Ministry of Higher Education and Scientific Research

Higher Business School Kolea

Problems and Challenges Facing Islamic Banking in Algeria

A thesis submitted in fulfillment of the requirements for the degree of Doctor in Management Sciences

"Accounting"

Author:

Imen Hiba ZIANI

Supervisor:

Pr. Mohamed BOUHADIDA

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Prepared by, **Imen Hiba ZIANI**

Jury members

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Mr. Mohammed Nabil Bersali Senior lecturer at University of Blida 2	**Examiner**

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To my beloved parents who have always shown me the path

To my dear husband who has chosen to join me

To my lovely sister and brothers

To my adorable daughters

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In the name of *Allah*, Most Merciful, Most Gracious, Praise be to *Allah*, the lord of the universe, and peace and prayers be upon his final prophet and messenger.

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Table of Contents

List of tables

List of figures

List of abbreviations

AAOIFI	Accounting and Auditing Organisation for *Islamic* Financial Institutions
AIBFI	Algerian Islamic Banking and Finance Industry
ASIFI	Accounting Standards for *Islamic* Financial Institutions
BAFIA	Banking and Financial Institution Act
CCBs	Conventional Commercial Banks
CEO	Chief Executive Officer
COO	Chief Operational Officer
GPS	Guidelines on Governance of *Shari'ah* Committee
GSIFI	Governance Standards *Islamic* Financial Institutions
HC	Human Capital
i.e.	that is
IAIB	International Association of *Islamic* Banks
IASB	International Accounting Standards Board
IB	*Islamic banking*
IBA	*Islamic Banking Act*
IBFI	*Islamic Banking and Finance Industry*
IBS	*Islamic Banking Subsidiary*
IBs	*Islamic Banks*
IBSc	*Islamic Banking Scheme*
ICBs	*Islamic Commercial Banks*
IFI	*Islamic Financial Institutions*
IFRS	International Financial Reporting Standards
IIBFI	International *Islamic* Banking and Finance Industry
KFH	Kuwait Finance House
PLS	Profit and loss sharing
SA	*Shari'ah Audit*
SC	*Shari'ah* Committee
SSB	*Shari'ah* Supervisory Board

Glossary of terms

Adalah Justice

Al-ijarah thumma al-bay' A contract of lease which is subsequently followed by a sale contract

Amanah Trust

Bay' al-dayn A contract of sale of debt

Bay' al-inah A back-to-back sale contract or a sale repurchase, usually the sale is at higher price while the buying back is at a lower price

Bay' al-salam A sales contract where the price is paid in advance and the goods are delivered in the future

Bay' bithaman ajil A sales contract on a deferred payment basis

Dharuriyyat Essentials

Falah Success in both this world and the Hereafter

Fiqh-mu'amalah Islamic law and commercial practices

Gharar Ambiguity and uncertainty present in any contractual relationship

Hadith Traditions of the holy Prophet of Islam describing his utterances, actions, instructions, and actions of others (Companions) tacitly approved by him

Hajiyyat Complementary requirements

Halal Permissible according to the Islamic Law

Haram Prohibited according to the Islamic Law

Harus Permissible practice according to the Islamic Law

Hibah Reward

Ibahah Permissibility

Ihtikar Hoarding

Ijarah A lease contract

Ijarah mawsufah fi al-thimmah A lease contract of a specified future asset which is not in existence at the time of contract

Ijtihad Legal opinion

Israf Extravagance, exaggeration in spending wealth and wasting

Khiyannah Embezzlement

Ma'aruf Propagation of Good

Maqasid-as-Shari'ah Objectives of the Islamic Law

Maslahah Benefits or interest

Maslahah Benefits on different changed circumstances

Mu'amalah All kinds of economic activities related to exchange of goods and services

Mudharabah It is a form of silent partnership between two parties where one provides the capital for a project and the other, *Mudharib*, manages the project. Profits are distributed according to a predetermined ratio while losses are borne by the provider of the capital

Mudharib Entrepreneur within the *Mudharabah* contract

Murabahah A sales contract where the goods are sold at a price which includes a profit margin agreeable to both parties

Musharakah A partnership contract where partners contribute the capital for financing the project. All parties share profits on a pre-agreed ratio but losses are shared on the basis of equity participation

Musharakah mutanaqisah A diminishing partnership contract where the partners usually enter into two types of contracts: a joint ownership contract and an *Ijarah* (lease) contract in which the bank will gradually sell its shares to the client. In terms of distribution of profit and loss in *Musharakah* type of financing, all profits generated will be shared among the partners in a proportion which is mutually agreed on in the contract, while the losses will be shared in proportion to the partners' capital.

