IUC fails to issue an approval letter, these SA candidates are automatically considered as SAs of IBs in Indonesia.

Based on table 5.16, the appointment process of the SAs of IBs in Indonesia is not clearly governed by the NSC-IUC (2000) except NSC-IUC will provide a recommendation for those who are eligible to be SAs of IBs in Indonesia. Moreover, according to the NSC-IUC, management of IBs can nominate at least three people to the NSC-IUC. However, SA5 states that sometimes in the practice, the NSC-IUC will directly provide the IBs with people who are eligible to be the SAs. This is possibly because those people who are appointed directly to be member of SAs by NSC-IUC are prominent religious scholars who have a good reputation as experts either in general knowledge of Islam or in *Shari'ah (fiqh al-mu'amalah)*.

Meanwhile, BI (2004b) has determined that IBs are obliged to coordinate with the NSC-IUC in the nomination process. In addition, the IBs are obliged to submit all of SA nominees' required documents. BI (2004b) also determined that there are at least two stages in the endorsement process of SAs of IBs in Indonesia: (1) nomination process document evaluation of each of the SA nominees, and (2) a fit and proper test (through an interview).

In the first stage, BI will verify all of the SA nominees' documents required to be appointed as SAs of IBs in Indonesia. After the documents have been checking, those SA nominees who have sufficient documents as required will be eligible to go for the fit and proper test. In the second stage, BI will conduct a fit and proper test (through an interview) for each of the SAs nominees. This interview is intended to ascertain the SAs nominees' integrity and competency.

Nevertheless, this second stage of the endorsement process as prescribed by BI (2004b) is not in accordance with the views of all of the SAs who argue that the NSC-IUC must conduct a fit and proper test for those who are nominated as SAs of IBs in Indonesia. Specifically, SA2, SA3 and SA4 are of the view that NSC-IUC should be responsible to conduct a fit and proper test of *Shari'ah* knowledge whereas BI is responsible to conduct a fit and proper test of Islamic banking transactions for those nominees of SAs of IBs in Indonesia³⁰.

In addition, in the endorsement of SA nominees to be SA candidates, BI has a very powerful decision. BI (2004b) requires that it will directly consider those SA

³⁰ Please refer to APPENDIX VI Section D, Appointment of SAs.

candidates to be the SAs, although the NSC-IUC fails to issue approval letters for those who have passed a fit and proper test conducted by BI. This indicates that the power to appoint the SAs of IBs in Indonesia lies with Bank Indonesia. On the other hand, SA2, SA3 and SA4 are of the view that the NSC-IUC will appoint those who have passed the fit and proper test and have got recommendation letter from BI to be SAs of IBs in Indonesia.

However, the results of the section who should appoint the SAs, in order to maintain their independence, are still influenced by the NSC-IUC Decree No. 02/2000 due to the collection of the data in this study. This is because the data was collected before BI issued rule No. 06/24/PBI/2004. Nevertheless, the perceptions of the overall respondents may also be influenced by the nature of the banking industry which is highly regulated. This means that although at the time data was collected BI still did not issue the rule related with the IBs' operations in Indonesia, the overall respondents realised that BI is the Central Bank who has single authority to supervise and control all of banks in Indonesia. Accordingly, the result shows that the overall respondents tend to agree that the SAs of IBs in Indonesia should be appointed by BI, in order to remain independent.

Following the line of discussion above, this can be seen that there are some issues which contradict one to the other between BI rule (2004b) and the NSC-IUC decree (2000). For example, the NSC-IUC (2000) clearly states that the SAs are their representative in the IBs; however this relationship is not recognised in BI Rule No. 6/24/PBI/2004. In addition, BI seems not to consider the existence of NSC-IUC in the

appointment process of the SAs. Therefore, BI and NSC-MUI should have intensive discussions on the relationship between the SAs, BI and the NSC-IUC.

Basically, it should be noted that it is normal if the right to appoint SAs of IBs in Indonesia is in the hand of BI. This is because BI is the Central Bank whose single authority to supervise and monitor all of banks in Indonesia. However, BI should not conduct the fit and proper test for SA nominees alone without any coordination with the NSC-IUC. This is because there are at least two skills and areas of knowledge that SA nominees should have in order to be SAs of IBs in Indonesia, such as *Shari'ah* (*fiqh al-mu'amalah*) and banking and finance. Thus, the fit and proper test for the *Shari'ah* skills should be conducted by the NSC-IUC whereas for banking and finance knowledge should be conducted by BI. Therefore, BI should invite the NSC-IUC to have the fit and proper test together.

Moreover, Research Question No.10 (RQ10) examines whether there are significant differences on the independence of SAs between the perceptions of ICB's and CBI's respondents. In order to answer RQ10, the researcher compares the mean scores of both groups of respondents on (1) the factors that may improve the independence of SAs and (2) the parties who should appoint SAs of IBs in Indonesia; in order for them to remain independent. Since the data for both groups are not in normal distribution, the study has carried out a non parametric statistical test, namely the Mann-Whitney *U* test.

Table 5.14 shows that there are differences between the mean scores of ICB's and CBI's respondents on all factors that may improve the independence of SAs of IBs in

Indonesia. However, after being tested with Mann-Whitney *U* test, the differences are not significant at 10 % level. As for the view of who should appoint SAs in order for them to be independent, Table 5.15 shows that there are differences between the mean scores of ICB's and CBI's respondents on all of the parties. However, after being tested with the Mann-Whitney *U* test, the significant differences at 10 % level between the mean scores of both groups exist only on two parties: (1) directors and (2) the NSC-IUC. The mean scores of ICB's and CBI's respondents on directors are 1.50 and 2.28 respectively and on the NSC-IUC are 4.90 and 4.23 respectively. Table 5.15 also exhibits that the differences between the mean scores of both groups are not significant at 10 % level on the other three parties: depositors, shareholders and regulators (e.g. Bank Indonesia).

The reason to explain why there is significant difference between the perceptions of ICB's and CBI's respondents on the NSC-IUC is possibly because ICB's respondents are more influenced by the appointment process of SAs of IBs in Indonesia as ruled in the NSC-IUC Decree No. 02/2000 as compared to their counterparts who work at CBsI. This is because before BI issued BI Rule No. 06/24/2004 in October 2004, the appointment process of SAC has been exclusively governed based on NSC-IUC Decree No. 02/2000. Meanwhile, the average working experience in Islamic banking industry of ICB's and CBI's respondents is about 5.5 and 2.8 years respectively. This means that the ICB's respondents are more familiar and informed about the NSC-IUC Decree No. 02/2000 as compared to CBI's respondents. Therefore, ICB's respondents registered a significantly stronger perception as compared to CBI's respondents that the SAs should be appointed by the NSC-IUC, in order for them to remain independent.

5.5.4. Research Objective No. 4

Research Objective No. 4 (RO4) is intended to examine the *Shari'ah* review procedures as conducted by the SAs of IBs in Indonesia. This particular objective is supported with five Research Questions (RQs) as follows:

Table 5.17 Research Questions Emerging from Research Objective No. 4

Research Questions
No. 11 <i>What are the procedures that need to be conducted by the SAs of IBs in Indonesia in order to properly execute the Shari'ah review?</i>
No. 12 <i>To whom should SAs of IBs in Indonesia make a Shari'ah review report published in the annual report of IBs?</i>
No.13 <i>To whom should SAs of IBs in Indonesia make a special Shari'ah review report?</i>
No. 14 <i>Are there any significant differences between the perceptions of ICB's and CBI's respondents on the Shari'ah review process of IBs in Indonesia?</i>

The overall respondents were asked about the procedures that the SAs should follow in order to prepare a *Shari'ah* review (RQ11). Table 5.17 shows that the overall respondent perceived that SAs of IBs in Indonesia should conduct all of those procedures in order to have properly *Shari'ah* review (mean scores are more than 4.00). In addition, the overall respondents perceived strongly that SAs of IBs in Indonesia should conduct five procedures as follows: (1) the SAs must prepare a *Shari'ah* review plan which is made based on the deep understanding of the operations of IBs, in terms of products, size of operation, location, branches etc. (4.41), (2) the SAs must review IBs' transactions, contracts, agreements and others

(4.51), (3) the SAs must evaluate whether IBs have had transactions based on the approved products (4.61), (4) the SAs must discuss the findings obtained from *Shari'ah* review with the board of directors (4.45), and (5) the SAs must prepare a *Shari'ah* review report after having a discussion with the board of directors (4.55).

Table 5.18 Procedures that SAs Should Conduct in order to Properly Execute *Shari'ah* Review

Statement		All		ICB		CBI		p Value
		N	Mean	N	Mean	N	Mean	
1	The <i>Shari'ah</i> review plan should be developed to include a complete understanding about Islamic banks' and Islamic banking scheme banks' operations in terms of products, size operations and locations, branches and subsidiaries.	66	4.41	20	4.90	46	4.20	.003
2	The <i>Shari'ah</i> review is performed on sample basis of transactions done by the Islamic banks and Islamic banking scheme banks.	66	4.23	20	4.65	46	4.04	.007
3	The criteria and size of sample of transactions done by the Islamic banks should be planned in consideration of complexity and frequency of the transactions.	66	4.38	20	4.65	46	4.26	.025
4	The <i>Shari'ah</i> Advisors need to obtain an explicit statement from the management that the responsibility for <i>Shari'ah</i> compliance lays on the management and not on the <i>Shari'ah</i> Advisors.	67	4.07	20	3.95	47	4.13	.399
5	The <i>Shari'ah</i> Advisors should review transactions, contracts, agreements and etc.	67	4.51	20	4.65	47	4.45	.176
6	The <i>Shari'ah</i> Advisors should determine whether transactions in that particular year were inline with the products authorized by the <i>Shari'ah</i> Advisory Council.	67	4.61	20	4.65	47	4.60	.177
7	The <i>Shari'ah</i> Advisors need to review other information and reports such as circulars, minutes, operating and financial reports, policies and procedures.	67	4.10	20	4.20	47	4.06	.230

Table 5.18 Continued

Statement		All		ICB		CBI		p Value
		N	Mean	N	Mean	N	Mean	
8	The <i>Shari'ah</i> Advisors should have coordination and consultation with other advisors such as external Reviewer (public accountant).	67	4.19	20	4.25	47	4.17	.423
9	The <i>Shari'ah</i> Advisors need to discuss their findings with Islamic banks' and Islamic banking scheme banks' management.	67	4.45	20	4.70	47	4.34	.012
10	<i>Shari'ah</i> Advisors should prepare their report to the shareholders based on the work done and discussion held.	67	4.55	20	4.90	46	4.40	.002

Note: ICB is Islamic Commercial Bank

CBI is Conventional Bank that offers an Islamic banking scheme

Based on the mean scores in table 5.17, the overall respondents perceived strongly that SAs must review IBs' transactions, contracts, agreements and others (mean score is 4.51). In addition, the SAs must also evaluate whether all of the IBs' transactions based on approved products (mean score is 4.61). The results indicate that there is a greater expectation that SAs should perform the general responsibility to ensure that all products and transactions are in accordance with *Shari'ah* principles. This is supported by the mean score of overall respondents that SAs must review other information and reports such as financial report (mean score is only 4.10) which is reasonably lower as compared to those two mean scores. These results are in line with the current practices of IBs in Indonesia where SAs of IBs are expected to ensure that the transactions and products of IBs are in compliance with *Shari'ah* principles (NSC-IUC, 2000).