Qard al-hasan Charitable loan with no interest

Qiyas Analogical reasoning

Quran The book of Allah revealed to the Prophet *Muhammad* (pbuh)

Riba' An increase over the principal in a loan transaction; usury or interest. In a commodity exchange *Riba* denotes the disparity in the quantity or time of delivery. Technically, *Riba* denotes any increase that must be paid by the borrower to the lender along with the principal sum as a condition for the loan or loan extension

Shari'ah The divine guidance as given by the Holy *Qur'an* and the *Sunnah*, it embodies all aspects of the Islamic faith, including belief and practice

Sunnah Actions, sayings and utterances of the holy Prophet *Muhammad* (pbuh)

Tahsiniyyat Desirable

Takaful A system of insurance in Islam that is based on the principle of mutual assistance (*ta'awun*)

Taqlif Accountability

Tatfif Causing damage

Tawarruq A sale contract where the financial institution will buy an asset and immediately sell it to a customer on a deferred payment basis. The customer then sells the same asset to a third party for immediate delivery and payment, the end result being that the customer receives a cash amount and has a deferred payment obligation for the marked-up price to the financial institution

Tawheed A principle in Islam, i.e. oneness of God

Ummah Muslim nation

Uqud Contracts

Usul al-Fiqh The study of evidences and indications of rules within Islamic law

Usury An equivalent to Riba

Wadi'ah Safekeeping of deposits by customers in a financial institution

Wadi'ah yad dhamanah Safekeeping of deposits by customers in a financial institution where the deposit is guaranteed by the financial institution

Waqf Retention of a property for the benefit of a charitable or a humanitarian objective

Zakat Fund supposed to be collected from the rich to be distributed to the poor to ensure socioeconomic justice through equitable distribution of wealth

Abstract

This research aims to analyse the theoretical and practical aspects of the problems and challenges that impede Islamic Banking and Finance in Algeria. The study focuses on four main issues: the *Shari'ah* Compliance, Legal and Regulatory framework and environment, Accounting and Auditing, and Management. In an attempt to reach the objectives, this research examines the different participants engaged in Islamic Banking and Finance using semi-structured interviews. The main participants are representatives of the Head of *Shari'ah* Committee, *Shari'ah* Supervisors, Heads of Participatory Finance, national and international academicians, and Chief Executive Officers (CEOs). The main problems and challenges that arose from the interview findings are the absence of the Legal and Regulatory structure, inadequate micro-economic and macro-economic environment, *Shari'ah* Compliance under a secular environment, shortage of Human Capital expertise, and lack of Accounting and Auditing influence. These results were explicitly emphasized by the majority of main participants. As in most Islamic Banking environments, the main challenge facing Islamic Banking is also regarded to be inappropriate accounting practices. The Islamic Banking system has failed to achieve the ultimate goal of applying *Shari'ah* in the banking system. In conclusion, the sector requires government assistance to establish a robust Legal framework, overall banking regulations (or particular IB regulations) must define the nature of IBs and Windows in order to provide the legal foundation for IB oversight. Authorities should ensure the Regulatory Framework for IBs and Windows and enable them to compete with CBs in a level playing field.