As for the view that SAs should discuss the findings obtained from *Shari'ah* review with the directors, the overall respondents expected that by following this procedure, SAs could clarify the findings with the directors, before SAs make conclusions published in the *Shari'ah* review report. This is supported by all of the SAs who are involved in the interview whereby they claim that they would always discuss all the findings obtained from *Shari'ah* review with the management of IBs before they make conclusions³¹.

In general, the overall respondents' perceptions on procedures that SAs should conduct in order to properly execute the *Shari'ah* review plan are in accordance with the AAOIFI Governance Standard (2002c).

The overall respondents were also asked about to whom SAs should issue a *Shari'ah* review report published in the Annual Report (RQ12). According to the AAOIFI Governance Standard (2002b), the *Shari'ah* review report should be published in the annual report of the bank. Basically, this report contains the SAs' opinions on the *Shari'ah* compliance of the IBs' activities and transactions. The results show that the overall respondents perceived strongly that the *Shari'ah* review report published in the annual report is aimed at the shareholders (mean score is 4.28).

³¹ Please refer APPENDIX VI Section J, Method to Ensure that the IBs' Operations are in Compliance with the *Shari'ah*.

Table 5.19 To Whom Should SAs Issue a *Shari'ah* Review Report Published in the Annual Report of IBs

Statement		All		ICB		CBI		p Value
		N	Mean	N	Mean	N	Mean	
PD31	Depositors (e.g. <i>Wadhi'ah</i> and <i>Mud'arabah</i>)	64	3.30	20	2.95	44	3.45	.291
PD32	Shareholders	67	4.28	20	4.45	47	4.21	.016
PD33	Customer Financing	64	3.22	20	2.85	44	3.39	.233
PD34	Muslim Public	65	3.57	20	3.65	45	3.53	.930

Note: ICB is Islamic Commercial Bank

CBI is Conventional Bank that offers an Islamic banking scheme

Meanwhile, the overall respondents tend to agree that the *Shari'ah* review report published in the annual report is also aimed at other stakeholders of the IBs such as depositors (3.30), Customer financing (3.22) and Muslim society (3.57). Since the mean score for Muslim society is moderately higher than the other two groups, this is possibly because the overall respondents expected that the *Shari'ah* review report could convince Muslim society in general that all of the IBs' activities and transactions are in accordance with *Shari'ah* principles.

These results are expected as the shareholders are the party who usually read the performance of IBs through annual report. Thus, the results indicate that the overall respondents perceived that the shareholders are more important than the other external stakeholders who should be informed about SAs' opinion on the IBs' transactions and activities.

The AAOIFI Governance Standard (2002c) requires the SAs to issue a special *Shari'ah* review report, which is more detailed as compared to the *Shari'ah* review report which is published in the annual report, to the management of IBs. The study

shows that, as for the view about to whom should the SAs of IBs in Indonesia issue a special *Shari'ah* review report (RQ13), the mean scores of the overall respondents for directors, regulators (e.g. Bank Indonesia) and the NSC-IUC are reasonably high (the mean scores are above 4.00). As for the directors of IBs, the result supports the AAOIFI Governance Standard guideline (2002c). This result also indicates that the overall respondent viewed that SAs should submit a special *Shari'ah* review report to the directors so that the directors can know whether all of IBs' products, transactions and activities are in accordance with *Shari'ah* principles.

Table 5.20 To Whom Should SAs Issue a Special *Shari'ah* Review Report

Statement		All		ICB		CBI		p Value
		N	Mean	N	Mean	N	Mean	
PD41	Directors.	66	4.42	20	4.65	46	4.33	.013
PD42	Regulators (e.g. Bank Indonesia).	66	4.52	20	4.80	46	4.39	.010
PD43	National <i>Shari'ah</i> Council- Indonesian <i>'Ulamā</i> Council (NSC-IUC).	66	4.56	20	4.90	46	4.41	.003

Note: ICB is Islamic Commercial Bank

CBI is Conventional Bank that offers an Islamic banking scheme

Meanwhile, as for the NSC-IUC, the overall respondent strongly perceived that the SAs should also issue a special *Shari'ah* review report. This is probably because the NSC-IUC (2000) obliges the SAs to provide a *Shari'ah* review report at least once a year for the NSC-IUC. Similarly, as for regulators (e.g. Bank Indonesia), although, when the data was collected, BI had still not issued the rule related to the existence of SAC, the overall respondents strongly perceived that SAs should also submit the report to the regulators (e.g. Bank Indonesia). This result proves that the overall

respondents realised that BI is the Central Bank in Indonesia. Moreover, the result supports a view that banking industry is considered as a highly regulated industry.

In order to answer RQ14, the study compares the mean scores of ICB's and CBI's respondents on (1) the procedures that SAs should conduct in order to properly execute the *Shari'ah* review plan, (2) to whom SAs should make a *Shari'ah* review report published in the annual report (3) to whom SAs should make a special *Shari'ah* review report. Since the data for both groups are not normally distributed, the study utilises a non parametric statistical analysis, Mann-Whitney *U* test, in order to determine whether the differences between both groups' perceptions are significant.

As for the view on the procedures that SA should conduct in order to properly execute *Shari'ah* review plan, the differences exist between the perceptions of ICB's and CBI's respondents in all of the procedures that SAs should take. However after being tested with Mann-Whitney *U* test, the differences are significant at 10 % level only for procedures as follows: (1) the *Shari'ah* review plan must be made based on the deep understanding of the operations of IB in terms of products, size of operation, locations, branches, subsidiaries and divisions (the mean scores of both groups are 4.90 and 4.20 respectively), (2) the *Shari'ah* review on the IB transactions is conducted through the sampling method (4.65 and 4.04), (3) the SAs depend on the complexity and frequency of the transactions in order to determine the criteria and size of the sample (4.65 and 4.26), (4) the SAs must discuss the findings with the board of directors (4.70 and 4.34), and (5) the SAs must prepare a *Shari'ah* review report after having a discussion with the board of directors (4.90 and 4.40).

The possible reason to justify the significant difference between ICBs and CBsI perceptions on views no 1, 2 and 3 is because ICB is much bigger than CBI in terms of networks³². Therefore, The ICBs respondents perceived strongly that SAs will conduct a *Shari'ah* review based on sample since it seems impossible to review all of the transactions, 'aqd, agreements, etc.

In addition, for views no. 4 and 5, ICB's respondents believed that the SAs in ICB will be much easier to meet the board of directors to discuss any findings obtained from *Shari'ah* review as compared to the SAs in CBI. Since the CBI is the bank whose all of its operations are subject to *Shari'ah* principles, definitely, the board of directors will be more focused on any issues related with *Shari'ah* compliance. Meanwhile, since CBI is only one special (Islamic) branch, normally, SAs of CBsI will be normally easier to meet the head of division rather than board of directors.

As for the views about to whom SAs should issue a *Shari'ah* review report published in the annual report, there is a significant difference at 10 % level between the perceptions of ICB's (mean score is 4.45) and CBI's respondents (mean score is 4.21) on the shareholders. The possible reason to explain this finding is because the shareholders of ICB are really concerned with the *Shari'ah* compliance in all of IBs' transactions since all of ICB's activities and transactions should be in accordance with *Shari'ah* principles. Therefore, ICBs respondents perceived strongly that the SAs should provide the shareholders with a *Shari'ah* review report published in the annual report.

³² Please refer to Table 2.2 Number of Indonesian IBs' Networks in 2004

Furthermore, the perceptions of ICB's and CBI's respondents are significantly different at 10 % level for three parties to whom SAs should make a special *Shari'ah* review report: directors, regulators (e.g. Bank Indonesia) and the NSC-IUC. The mean scores of ICB's respondents for those three parties are 4.65, 4.80 and 4.90 respectively whereas the mean scores of CBI's respondents are 4.33, 4.39 and 4.41 respectively. Again, this result might indicate that ICB's respondents perceived that ICB always have to maintain the banks' corporate image as banks which all of the activities which are run based on *Shari'ah* principles. Thus, this is assumed that by providing a special *Shari'ah* review report to those different parties, it may improve the level of IBs' *Shari'ah* compliance in all of their activities and transactions.

CHAPTER 6

CONCLUSIONS

6.1. Introduction

This chapter discusses the main findings as presented in the previous chapter. The discussion in this chapter is initiated with the general conclusion for each of the research objectives. This is followed by the limitations faced in this study. In addition, the contributions of this study are presented in the following section. Finally, this chapter ends with suggestion for further research.

6.2. Conclusions for each of research objectives

Karim (1990b) argues that the speciality of IB lies in the *Sharī'ah* compliance of its transactions and activities. Indeed that it is a must for the IB to conduct all of its activities and transactions in accordance with *Sharī'ah* principles. In order to ensure that the IB activities and transactions are in compliance with *Sharī'ah* principles, the IB needs to be provided with a reliable and credible body, named the *Sharī'ah* Advisory Council (SAC). In short, SAs have very important roles in the operations of IBs in Indonesia.

However, since there is a lack of comprehensive regulations and standards related to the responsibility and independence of SAs and the Shari'ah review process, the study is designed to obtain the perceptions of the managers and SAs of IBs in Indonesia on

those three issues as mentioned earlier. Thus, the general conclusion for each of research objectives of this study is presented as follows:

6.2.1 The Importance of *Shari'ah* Advisory Council of Islamic Bank in Indonesia

The first research objective aimed to examine the importance SAC of IB in Indonesia. There are two issues related with this particular objective, such as: (1) the benefits derived from the existence of the SAC; and (2) the characteristics of SAs of IBs in Indonesia.

As for the view on the benefits derived from the existence of SAC, the overall respondents strongly perceived that the existence of SAC will provide the IB with a reliable and credible body which ensures that all of IBs activities and transactions are in accordance with *Shari'ah* principles. The overall respondents also expected that the existence of SAC will provide the IBs with *fatwa(s)* and guidelines. In general, these findings support the views that SAC are required to monitor and supervise whether all of IBs' operations are in accordance with the *Shari'ah*.