Key words: Islamic Banks, Islamic Windows, *Shari'ah* Compliance, Legal and Regulatory Framework, Accounting and Auditing, Management

Résumé

Cette recherche vise à analyser les aspects théoriques et pratiques des problèmes et défis qui entravent le secteur bancaire et financier Islamique en Algérie. L'étude se concentre sur quatre questions principales : Conformité à la *Shari'ah*, Cadre Juridique et Réglementaire, Comptabilité et Audit, et Gestion. Dans une tentative d'atteindre les objectifs, cette recherche examine les différents acteurs engagés dans le secteur bancaire et financier Islamique à l'aide d'entrevues semi-structurées.

Les principaux participants sont des représentants du Comité de la *Shari'ah*, des superviseurs *de la Shari'ah*, des directeurs de Finance Participative dans les banques conventionnelles étatiques et étrangères, des chefs de départements, ainsi que des académiciens nationaux et internationaux. Les principaux problèmes et difficultés qui se sont présentés à partir de l'entrevue sont l'absence de la structure juridique et réglementaire, l'environnement micro-économique et macro-économique inadéquat, la conformité à la *Shari'ah* en vertu de la laïcité de l'environnement, la pénurie du capital humain en expertise et l'absence de l'influence de la comptabilité et de l'audit. Ces résultats ont été expressément reconnus par la majorité des principaux participants. Comme dans la plupart des environnements bancaires islamiques, le principal défi est que les méthodes comptables sont inopportunes au système bancaire islamique. Le système bancaire islamique n'a pas réussi à atteindre l'objectif ultime de l'application de la *Shari'ah* dans le cadre d'un système bancaire traditionnel. En conclusion, le secteur a besoin d'aide du gouvernement à établir un cadre juridique robuste, à mettre en place une réglementation bancaire globale appropriée (ou règlements spécifiques aux Banques Islamiques), à définir la nature des Banques et des Fenêtres Islamiques afin de fournir les bons fondements juridiques conformes à la *Shari'ah*. Les autorités devraient s'assurer que le cadre réglementaire pour les Banques Islamiques est adéquat en leur permettant de rivaliser avec les Banques Conventionnelles dans un terrain de jeu équitable.

Mots clés : Banques Islamiques, Fenêtres Islamiques, Conformité à la *Shari'ah*, Cadre Juridique et Règlementaire, Comptabilité et Audit, Gestion.

General Introduction

General Introduction

Background of the Study

The Islamic banking system was introduced in the sixties of the last century, while the Islamic banking system is old. The Islamic Banking scheme has been implemented to meet Muslim communities' needs and demands where usury or *Riba's* practice is forbidden. In Islam, interest is called *Riba* which drives against the principle of *Shari'ah* (*Maqsaid as-Shari'ah*) and a termed as a haram (forbidden) as explained by (Abidin, Bakar and Haseeb, 2014, 2015; Kameel and Larbani, 2009). Since the Conventional Banking industry is based totally on the interest-based scheme, the Muslims need such an institution that provides them with the Islamic platform for their financial transactions.

Islamic banking has become systemically important in a dozen countries across a wide range of regions and operates in parallel with Conventional Banking. Islamic Banking is projected to continue to expand in response to economic growth in countries with large and relatively unbanked Muslim populations, including Algeria which is a large and still untapped market in North African region. Therefore, it becomes an important element in the development agenda in the Maghreb countries (Algeria, Tunisia, and Morocco). It is also gaining significance in the financial landscape of the region as well as of the individual countries. North African markets are also attractive targets for expansion, for both Islamic banks and conventional banks offering Islamic products or opening subsidiaries. "Islamic banking is an attractive business because it is generally highly profitable. Major Islamic banks have been less impacted by the financial crisis than Conventional Banks," says Perrine Fiorina, an analyst with Celent's banking group and author of the report: "However, competition among banks has intensified in the Middle East, making the North African region more attractive for market entrants."

In Algeria, the banking sector is characterized by low intermediation and penetration rates, although both have risen dramatically in the latest years, mainly due to sufficient liquidity stemming from extensive income from hydrocarbons. The industry authority, the Bank of Algeria (BoA), has authorized 20 companies – including six state-owned banks, which mainly dominate the industry with 86% of the assets of the industry and constitute complete three-quarters of its domestic branches network.