With regard to the characteristics of SAs of IBs in Indonesia, the overall respondents perceived that SAs must have a good knowledge and skills in *Shari'ah* (*fiqh-al mu'amalah*) as well as knowledge about the IBs' transactions and activities. In addition, the overall respondents strongly perceived the SAs' educational backgrounds should consist of three different areas of knowledge such as *Shari'ah*, Law (positive law) and Economics. The study also finds that ICB's respondents are more concerned with the issue of *Shari'ah* compliance in all of the IBs' transactions as compared to CBI's respondents.

6.2.2. The Responsibility of the *Shari'ah* Advisors of Islamic Banks in Indonesia

The second research objective is meant to examine the responsibility of SAs of IBs in Indonesia. There are two issues related with this particular objective, such as (1) the responsibility of SAs and (2) to whom SAs should be legally and religiously/socially responsible.

As for the view on the responsibility of SAs of IBs in Indonesia, the overall respondents perceived strongly that the SAs should be responsible for monitoring and ensuring that all IBs' products, transactions and activities are in line with the *Shari'ah*. In addition, the overall respondents perceived that the SAs should be responsible for specific issues such as evaluating whether the profit sharing methods are in line with *Shari'ah*; ensuring that all of IBs revenues are in line with *Shari'ah* and evaluating whether the *zakāt* calculations of IBs are in line with *Shari'ah*.

As for the views of the overall respondents as to whom the SAs should be legally responsible, the overall respondents perceived strongly that the SAs should be legally responsible to Muslim society, regulators (e.g. Bank Indonesia) and the NSC-IUC while as for the view of the overall respondents on to whom the SAs should be religiously/socially responsible, the findings exhibit that the overall respondents perceived strongly that the SAs should be religiously/socially responsible to the NSC-IUC and Muslim Society.

This study also finds that CBI's respondents really expected the SAs to perform the general responsibilities as compared to ICB's respondents. These general responsibilities of SAs focus on how to ensure that all of the IBs' products,

transactions and activities are in the accordance with *Shari'ah* principles. On the other hand, ICB's respondents had a higher expectation that the SAs should perform specific responsibilities, such as: to evaluate whether the profit sharing methods are in line with *Shari'ah*; to ensure that all of IBs' revenues are in line with *Shari'ah* principles and to evaluate whether *zakāt* calculation of IBs' is in line with *Shari'ah* principles.

6.2.3. The Independence of the *Shari'ah* Advisors of Islamic Banks in Indonesia

This research objective aimed to examine the factors that may influence the independence of SAs of IBs in Indonesia. There are two issues related with this particular objective: (1) factors that may improve the independence of SAs of IBs in Indonesia, (2) who should appoint the SAs of IBs in Indonesia, in order for them to remain independent.

As for the view of factors which may improve the independence of SAs of IBs in Indonesia, the study finds that the overall respondents strongly agree if the SAs are prohibited from becoming consultants for the same IBs or becoming the majority shareholders of IBs where they act as members of the SAC. In addition, the overall respondents tend to agree that if the remuneration of SAs is exclusively given by regulator (e.g. Bank Indonesia) and that if SAs are prohibited from acting as members of the NSC-IUC, these can maintain the independence of the SAs. As for the view about who should appoint the SAs in order to remain independent, the overall respondents assumed that the SAs should be appointed by the NSC-IUC or BI. Furthermore, the study finds that ICB's respondents perceived more strongly that the SAs should be appointed by the NSC-IUC in order to maintain their independence.

6.2.4. The *Shari'ah* Review Process in Islamic Banks in Indonesia

This research objective aimed to examine the *Shari'ah* review procedures as conducted by the SAs of IBs in Indonesia. There are three issues related with this particular objective: (1) the procedures that SAs of IBs in Indonesia should conduct in order to execute properly *Shari'ah* review, (2) the parties to whom the SAs should publish a *Shari'ah* review report in the annual report of the IBs and (3) the parties to whom the SAs should submit a special *Shari'ah* review report.

As for the view about the procedures that the SAs should take in order to prepare a *Shari'ah* review, the overall respondents perceived strongly that SAs should conduct five procedures, such as (1) the SAs must prepare a *Shari'ah* Review plan which is made base on the deep understanding of the operations of IBs, in terms of products, size of operation, location, branches etc.; (2) the SAs must review the IBs' transactions, contracts, agreements and others; (3) the SAs must evaluate whether the IBs have had transactions based on the approved products; (4) the SAs must discuss the findings obtained from *Shari'ah* review with the board of directors; (5) the SAs must prepare a *Shari'ah* review report after having a discussion with the board of directors.

As for the view as to whom the SAs should issue a *Shari'ah* review report which is published in the annual report, the overall respondents perceived strongly that the *Shari'ah* review published in the annual report is aimed at the shareholders. In addition, as for the view as to whom the SAs should issue a special *Shari'ah* review report, the overall respondents perceived that the SAs should make a special report to directors, regulators (e.g. Bank Indonesia) and the NSC-IUC.

In addition, the study finds that the ICB's respondents perceived stronger as compared to the CBI's respondents on certain procedures of the *Shari'ah* review, such as: (1) the *Shari'ah* review plan must be made based on the deep understanding of the operation of IB in terms of products, size of operation, locations, branches, subsidiaries and divisions; (2) the *Shari'ah* review on the IB transactions is conducted through the sampling method; (3) the SAs depend on the complexity and frequency of the transactions, in order to determine the criteria and size of the sample; (4) the SAs must discuss the findings with the board of directors; and (5) the SAs must prepare a *Shari'ah* review report after having a discussion with the board of directors.

As for the view about who SAs should issue a *Shari'ah* review report published in the annual report, the ICB's respondents showed a stronger preference than the CBI's respondents for the shareholders of IBs. In addition, the study also finds that ICB's respondents felt more strongly than CBI's respondents that the SAs should make a special for, such as: (1) directors, regulators (e.g. Bank Indonesia) and the NSC-IUC.

6.3. Limitations of the Study

The above findings are, however, subject to several limitations. First, the methodology adopted by this study is exploratory in nature. Thus, the theoretical development adopted was conducted in the absence of comprehensive regulations and standards with regard to the existence of SAs of IBs in Indonesia. Therefore, this study utilised the opinions of various scholars (such as Bristhon & El-Ashker, 1986; Abu Moamer, 1989; Karim, 1990b; Abdallah, 1994; Banaga et al. 1994; Bakar, 2002; AAOIFI Governance Standard 2002b&c; and Al-Qattan, 2003).

Second, since this study is constrained by the absence of comprehensive regulations with regard to the existence of SAC of IB in Indonesia, the perceptions of the overall respondents to some extent are more influenced by the nature of the type of bank where they are working and the respondents' working experience in Islamic banking industry. As a result, on certain sensitive issues, such as the independence of SAs, the respondents' perceptions are very difficult to be predicted.

6.4. Contributions of the Study

However, despite the limitations in this study, the study is intended as a small contribution to the dearth of studies that specifically elaborate issues regarding the responsibility and independence of SAs and the *Shari'ah* review process of Islamic banks. The findings in the study depict that the SAC of IB in Indonesia have a very important role to ensure that the IB's activities and transactions are in line with *Shari'ah* principles. In addition, the findings show that it is very important for SAs of IBs to be perceived not only as independent in mind but also independent in appearance. Furthermore, the findings suggest that SAs should conduct all of the procedures as proposed by the AAOIFI Governance Standard (2002c) in order to execute properly *Shari'ah* review in IBs.

Second, this study is the first to explore the responsibility, independence of SAs and the *Shari'ah* review process of Islamic banks in Indonesia. Although the findings should be considered as preliminary, the study does provide a basis to generate more comprehensive regulations and standards related with the existence of SAC of IB in Indonesia. Thus the study suggests the need for proper and comprehensive regulations

and standard by Bank Indonesia and the NSC-IUC in order to give more credibility to the Islamic banking activities in Indonesia.

Third, the study shows that, after BI issued the BI Rule No, 6/24/PBI/2004, there is apparent sidelining of the NSC-IUC by Bank Indonesia particularly on the appointment of SAs of IBs in Indonesia. On the other hand, since the existence of SAC involves two different areas such as Islamic banking and finance and *Shari'ah* (*fiqh al-mu'amalah*), the study suggests that the existence of SAC of IBs in Indonesia should be regulated under the coordination BI and the NSC-IUC. Perhaps, the establishment of National *Shari'ah* Council under Bank Indonesia, which is intended to exclusively supervise the *Shari'ah* compliance of IB operations in Indonesia, could be used as one of alternatives to solve this problem.

6.5. Suggestions for Further Research

Future studies can extend this analysis by examining the perceptions of the other stakeholders of IB. According to Karim (1990b), the depositors, customer financing, shareholders, regulators and Muslim society as a whole are very concerned with the *Shari'ah* compliance of IB's activities and transactions. Therefore, the study will generate more comprehensive perceptions toward the existence of SAC of IB in Indonesia.

Also, since this study only examines the perceptions of IB managers in general, it would be interesting to further investigate the perceptions of IB managers based on

the functional areas (such as audit, product development and etc) to see whether their perceptions will be similar to the perceptions of IB managers in general.

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APPENDIX I

RECOMMENDATION LETTER

(DIRECTORATE OF ISLAMIC BANKING-BANK INDONESIA)



BANK INDONESIA

No. : *)
Lamp. : 1 (satu) berkas

Jakarta, 15 September 2004

Kepada
Direktur Bank (**)
Di Jakarta

Perihal: Permohonan Bantuan Pemberian Informasi

Assalamu'alaikum Wr.Wb.

Selubungan dengan penelitian "The Role and Independence of Syariah Advisors, and The Syariah Review Process: The Views of Indonesian Bank Managers and Syariah Advisors" yang dilakukan oleh Sdr. Ade Wirman, mahasiswa program Master of Science in Accounting di International Islamic University Malaysia, Kuala Lumpur - Malaysia, dengan ini kami mengharapkan bantuan Saudara untuk memberikan informasi sesuai dengan kuisioner (terlampir). Secara teknis jumlah kuisioner yang akan disampaikan sebanyak 1 (satu) berkas (terdiri dari 6 (enam) lembar) yang diharapkan dapat diisi oleh pihak Manajemen Bank Saudara.

Saat ini peran dan posisi Dewan Pengawas Syariah (DPS) begitu strategis dalam dinamika industri perbankan syariah Indonesia, sehingga menurut hemat kami *feedback* dari pelaku industri akan sangat bermanfaat bagi penyempurnaan peran dan posisi DPS dimasa yang akan datang. Secara utuh hasil penelitian ini diharapkan dapat memberikan kontribusi positif bagi pengembangan industri perbankan syariah di Indonesia.

Demikian, atas kerjasama Saudara kami ucapkan terima kasih

DIREKTORAT PERBANKAN SYARIAH

Hawibai - -

Hawibai
Direktur

R

APPENDIX II

SAMPLE QUESTIONNAIRE

(ENGLISH VERSION)



الجامعة الإسلامية العالمية ماليزيا
INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA
وَنَسْتَعِينُ بِإِسْلَامِهِ وَأَنْبِيَائِهِ جَمِيعًا

KULLIYAH OF ECONOMICS AND MANAGEMENT SCIENCES

**RESEARCH QUESTIONNAIRE ON THE RESPONSIBILITY AND INDEPENDENCE
OF SHARĪAH ADVISORS; AND THE SHARĪAH REVIEW PROCESS**

SECTION 1-RESPONDENT IDENTITY

1. Age

20-29 30-39 40-49 50-59 More than 60

2. Gender

Male Female

3. Educational Background

Junior High School

Government School Islamic School Islamic Boarding School

High School

Government School Islamic School Islamic Boarding School

Others (Please Specify): _____

Diploma

Accounting Shari'ah Marketing Economics
 Finance Business Administration Others (Please Specify): _____

Bachelor

Accounting Shari'ah Marketing Economics Finance
 Business Administration Law Others (Please Specify): _____

Master

Accounting Shari'ah Marketing Economics Finance
 Business Administration Business Law Others (Please Specify): _____

4. Type of Islamic Bank:

Islamic Commercial Bank Conventional bank with Islamic Banking Scheme

5. Are you aware of the existence of Shari'ah Advisory Council of Islamic bank in Indonesia?

Yes No

6. Post : _____

7. No of years of serving the bank in the ongoing post : year(s), month(s)
8. No of Years of Total Work Experience in Islamic Bank : year(s), month(s)
9. No. of Years of Total Work Experience in Banking Industry: year(s), month(s)
10. Optional Data (correspondence details)

Email Address : _____ Telephone no. : _____

General Instruction:

Please answer ALL questions.

Please UNDERLINE/CIRCLE one of the scale that you think is the most appropriate.

1=Disagree.....5=Agree

SECTION 2-The IMPORTANCE of *Shari'ah* Advisors

Note: The term *Shari'ah* advisors' here refers to those employed by the banks to conduct supervision in Islamic banks.

1. The benefit on the existence of *Shari'ah* Advisory Council

		Disagree			Agree	
1	To provide the Islamic banks' and Islamic banking scheme's banks' stakeholders a credible and reliable body which ensures that all activities and transactions of the banks are in compliance with the <i>Shari'ah</i> principles.	1	2	3	4	5
2	To provide guidance such as fatwa and rulings which are related with the <i>Shari'ah</i> compliance of Islamic banks' and Islamic banking scheme's banks' activities and transactions.	1	2	3	4	5
3	To provide advices which are related with the <i>Shari'ah</i> compliance of Islamic banks' and Islamic banking scheme's banks' activities and transactions.	1	2	3	4	5
4	To provide and perform trainings which are related with the <i>Shari'ah</i> compliance of Islamic banks' and Islamic banking scheme's banks' activities and transactions.	1	2	3	4	5

Others (please state): _____

2. Characteristics of *Shari'ah* Advisors:

		Disagree			Agree	
1	<i>Shari'ah</i> Advisory Council of Islamic banks and Islamic banking scheme banks should consist of <u>at least three</u> members.	1	2	3	4	5
2	Members of <i>Shari'ah</i> Advisory Council of Islamic banks and Islamic banking scheme banks should have good expertise and knowledge on <i>Shari'ah</i> rulings and fiqh muamalah.	1	2	3	4	5
3	Members of <i>Shari'ah</i> Advisory Council of Islamic banks and Islamic banking scheme banks should have a formal religious (<i>Shari'ah</i> and fiqh muamalah) degree.	1	2	3	4	5
4	Members of <i>Shari'ah</i> Advisory Council of Islamic banks and Islamic banking scheme banks should have enough experiences on Islamic banking activities and transactions.	1	2	3	4	5
5	Ideally, members of <i>Shari'ah</i> Advisory Council of Islamic banks and Islamic banking scheme banks should have at least three different educational backgrounds such as <i>Shari'ah</i> (fiqh Muamalah), accounting and law (positive law).	1	2	3	4	5

Others (please state): _____

SECTION 3- *Shari'ah* Advisors RESPONSIBILITY

1. The Role and Responsibility of *Shari'ah* Advisors are as follow:

		Disagree			Agree	
1	To monitor and confirm that all the Islamic banks' and Islamic banking scheme's banks' <u>activities and transactions</u> are in conformity with Islamic <i>Shari'ah</i> principles.	1	2	3	4	5
2	To monitor and confirm that all the Islamic banks' and Islamic banking scheme's banks' <u>products</u> are compatible with Islamic <i>Shari'ah</i> .	1	2	3	4	5
3	To monitor and confirm that the Islamic banks' and Islamic banking scheme's banks' transactions are in conformity with Islamic <i>Shari'ah</i> principles on the <u>basis of sample</u> .	1	2	3	4	5
4	To monitor and confirm that all the Islamic banks' and Islamic banking scheme's banks' products are compatible with Islamic <i>Shari'ah</i> on the <u>basis of sample</u> .	1	2	3	4	5
5	To examine the appropriateness of the <i>Shari'ah</i> basis of allocation of profit between the equity holders and the investment account holders.	1	2	3	4	5

6	To ensure that all of earnings generated by the Islamic banks are in accordance with <i>Shari'ah</i> principles.	1	2	3	4	5
7	To examine whether calculation of the Islamic banks' and Islamic banking scheme's banks' <i>zakāt</i> obligation is in compliance with Islamic principles	1	2	3	4	5

Others (please state): _____

2. The *Shari'ah* advisors should be responsible legally to the following groups:

		Disagree				Agree
1	Depositors (e.g. <i>Wadhi'ah</i> and <i>Mudārabah</i>)	1	2	3	4	5
2	Shareholders	1	2	3	4	5
3	Directors	1	2	3	4	5
4	Regulators (e.g. Bank Indonesia)	1	2	3	4	5
5	National <i>Shari'ah</i> Council -Indonesian 'Ulamā Council (NSC-IUC)	1	2	3	4	5
6	Customers (Financing products)	1	2	3	4	5
7	Muslim Public	1	2	3	4	5

Others (please state): _____

The *Shari'ah* advisors should be responsible religiously/socially to the following groups:

		Disagree				Agree
1	Depositors (e.g. <i>Wadhi'ah</i> and <i>Mudārabah</i>)	1	2	3	4	5
2	Shareholders	1	2	3	4	5
3	Directors	1	2	3	4	5
4	Regulators (e.g. Bank Indonesia)	1	2	3	4	5
5	National <i>Shari'ah</i> Council -Indonesian 'Ulamā Council (NSC-IUC)	1	2	3	4	5
6	Customers (Financing products)	1	2	3	4	5
7	Muslim Public	1	2	3	4	5

Others (please state): _____

SECTION 4- Shari'ah Advisors' INDEPENDENCE

1. In order to remain independent, *Shari'ah* advisors need:

		Disagree			Agree	
1	To perform their duties on part time basis as <u>part time staff</u> .	1	2	3	4	5
2	To receive a remuneration only from Regulatory Body (e.g. Bank Indonesia)	1	2	3	4	5
3	To be restricted from becoming member of National <i>Shari'ah</i> Council at the same time.	1	2	3	4	5
4	To be restricted from becoming consultant, e.g. consultant for product development, for the Islamic bank or Islamic banking scheme bank whereby he/she acts as a member of <i>Shari'ah</i> advisory council.	1	2	3	4	5
5	To be restricted from becoming the major shareholders of the Islamic banks or Islamic banking scheme banks whereby he/she acts as a member of <i>Shari'ah</i> advisory council.	1	2	3	4	5

Others (please state): _____

2. In order to remain independent, *Shari'ah* advisors should be appointed by:

		Disagree			Agree	
1	Depositors of the banks (e.g. Wadhi'ah and Muḍārabah).	1	2	3	4	5
2	Shareholders	1	2	3	4	5
3	Management	1	2	3	4	5
4	Regulators (e.g. Bank Indonesia).	1	2	3	4	5
5	National <i>Shari'ah</i> Council-Indonesian 'Ulamā Council (NSC-IUC).	1	2	3	4	5

Others (please state): _____

SECTION 5-PROCEDURES of Shari'ah Review

In order to perform *Shari'ah* review, *Shari'ah* advisors need to conduct these following procedures as follow:

		Disagree			Agree	
1	The <i>Shari'ah</i> review plan should be developed to include a complete understanding about Islamic banks' and Islamic banking scheme banks' operations in terms of products, size operations and locations, branches and subsidiaries.	1	2	3	4	5

2	The <i>Shari'ah</i> review is performed on sample basis of transactions done by the Islamic banks and Islamic banking scheme banks.	1	2	3	4	5
3	The criteria and size of sample of transactions done by the Islamic banks should be planned in consideration of complexity and frequency of the transactions.	1	2	3	4	5
4	The <i>Shari'ah</i> Advisors need to obtain an explicit statement from the management that the responsibility for <i>Shari'ah</i> compliance lays on the management and not on the <i>Shari'ah</i> Advisors.	1	2	3	4	5
5	The <i>Shari'ah</i> Advisors should review transactions, contracts, agreements and etc.	1	2	3	4	5
6	The <i>Shari'ah</i> Advisors should determine whether transactions in that particular year were inline with the products authorized by the <i>Shari'ah</i> Advisory Council.	1	2	3	4	5
7	The <i>Shari'ah</i> Advisors need to review other information and reports such as circulars, minutes, operating and financial reports, policies and procedures.	1	2	3	4	5
8	The <i>Shari'ah</i> Advisors should have coordination and consultation with other advisors such as external Reviewer (public accountant).	1	2	3	4	5
9	The <i>Shari'ah</i> Advisors need to discuss their findings with Islamic banks' and Islamic banking scheme banks' management.	1	2	3	4	5
10	<i>Shari'ah</i> Advisors should prepare their report to the shareholders based on the work done and discussion held.	1	2	3	4	5

Others (please state): _____

2. After conducting a *Shari'ah* review, *Shari'ah* advisors need to make a review report which is published in annual report to:

		Disagree			Agree	
1	Depositors of the banks (e.g. Wadhi'ah and Mudarabah).	1	2	3	4	5
2	Shareholders.	1	2	3	4	5
3	Customers (Financing products).	1	2	3	4	5
4	Muslims Public.	1	2	3	4	5

Others (please state): _____

3. After conducting a *Shari'ah* review, *Shari'ah* advisors need to make a special review report to:

		Disagree			Agree	
1	Management.	1	2	3	4	5
2	Regulators (e.g. Bank Indonesia).	1	2	3	4	5
3	National <i>Shari'ah</i> Council-Indonesian <i>Ulama</i> Council (NSC-IUC).	1	2	3	4	5

Others (please state): _____

Thank You Very Much for Your Kind Cooperation

APPENDIX III
SAMPLE QUESTIONNAIRE
(BAHASA INDONESIA VERSION)



الجامعة الإسلامية العالمية ماليزيا
INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA
وَنَسْتَعِينُ بِإِسْلَامِهِ وَإِنْبَارًا بِجَنَابِ مَلِكِنَا

KULLIAH OF ECONOMICS AND MANAGEMENT SCIENCES

Kusioner Penelitian :

Tugas dan Independensi Dewan Pengawas Syari'ah Serta Proses Pengawasan Syari'ah

BAGIAN I-IDENTITAS RESPONDEN

1. Umur

20-29 30-39 40-49 50-59 Lebih dari 60

2. Jenis Kelamin

Laki-Laki Wanita

3. Latar Belakang Pendidikan

Sekolah Menengah Pertama (SMP)

SMP Umum Madrasah Tsanawiyah (MTs) Pesantren

Sekolah Menengah Atas (SMA)

SMA Umum Madrasah Aliyah (MA) Pesantren Lainnya (Sebutkan):__

Diploma

Akuntansi Syari'ah Pemasaran Ekonomi Pembangunan
 Keuangan Administrasi Bisnis Lainnya (Sebutkan):_____

S-1

Akuntansi Syari'ah Pemasaran Ekonomi Pembangunan
 Keuangan Administrasi Bisnis Hukum Lainnya (Sebutkan):_____

S-2

Akuntansi Syari'ah Pemasaran Ekonomi Pembangunan
 Keuangan Administrasi Bisnis Hukum Bisnis Lainnya (Sebutkan):_____

4. Bank tempat anda bekerja termasuk tipe :

Bank Umum Syari'ah Unit Usaha Syari'ah

5. Apakah anda mengetahui tentang keberadaan Dewan Pengawas Syari'ah (DPS) pada Bank Syari'ah di Indonesia?

Ya Tidak

6. Jabatan : _____

7. Sudah berapa lama anda memegang jabatan yang sekarang : Tahun, Bulan

8. Total pengalaman kerja di bank Syari'ah : Tahun, Bulan

9. Total pengalaman kerja di bank secara keseluruhan : Tahun, Bulan

10. Alamat korespondensi yang dapat dihubungi:

Alamat E-mail : _____ No. Telephone : _____

PETUNJUK UMUM

Anda diminta untuk menjawab semua pertanyaan.

Silahkan untuk melingkari salah satu dari skala yang tersedia yang paling sesuai menurut anda.

1=Tidak Setuju.....5=Setuju

BAGIAN II-URGENSI KEBERADAAN Dewan Pengawas Syari'ah (DPS)

1. Manfaat atas keberadaan DPS

		Tidak Setuju			Setuju	
1	Memberikan keyakinan kepada semua pihak yang berkepentingan dengan bank Syari'ah bahwa seluruh kegiatan dan transaksi bank Syari'ah memenuhi prinsip-prinsip Syari'ah.	1	2	3	4	5
2	Menyediakan pedoman berupa fatwa dan peraturan-peraturan yang terkait dengan pemenuhan prinsip-prinsip Syari'ah dalam kegiatan dan transaksi yang dilakukan oleh bank Syari'ah.	1	2	3	4	5
3	Menyediakan saran-saran yang terkait dengan pemenuhan prinsip-prinsip Syari'ah dalam kegiatan dan transaksi yang dilakukan oleh bank Syari'ah.	1	2	3	4	5
4	Menyediakan dan melaksanakan pelatihan-pelatihan yang terkait dengan pemenuhan prinsip-prinsip Syari'ah dalam kegiatan dan transaksi yang dilakukan oleh bank Syari'ah.	1	2	3	4	5

Lainnya (Sebutkan): _____

2. Karakteristik Anggota DPS:

		Tidak Setuju			Setuju	
1	Anggota Dewan Pengawas Syari'ah (DPS) Bank Umum Syari'ah dan Unit Usaha Syari'ah <u>minimum</u> terdiri dari tiga orang.	1	2	3	4	5
2	Anggota DPS Bank Umum Syari'ah dan Unit Usaha Syari'ah harus memiliki keahlian dan pengetahuan Syari'ah dan Fiqh Mu'amalah yang mendalam.	1	2	3	4	5
3	Anggota DPS Bank Umum Syari'ah dan Unit Usaha Syari'ah harus memiliki gelar keilmuan formal sekurang-kurangnya S-1 dalam bidang Syari'ah (Fiqh Mu'amalah).	1	2	3	4	5

4	Latar belakang ke-ilmuan anggota DPS Bank Umum Syari'ah dan Unit Usaha Syari'ah idealnya terdiri dari tiga bidang ilmu yaitu Syari'ah (Fiqh Mu'amalah), Ekonomi dan Hukum.	1	2	3	4	5
5	Anggota DPS Bank Umum Syari'ah dan Unit Usaha Syari'ah harus memiliki pengetahuan yang mendalam tentang aktifitas dan transaksi yang dilakukan oleh bank Syari'ah.	1	2	3	4	5

Lainnya (Sebutkan): _____

Bagian III-TANGGUNG JAWAB Dewan Pengawas Syari'ah (DPS)

1. Peran dan tanggung jawab anggota DPS adalah sebagai berikut:

		Tidak Setuju			Setuju	
1	Mengawasi dan memastikan <u>seluruh kegiatan dan transaksi</u> bank Syari'ah memenuhi prinsip-prinsip Syari'ah.	1	2	3	4	5
2	Mengawasi dan memastikan <u>seluruh produk</u> bank Syari'ah memenuhi prinsip-prinsip Syari'ah.	1	2	3	4	5
3	Menggunakan <u>metode sampel</u> dalam mengawasi dan memastikan <u>seluruh kegiatan dan transaksi</u> bank Syari'ah memenuhi prinsip-prinsip Syari'ah.	1	2	3	4	5
4	Menggunakan <u>metode sampel</u> dalam mengawasi dan memastikan <u>seluruh produk</u> bank Syari'ah memenuhi prinsip-prinsip Syari'ah.	1	2	3	4	5
5	Menilai apakah dasar pembagian laba untuk pemegang saham dan nasabah (tabungan dan deposito Mudārabah) memenuhi prinsip-prinsip Syari'ah.	1	2	3	4	5
6	Memastikan <u>seluruh pendapatan</u> bank Syari'ah memenuhi prinsip-prinsip Syari'ah.	1	2	3	4	5
7	Menilai apakah perhitungan kewajiban Zakat bank Syari'ah memenuhi prinsip-prinsip Syari'ah	1	2	3	4	5

Lainnya (Sebutkan): _____

2. Anggota DPS harus bertanggung jawab secara legal (menurut undang-undang) kepada:

		Tidak Setuju			Setuju	
1	Nasabah Penabung (seperti Wadi'ah dan Mudārabah)	1	2	3	4	5
2	Pemegang Saham	1	2	3	4	5
3	Direksi	1	2	3	4	5
4	Bank Indonesia (Badan Regulator)	1	2	3	4	5

5	Dewan Syari'ah Nasional-Majelis 'Ulamā Indonesia (DSN-MUI)	1	2	3	4	5
6	Nasabah pembiayaan (seperti Murābahah dan Ijarah)	1	2	3	4	5
7	Masyarakat Muslim secara keseluruhan	1	2	3	4	5

Lainnya (sebutkan): _____

1. DPS harus bertanggung jawab secara keagamaan dan sosial kepada:

		Tidak Setuju			Setuju	
1	Nasabah Penabung (seperti Wadi'ah dan Mudārabah).	1	2	3	4	5
2	Pemegang Saham.	1	2	3	4	5
3	Direksi.	1	2	3	4	5
4	Bank Indonesia (Badan Regulator).	1	2	3	4	5
5	Dewan Syari'ah Nasional-Majelis 'Ulamā Indonesia (DSN-MUI).	1	2	3	4	5
6	Nasabah pembiayaan (seperti Murābahah dan Ijarah)	1	2	3	4	5
7	Masyarakat Muslim secara keseluruhan.	1	2	3	4	5

Lainnya (sebutkan): _____

BAGIAN IV-INDEPENDENSI Anggota Dewan Pengawas Syari'ah (DPS)

Untuk menjaga independensinya, anggota DPS seharusnya:

		Tidak Setuju			Setuju	
1	Menjalankan peran dan tanggung jawabnya sebagai <u>karyawan paruh waktu</u> dari bank Syari'ah yang bersangkutan.	1	2	3	4	5
2	<u>Hanya</u> memperoleh honorarium yang berasal dari <u>badan regulator</u> (misalnya Bank Indonesia).	1	2	3	4	5
3	Tidak merangkap jabatan sebagai anggota DSN-MUI pada saat yang bersamaan.	1	2	3	4	5
4	Dilarang untuk menjadi konsultan, misalnya untuk pengembangan produk, pada bank Syari'ah dimana ia bertindak sebagai anggota DPS.	1	2	3	4	5
5	Dilarang untuk menjadi pemegang saham mayoritas pada bank Syari'ah dimana ia bertindak sebagai anggota DPS.	1	2	3	4	5

Lainnya (Sebutkan): _____

Untuk tetap independen, anggota DPS harus ditunjuk oleh:

		Tidak Setuju			Setuju	
		1	2	3	4	5
1	Nasabah penabung (seperti Wadi'ah dan Mud'arabah).	1	2	3	4	5
2	Pemegang saham.	1	2	3	4	5
3	Direksi.	1	2	3	4	5
4	Bank Indonesia (Badan Regulator).	1	2	3	4	5
5	Dewan Syari'ah Nasional-Majelis 'Ulama Indonesia (DSN-MUI).	1	2	3	4	5

Lainnya (Sebutkan): _____

BAGIAN V- PROSEDUR Pengawasan Syari'ah

Dalam melaksanakan pengawasan Syari'ah, Anggota DPS harus mengikuti prosedur berikut:

		Tidak Setuju			Setuju	
		1	2	3	4	5
1	Perencanaan audit Syari'ah harus disusun berdasarkan pemahaman yang mendalam atas operasional bank Syari'ah; seperti produk yang ditawarkan, nilai aset, jumlah dan lokasi cabang yang dimiliki	1	2	3	4	5
2	Audit Syari'ah dilakukan dengan menggunakan metode sampel atas transaksi dan kegiatan yang dilakukan oleh bank Syari'ah	1	2	3	4	5
3	Dalam menentukan kriteria dan besarnya sample transaksi-transaksi yang diambil tergantung kepada tingkat kerumitan dan frekuensi transaksi tersebut	1	2	3	4	5
4	Anggota DPS harus mendapatkan pernyataan dari manajemen bahwa manajemen bertanggung jawab sepenuhnya atas pemenuhan prinsip-prinsip Syari'ah dalam seluruh aktivitas dan transaksi bank Syari'ah.	1	2	3	4	5
5	Anggota DPS harus menelaah transaksi, kontrak, perjanjian dan lain-lain yang dilakukan oleh bank Syari'ah.	1	2	3	4	5
6	Anggota DPS harus menilai apakah bank Syari'ah melakukan transaksi berdasarkan produk yang sudah disetujui oleh DPS.	1	2	3	4	5
7	Anggota DPS perlu menelaah informasi dan laporan lainnya seperti surat edaran dan surat keputusan yang dikeluarkan oleh direksi untuk kalangan internal bank Syari'ah; pelaporan keuangan dan lain-lain.	1	2	3	4	5

8	Anggota DPS perlu berkoordinasi dan berkonsultasi dengan pengawas lainnya seperti Akuntan publik, Bank Indonesia dan lain-lain.	1	2	3	4	5
9	Anggota DPS harus mendiskusikan hasil temuannya selama mereka melakukan audit Syari'ah dengan direksi.	1	2	3	4	5
10	Anggota DPS membuat laporan setelah melaksanakan dan mendiskusikan temuan audit Syari'ah dengan direksi.	1	2	3	4	5

Lainnya (sebutkan): _____

2. Setelah melaksanakan pemeriksaan Syari'ah, anggota DPS harus membuat laporan hasil pemeriksaan yang dimuat dalam laporan tahunan bank Syari'ah kepada:

		Tidak Setuju			Setuju	
1	Nasabah penabung (seperti Wadi'ah dan Mu'ārabah)	1	2	3	4	5
2	Pemegang Saham	1	2	3	4	5
3	Nasabah pembiayaan (seperti Murābahah dan Ijarah)	1	2	3	4	5
4	Masyarakat Muslim secara keseluruhan	1	2	3	4	5

Lainnya (Sebutkan): _____

3. Setelah melaksanakan pemeriksaan Syari'ah, anggota DPS harus membuat laporan khusus yang memuat hasil pemeriksaan kepada:

		Tidak Setuju			Setuju	
1	Direksi	1	2	3	4	5
2	Bank Indonesia	1	2	3	4	5
3	Dewan Syari'ah Nasional-Majelis Ulama Indonesia (DSN-MUI)	1	2	3	4	5

Lainnya (Sebutkan): _____

Terima Kasih Atas Kerja Sama dan Perhatian yang Bapak/ Ibu Berikan

APPENDIX IV

MEMBERS OF *SHARĪ'AH* ADVISORY COUNCIL OF ISLAMIC BANK IN INDONESIA

Members of *Shari'ah* Advisory Council of Islamic Bank in Indonesia

No	Name of Bank	Name of <i>Shari'ah</i> Advisor
1	Bank Muamalat Indonesia	1. KH. Sahal Mahfudh
		2. KH. Ma'ruf Amin
		3. Prof.Dr. H. Umar Sihab
		4. Prof.Dr.H. Muardi Chatib
2	Bank Syari'ah Mandiri	1. Prof. KH. Ali Yafie
		2. Prof.Dr. H. Said Agil Munawar
		3. Drs. H. Moh. Hidayat, MA
		4. Dr. H. M. Syafi'i Antonio, M.Ec
3	Islamic Banking Unit-BNI	1. KH. Ma'ruf Amin
		2. Drs. Hasanudin, M.Ag
4	Islamic Banking Unit-BRI	1. Prof. KH. Asmuni Abdurrahman
		2. Drs. Kamaen Perwataatmadja, MPA
		3. Cholid Fadlullah, SH
5	Islamic Banking Unit-Bank Danamon	1. Prof.Dr.H. Din Syamsuddin
		2. Drs. Hasanudin, M.Ag
		3. Ir. H. Adiwaman A.Karim, MAEP
6	Islamic Banking Unit-Bukopin	1. Dr. H. Didin Hafiduddin, MS
		2. Prof. H. Mustafa Ya'qub, MA
		3. H. Ikhwan Abidin Basri, MA, M.Ec
7	Islamic Banking Unit-BII	1. Dr. H. Anwar Ibrahim, MA
		2. Drs. Nahar Nahrawi, MA
		3. Abdul Jabar Madjid, MA
8	Islamic Banking Unit-Bank IFI	1. Dr. H. Didin Hafiduddin, MS
		2. Drs. Ichwan Sam
		3. H. Ikhwan Abidin Basri, MA, M.Ec

Source: Bank Indonesia (2004c)

APPENDIX V

SAMPLE QUESTION FOR INTERVIEW

QUESTIONS USED TO INTERVIEW THE SHARĪ'AH ADVISORS

I. RESPONSIBILITY OF Sharī'ah Advisory Council

1. What are the responsibilities of the Sharī'ah Advisory Council?
2. How do the Sharī'ah Advisory Council ensure that all of Islamic banks' activities and transactions are in compliance with Sharī'ah principles?
3. Once the Sharī'ah Advisory Council have approved that the products are in accordance with the Sharī'ah principles, e.g. Murabahah, how do the Sharī'ah Advisory Council ensure that the Islamic banks have followed all of the requirements related with that particular products?
4. How do the SAC find out that all of Islamic banks' investments are in accordance with Sharī'ah principles?
5. What are the requirements that a person needs to full fill in order to be a member of Sharī'ah Advisory Council of Islamic bank?
6. In order to be able to perform the responsibilities of Sharī'ah A Advisory Council, how many are the minimum members of Sharī'ah Advisory Council in an Islamic bank?
7. Do you think that the numbers of SAC members in an Islamic bank should be limited? Why or Why not?

II. Sharī'ah Advisors' INDEPENDENCE

1. What is the mechanism in appointing a person to be the member of Sharī'ah Advisory Council?
2. What kind of relationship between the Sharī'ah advisors and management of Islamic banks should have in maintaining the independence of Sharī'ah advisors?
3. The Sharī'ah Advisory Council (SAC) in performing their duties bind with all of the *fatwa* and guidelines issued by the National Sharī'ah Advisory Council. Meanwhile, members of the National Sharī'ah Advisory Council are also able to be the member of Sharī'ah Advisory Council of an Islamic financial institution, eg. Islamic bank, at the same time. Will this particular situation create conflict of interest? Why? Or Why not?
4. The Islamic banks usually will employ the consultant, e.g. in developing a product. If the Sharī'ah advisors are allowed to be the consultant for the bank at the same time he/she acts as a member of Sharī'ah Advisory Council of the bank, will it influence or reduce the independence of Sharī'ah Advisors? Why? Or Why not?
5. Should the Sharī'ah Advisors be remunerated?
6. To whom should the Sharī'ah Advisory Council be responsible for?

III. Procedures of SHARĪ'AH REVIEW

1. What are the things that the Sharī'ah Advisors should prepare in making a proper Review plan?
2. How do the Sharī'ah Advisors ensure that all the products, *'aqd* (contracts), transactions and activities of Islamic banks are in accordance with the Islamic principles?
3. What are the documents and information that the Sharī'ah Advisors need to review in conducting a Sharī'ah Review?
4. Who are the other parties that the Sharī'ah Advisors need to discuss with in performing Sharī'ah Review?
5. How do the Sharī'ah Advisors prevent the Islamic banks from activities which break the Islamic principles?
6. What will the Sharī'ah Advisors do if they find out that the Islamic banks have done activities which are not inline with the Sharī'ah principles? Should the Sharī'ah Advisors need to discuss those unlawful activities and transactions with the management of Islamic banks? Why? Or Why not?
7. If the Sharī'ah Advisors found breach of Sharī'ah should they report the breach in the annual report?

APPENDIX VI

INTERVIEW SUMMARY

Interview Summary of *Shari'ah* Advisors (SAs) of Islamic Banks (IBs)

A. Responsibility of SAs

No	Interviewee <i>Shari'ah</i> Advisors	Opinion
1	SA1	<ol style="list-style-type: none"> To supervise the IBs' operations in following <i>Shari'ah</i> (<i>fatwa(s)</i>) of National <i>Shari'ah</i> Council-Majelis 'Ulamā Indonesia (NSC-IUC)). To monitor the attitudes of the IBs' employee.
2	SA2	<ol style="list-style-type: none"> To supervise the IBs' operations in following <i>Shari'ah</i> (<i>fatwa(s)</i>) of NSC-IUC).
3	SA3	<ol style="list-style-type: none"> To supervise the IBs' operations in following <i>Shari'ah</i> (<i>fatwa(s)</i>) of NSC-IUC).
4	SA4	<ol style="list-style-type: none"> To supervise whether the products offered are compliance with <i>Shari'ah</i> (<i>fatwa(s)</i>) of NSC-IUC) To supervise the IBs operations in following <i>Shari'ah</i> (<i>fatwa(s)</i>) of NSC-IUC). To initiate innovation of products offered by the IBs. However, at last the new products need to be endorsed by the NSC-IUC. In case, there is no any <i>fatwa(s)</i> which can cover the transactions and activities that will be done by the IBs, the SAs may provide them with <i>Shari'ah</i> opinion.
5	SA5	<ol style="list-style-type: none"> To supervise the IBs' operations in following <i>Shari'ah</i> (<i>fatwa(s)</i>) of NSC-IUC). In case, there is no any <i>fatwa</i> which can cover the transactions and activities that will be done by the IBs, the SAs may provide them with <i>Shari'ah</i> opinion.

B. Characteristics of SAs

No	Interviewee <i>Shari'ah</i> Advisors	Opinion
1	SA1	<ol style="list-style-type: none"> Since the SAs do not have to be able to read/understand well the Financial Statement, the members of SAs should consist of <i>Shari'ah</i> scholars only. Period of time is not more than 5 years. Well known with Islamic banking products. Have a good reputation as a Muslim.
2	SA2	<ol style="list-style-type: none"> Ideally, members of the <i>Shari'ah</i> Advisory Council (SAC) consist of <i>Shari'ah</i> scholars who are also expert in law (positive law) and Islamic banking (economy). Minimum three members; <i>Shari'ah</i>, law and economy.
3	SA3	<ol style="list-style-type: none"> Ideally, the SAs consist of <i>Shari'ah</i> scholars who are also expert in law (positive law) and Islamic banking (economy). Minimum three members; <i>Shari'ah</i>, law and economy.
4	SA4	<ol style="list-style-type: none"> The SAs have a good knowledge in <i>Shari'ah</i> (<i>Fiqh Al-Muamalah</i>). The SAs also have to have a good knowledge in economics, Islamic banking practices and also basic accounting. The SAs must have a good reputation. The SAs should supervise maximum only one or two IBs at the same time.
5	SA5	<ol style="list-style-type: none"> The SAs have a good knowledge in <i>Shari'ah</i> <i>Fiqh Al-Muamalah</i>). The SAs also have to have a good knowledge in economics, law, Islamic banking practices and also basic accounting.

B. Characteristics of SAs (Continued)

No	Interviewee <i>Shari'ah</i> Advisors	Opinion
5	SA5	<ol style="list-style-type: none"> 1. The SAs should supervise maximum only two IBs at the same time. 2. The SAs should be replaced each 5 years. Yet, the standard on the job of SAs must be prepared first.

C. Number of SAs

No	Interviewee <i>Shari'ah</i> Advisors	Opinion
1	SA1	1. Members of SAs depend on the size of the IB.
2	SA2	1. The ideal number of SAs of IBs is three people. This is related to the three different knowledge that the SAs must have, such as; <i>Shari'ah</i> , law and economy.
3	SA3	1. The ideal number of SAs of IBs is three people. This is related to the three different knowledge that the SAs must have, such as; <i>Shari'ah</i> , law and economy.
4	SA4	1. The ideal number is around of three to five. Yet, it also depends on the size of the IB. By having these numbers, it is expected that the SAs can perform their job well.
5	SA5	1. The ideal number of SAs of IBs is three people. This is related to the three different knowledge that the SAs must have, such as; <i>Shari'ah</i> , law and economy

D. Appointment of SAs

No	Interviewee <i>Shari'ah</i> Advisors	Opinion
1	SA1	<ol style="list-style-type: none"> 1. The SAs are nominated by the Shareholders of IBs during the Annual General Meeting. 2. The NSC-IUC will perform a fit and proper test. 3. The NSC-IUC will submit the names of nominees for SAs who pass the fit and proper test to Bank Indonesia. 4. Bank Indonesia will give recommendations. 5. The NSC-IUC will appoint the SAs nominees based on BI recommendations.
2	SA2	<ol style="list-style-type: none"> 1. The SAs are nominated by the Management of IBs. 2. If the person who is nominated by the management of IB has a good and qualify reputation in <i>Shari'ah</i>, the NSC-IUC will directly give their approval. 3. Yet, for those who are not well-known as experts in <i>Shari'ah</i>, they need to have a fit and proper test. The test for <i>Shari'ah</i> knowledge is managed by NSC-IUC, meanwhile for the Islamic banking expertise is at the hand of Bank Indonesia. 4. For those who have passed the fit and proper test, NSC-IUC will submit their names to Bank Indonesia, to verify their reputation and credibility in banking industry. 5. If Bank Indonesia assures that those particular names are considered to have a good reputation and credibility in banking Industry, the Bank Indonesia will give recommendation. 6. Based on the Bank Indonesia recommendation, the NSC-IUC will appoint the nominees for SAs.
3	SA3	<ol style="list-style-type: none"> 1. The SAs are nominated by the Management of IBs. 2. If the person who is nominated by the management of IB has a good and qualify reputation in <i>Shari'ah</i>, the NSC-IUC will directly give their approval.

D. Appointment of SAs (Continued)

No	Interviewee <i>Shari'ah</i> Advisors	Opinion
3	SA3	<ol style="list-style-type: none"> 1. The SAs are nominated by the Management of IBs. 2. If the person who is nominated by the management of IB has a good and qualify reputation in <i>Shari'ah</i>, the NSC-IUC will directly give their approval. 3. Yet, for those who are not well known expert in <i>Shari'ah</i>, they need to have a fit and proper test. The test for <i>Shari'ah</i> knowledge is managed by NSC-IUC, meanwhile for the Islamic banking expertise is in the hand of Bank Indonesia. 4. For those who have passed the fit and proper test, NSC-IUC will give their names to Bank Indonesia, to verify their reputation and credibility in banking industry. 5. If Bank Indonesia assures that those particular names are considered to have a good reputation and credibility in banking Industry, the Bank Indonesia will give recommendation. 6. Based on the Bank Indonesia recommendation, the NSC-IUC will appoint the SAs nominees for SAs.
4	SA4	<ol style="list-style-type: none"> 1. The SAs are nominated by the Management of IBs. 2. If the person who is nominated by the management of IB has a good and qualify reputation in <i>Shari'ah</i>, the NSC-IUC will directly give their approval. 3. Yet, for those who are not well known expert in <i>Shari'ah</i>, they need to have a fit and proper test. The test for <i>Shari'ah</i> knowledge is managed by NSC-IUC, meanwhile for the Islamic banking expertise is in the hand of Bank Indonesia. 4. For those who have passed the fit and proper test, NSC-IUC will give their names to Bank Indonesia, to verify their reputation and credibility in banking industry. 5. If Bank Indonesia assures that those particular names are considered to have a good reputation and credibility in banking Industry, the Bank Indonesia will give recommendation. 6. Based on the Bank Indonesia recommendation, the NSC-IUC will appoint the nominees for SAs.
5	SA5	<ol style="list-style-type: none"> 1. The SAs are nominated by the Management of IBs. These names are directly approved by the NSC-IUC since those names have a good reputation as experts in Islamic banking and finance. 2. Yet, the NSC-IUC should conduct a fit and proper test to the nominees for SAs.

E. SAs and NSC-IUC

No	Interviewee <i>Shari'ah</i> Advisors	Opinion
1	SA1	<ol style="list-style-type: none"> 1. If there is any member of SAs in an IB who is also acting as the member of NSC-IUC at the same time, it will not create conflict of interest. It is because the NSC-IUC does not consist of the SAs only. It should be noted that during period of 1992 until 1997, most of the SAC members of BMI acted as the leaders of IUC.
2	SA2	<ol style="list-style-type: none"> 1. One of the SAs must be acting as the NSC-IUC member at the same time. Thus, it can be assumed that the SAs really understand with all the <i>fatwa(s)</i> launched by the NSC-IUC as the sources to supervise the <i>Shari'ah</i> compliance of the IB. 2. If there is any transaction of the IB which is not ruled by any <i>fatwa(s)</i> of NSC-IUC, the particular SA may directly bring the case into the NSC-IUC meeting.

E. SAs and NSC-IUC (Continued)

No	Interviewee <i>Shari'ah</i> Advisors	Opinion
3	SA3	<ol style="list-style-type: none"> 1. One of the SAs must be acting as the NSC-IUC member at the same time. Thus, it can be assumed that the SAs really understand with all the <i>fatwa(s)</i> launched by the NSC-IUC as the sources to supervise the <i>Shari'ah</i> compliance of the IB. 2. If there is any transaction of the IB which is not ruled by any <i>fatwa(s)</i> of NSC-IUC, the particular SA may directly bring
4	SA4	<ol style="list-style-type: none"> 1. It is positive to keep that some members of SAs are also acting as the NSC-IUC at the same time. Thus, it can be assumed that the SAs really understand with all the <i>fatwa(s)</i> launched by the NSC-IUC as the sources to supervise the <i>Shari'ah</i> compliance of the IB. 2. Although there will be some possible negative impacts by keeping this particular relationship, it may reduce by having a proper regulation.
5	SA5	<ol style="list-style-type: none"> 1. One of the SAs must be acting as the NSC-IUC member at the same time. Thus, it can be assumed that the SAs really understand with all the <i>fatwa(s)</i> launched by the NSC-IUC as the sources to supervise the <i>Shari'ah</i> compliance of the IB. 2. If there is any transaction of the IB which is not ruled by any <i>fatwa(s)</i> of NSC-IUC, the particular SA may directly bring the case into the NSC-IUC meeting.

F. SAs and Consultant of IBs

No	Interviewee <i>Shari'ah</i> Advisors	Opinion
1	SA1	<ol style="list-style-type: none"> 1. If there is any member of SAs in an IB who is also acting as the consultant for the particular bank at the same time, it will create conflict of interest as the SAs should supervise the job of the consultant.
2	SA2	<p>The SAs are not allowed to be the consultant to the same IB at the same time since it can create conflict of interest.</p> <p>The consultant is assisting management of the bank in creating products offered to the market; meanwhile the SAs have to supervise whether the products and transactions have adhered with the <i>fatwa(s)</i> of the NSC-IUC.</p>
3	SA3	<ol style="list-style-type: none"> 1. The SAs are not allowed to be the consultant to the same IB at the same time since it can create conflict of interest. 2. It is because the consultant assists management of the bank in creating products offered to the market; meanwhile the SAs have to supervise whether the products and transactions have adhered with the <i>fatwa(s)</i> of the NSC-IUC.
4	SA4	-
5	SA5	<ol style="list-style-type: none"> 1. The SAs are not allowed to be the consultant to the same IB at the same time since it can create conflict of interest. 2. It is because the consultant assists management of the bank in creating products offered to the market; meanwhile the SAs have to supervise whether the products and transactions have adhered with the <i>fatwa(s)</i> of the NSC-IUC

G. Remuneration of SAs

No	Interviewee <i>Shari'ah</i> Advisors	Opinion
1	SA1	<ol style="list-style-type: none"> 1. The SAs receive remuneration from the IB based on certain percentage of the revenue earned by the IB. 2. The SAs should receive remuneration from the regulator (e.g. Bank Indonesia) in order to maintain and improve the SAs' independence.

G. Remuneration of SAs (Continued)

No	Interviewee <i>Shari'ah</i> Advisors	Opinion
1	SA1	1. Indeed that some members of SAC may have a significant amount of remuneration
2	SA2	1. Basically, SAs are not really influenced by the remuneration in a performing critics and corrections to managements. 2. Yet, if the remuneration is given by the regulators (e.g. bank Indonesia), it is enable to improve and maintain the independence of SAs.
3	SA3	1. Basically, SAs are not really influenced by the remuneration in a performing critics and corrections to managements. 2. Yet, if the remuneration is given by the regulators (e.g. bank Indonesia), it is enable to improve and maintain the independence of SAs
4	SA4	1. Basically, SAs are not really influenced by the remuneration in a performing critics and corrections to managements. 2. Yet, if the remuneration is given by the regulators (e.g. bank Indonesia), it is enable to improve and maintain the independence of SAs
5	SA5	1. Basically, SAs are not really influenced by the remuneration in a performing critics and corrections to managements. 2. However, it is true that there are some <i>Shari'ah</i> scholars who expect to have remuneration from the bank since the value is quite significant. 3. Yet, if the remuneration is given by the regulators (e.g. bank Indonesia), it is enable to improve and maintain the independence of SAs

H. To Whom SAs Should be Responsible

No	Interviewee <i>Shari'ah</i> Advisors	Opinion
1	SA1	1. Legally, the SAs should be responsible to NSC-IUC. 2. Yet, the SAs must attend the AGM in order to deliver their <i>Shari'ah</i> review report to the shareholders. 3. The SAs should have a standard form of <i>Shari'ah</i> review.
2	SA2	1. The SAs need to be religiously/socially responsible mainly to Allah SWT, NSC-IUC and the Muslim <i>Ummah</i> . 2. Yet, since the SAs are appointed by the NSC-IUC, they need to responsible to the NSC-IUC.
3	SA3	1. The SAs need to be religiously/socially responsible mainly to Allah SWT, NSC-IUC and the Muslim <i>Ummah</i> . 2. Yet, since the SAs are appointed by the NSC-IUC, they need to responsible to the NSC-IUC
4	SA4	1. Legally, the SAs need to be responsible to shareholders, if the NSC-IUC is assumed as the board of commissioners. 2. Yet, if the SAs are still assumed to be representing the NSC-IUC, they need to be legally responsible to NSC-IUC and Bank Indonesia. 3. Religiously, the SAs are responsible to Depositors, Shareholders, managements and NSC-IUC and Muslim society as a whole.
5	SA5	The SAs need to be religiously/socially responsible mainly to Allah SWT, NSC-IUC and the Muslim <i>Ummah</i> . Yet, since the SAs are appointed by the NSC-IUC, they need to responsible to the NSC-IUC. Legally, the SAs should be responsible to the shareholders and the NSC-IUC

I. Preparation of *Shari'ah* Review Planning

No	Interviewee <i>Shari'ah</i> Advisors	Opinion
1	SA1	<ol style="list-style-type: none"> 1. The SAs receive a report contained the information with regards to the IB's operations directly from the board directors regularly. 2. Based on this particular report, the SAs conclude the <i>Shari'ah</i> compliance of the IBs' operations.
2	SA2	<ol style="list-style-type: none"> 1. The SAs receive a report contained the information with regards to the IB's operations directly from the head of division regularly. 2. Based on this particular report, the SAs conclude the <i>Shari'ah</i> compliance of the IB's operations.
3	SA3	<ol style="list-style-type: none"> 1. The SAs receive a report contained the information with regards to the IB's operations directly from the head of division regularly. 2. Based on this particular report, the SAs conclude the <i>Shari'ah</i>
4	SA4	<ol style="list-style-type: none"> 1. The SAs will ask for documents and '<i>aqd</i>' of the IB's transactions.
5	SA5	<ol style="list-style-type: none"> 1. The SAs will ask for documents and '<i>aqd</i>' of the IB's transactions. 2. The SAs receive a report contained the information with regards to the IB's operations directly from the head of division regularly. 3. Based on this particular report, the SAs conclude the <i>Shari'ah</i> compliance of the IBs' operations

J. Method to Ensure that the IBs' Operations are in Compliance with the *Shari'ah*

No	Interviewee <i>Shari'ah</i> Advisors	Opinion
1	SA1	<ol style="list-style-type: none"> 1. The board of directors of IB needs to discuss with the SAs before they have launched a product. 2. If there is any report that the IB break the <i>Shari'ah</i>, the SAs will invite and confirm with the management of IB. 3. The SA should be assisted by some inspectors. These inspectors are responsible to evaluate directly the appropriateness of IBs operations with <i>fatwa(s)</i> NSC-IUC. 4. The Inspectors should not be considered as the IBs' employee. Yet, they are appointed by the NSC-IUC. In addition, they have to be responsible to the SAs.
2	SA2	<ol style="list-style-type: none"> 1. The head of division of IB needs to discuss with the SAs before they have launched a product. 2. If there is any report that the IBs break the <i>Shari'ah</i>, the SAs will invite and confirm with the head of division of IB. 3. The SAs must be assisted with a staff. He/she will be responsible to document the SAs' entire job.
3	SA3	<ol style="list-style-type: none"> 1. The head of division of IB needs to discuss with the SAs before they have launched a product. 2. If there is any report that the IBs break the <i>Shari'ah</i>, the SAs will invite and confirm with the head of division of IB. 3. The SAs must be assisted with a staff. He/she will be responsible to document the SAs' entire job.
4	SA4	<ol style="list-style-type: none"> 1. The SAs need to check all the '<i>aqd</i>'. 2. If the SAs conclude that all '<i>aqd</i>' are not inline with <i>Shari'ah</i>, the '<i>aqd</i>' would be revoked. 3. The SAs would check all of the '<i>aqd</i>' based on sampling method. 4. The SAs should visit the branch of the IBs, at least twice a year. Yet, it depends on the policy of the management. 5. The SAs need to be assisted by a secretary. This secretary is considered as the banks employee. 6. The secretary is responsible to document the SAs entire job. 7. The SAs do not need an explicit statement that the responsibility on <i>Shari'ah</i> compliance lays on the management.

J. Method to Ensure that the IBs' Operations are in Compliance with the *Shari'ah* (Continued)

No	Interviewee <i>Shari'ah</i> Advisors	Opinion
5	SA5	<ol style="list-style-type: none"> 1. The SAs should be assisted by the Internal <i>Shari'ah</i> auditor. Yet, this idea should be supported by the regulators and governments. 2. The SAs need to check all the 'aqd based on the sampling method, before the IB conduct a transaction. 3. The SAs should visit the branch of the IB, at least once in three months. This is aimed to check whether the branch(s) still conduct the transactions ('aqd) based on the NSC-IUC <i>fatwa(s)</i>. 4. The SAs do not need an explicit statement that the responsibility on <i>Shari'ah</i> compliance lays on the management. 5. The management of IB is responsible to follow the <i>fatwa(s)</i> of NSC-IUC.

K. Kinds of Documents Reviewed by the SAs

No	Interviewee <i>Shari'ah</i> Advisors	Opinion
1	SA1	<ol style="list-style-type: none"> 1. The entire model of 'aqd before the product or transaction is made with the clients. 2. Only a report prepared regularly which is reviewed by the SAs.
2	SA2	<ol style="list-style-type: none"> 1. The entire model of 'aqd before the product or transaction is made with the clients. 2. Only a report prepared regularly which is reviewed by the SAs.
3	SA3	<ol style="list-style-type: none"> 1. The entire model of 'aqd before the product or transaction is made with the clients. 2. Only a report prepared regularly which is reviewed by the SAs.
4	SA4	<ol style="list-style-type: none"> 1. Every single 'aqd done by the IBs needs to be reviewed by the SAs.
5	SA5	<ol style="list-style-type: none"> 1. The entire model of 'aqd before the product or transaction is made with the clients 2. Every single 'aqd done by the IBs needs to be reviewed by the SAs.

L. Method to Prevent the IBs in Breaking the *Shari'ah*

No	Interviewee <i>Shari'ah</i> Advisors	Opinion
1	SA1	<ol style="list-style-type: none"> 1. The SAs will give some advices to the management (board of directors) of IB so that the IB must adhere with the <i>Shari'ah</i> in all of their operations.
2	SA2	<ol style="list-style-type: none"> 1. The SAs will give some advices to the management (head of division) of IB so that the IB must adhere with the <i>Shari'ah</i> in all of their operations.
3	SA3	<ol style="list-style-type: none"> 1. The SAs will give some advices to the management (head of division) of IB so that the IB must adhere with the <i>Shari'ah</i> in all of their operations
4	SA4	<ol style="list-style-type: none"> 1. The SAs should take initiatives to inform all the <i>fatwa(s)</i> issued by the NSC-IUC. 2. The management (head of division) of IBs should invite the SAs before the banks launch a new product.
5	SA5	<ol style="list-style-type: none"> 1. The SAs release a formal letter to inform and to remind the management (head of division) to adhere the <i>Shari'ah</i> (<i>fatwa(s)</i> of NSC-IUC) 2. This formal letter is sent to the Top Management (board of directors).

M. Procedures Taken by SAs if They Found the IBs Break the *Shari'ah*

No	Interviewee <i>Shari'ah</i> Advisors	Opinion
1	SA1	<ol style="list-style-type: none"> 1. The SAs will directly make a confirmation with the management of IB (board of directors). 2. If it is true, the SAs will report these unlawful operations (if any) to the Board of Commissioners (representing the share holders). 3. The board of Commissioners will write a memo to remind the management for not conducting any prohibited transactions. 4. If after the management of IBs got a memo from the board of commissioners, the SAs still find that the IBs still perform an unlawful transaction, the SAs will report this particular matter directly to the NSC-IUC. 5. The NSC-IUC will make a report on this unlawful transaction to Bank Indonesia. Finally, the Bank of Indonesia will make a final decision.
2	SA2	<ol style="list-style-type: none"> 1. The SAs will directly make a confirmation with the management of IB (head of division). 2. If it is true, the SAs will report these unlawful operations (if any) to the Board of Directors and Board of Commissioners (representing the share holders).
3	SA3	<ol style="list-style-type: none"> 1. The SAs will directly make a confirmation with the management of IB (head of division). 2. If it is true, the SAs will report these unlawful operations (if any) to the Board of Directors and Board of Commissioners (representing the share holders).
4	SA4	<ol style="list-style-type: none"> 1. If the management of the banks would like to do a transaction which is not governed by the <i>fatwa(s)</i> of NSC-IUC, the SAs will issue a <i>Shari'ah</i> opinion. 2. Yet, this <i>Shari'ah</i> opinion should be immediately brought to the NSC-IUC meeting. The NSC-IUC meeting will review whether this <i>Shari'ah</i> opinion can be formally stated as a <i>fatwa</i>. 3. If the SAs find the managements of IBs perform transactions which break the <i>Shari'ah</i>, the SAs will write a memo to remind the management (head of division) to stop doing prohibited transactions and if it is necessary (after received the memo, the management still conduct prohibited transactions), the SAs will punish the management.
5	SA5	<ol style="list-style-type: none"> 1. The SAs believe that they have supervised the management for not doing any transactions which break the <i>Shari'ah (fatwa(s))</i> of the NSC-IUC)