General Introduction

After the reform of 1988, the government issued the Law on Money and Credit act of 1990; it was the first step to be taken to remove many barriers towards domestic and foreign banks. The law for the first time enabled both private banks and foreign banks to operate in parallel with state-owned banks. Algeria's first private bank, Al Baraka (Islamic Bank), was introduced in 1991. Several domestic personal companies were registered, but they all collapsed in the 2000s. As a consequence, in 2008, following the Khalifa (first national private bank bankrupt in 2003) affair and the global financial crisis, registration of a new bank requires compliance with the minimum capital requirement set at AD10bn (€ 92 m) and compliance with the foreign investor's cap of 49%:51%. Since, no new banks have been licensed, either with international or national ownership, as the sector has witnessed a de facto freeze on new licenses.

Today, 14 private banks represent the remaining 14 percent of the assets of the banking sector, all of which are foreign-owned. Seven of them maintain liaison offices in Algeria. Although they are not allowed to conduct commercial operations, they are allowed to promote the company by corresponding between local customers and their headquarters. Despite private sector banks' restricted asset size and customer base, their performance was impressive. They hold just 14% of the market share in the latest years, and however, they managed to acquire around 30% of the industry's revenue. The profits of private banks make Algeria an attractive market for foreign investors. They also demonstrated a powerful desire to introduce new products, driving the fast development of leasing, banking, Islamic Finance, and other lucrative niches in the latest years.

Given the rapid decline in hydrocarbon revenues at the end of 2014, which led to the country's first current account deficit in more than a decade, the Algerian authorities accelerated the implementation of the planned reforms and announced new measures to empower the banking sector to finance broad-based economic development. These include redirecting banks away from lucrative import financing in favor of increased lending to domestic producers. Today, Algerian banks are eagerly seeking new revenue streams as they adapt to the demands of an evolving macroeconomic climate.

Islamic banking is one of the expanding fields. Islamic finance is presently almost completely dominated by Algeria's oldest private Islamic Bank, Al Baraka Bank, a subsidiary of the Bahraini Al Baraka Banking Group, and Al Salam Bank (Algeria’s second Islamic bank) launched in 2008 a subsidiary of Bahraini, offers a range of *Shari’ah*-compliant saving, lending, investment and leasing products. Since its establishment of the Islamic banks, today they claim 4% of Algeria's overall banking market and nearly 30% of the private segment.

In addition, Conventional Banks, including Gulf Bank Algeria and Trust Bank, have also introduced Islamic Finance Windows; 22% of Gulf Bank loans issued in 2013 is allegedly compliant with *Shari'ah*, and the industry continues to demonstrate potential growth. This, in turn, led the government to plan to launch "Participative" Islamic Windows from its banks. "The six state banks have now almost finished preparations for *Shari'ah* -based financial services, said Boualem Djebbar, who heads the Banks and Financial Institutions Association as well as the Banque de l'Agriculture et du Developpement Rural. "They will offer participative financing soon," he said. Today, Islamic Banking is planning to offer products as part of wider reforms aimed at modernizing the underdeveloped banking sector.

However, "Islamic finance is still relatively small scale in Algeria, accounting for less than 4% of all assets across the banking system. Nevertheless, there is big potential for Islamic Banks to capture a greater share of household savings that are currently held outside traditional banks," Rachid Sekak, senior consultant at BRS Consultants. In Algeria, there is no specific legislation for IBs or specific provision under general legislation and specific regulation to regulate IBs such as Morocco and Tunisia. Also, the government does not give complete support in providing institutional infrastructure and architecture for Islamic Banks to operate lawfully. Algeria's banks already operate according to Basel II standards, and are transitioning to the more stringent, risk-based norms of Basel III. In its 2017 Article IV review, however, the IMF urged the authorities to "accelerate the transition to a risk-based supervisory framework, enhance the role of macro prudential policy, strengthen the governance of public banks and develop a crisis resolution framework". Islamic Banks in Algeria operate under the same conventional law as their counterpart Conventional Banks. For example, the licensing requirements for Islamic Banks are identical to those for Conventional Banks. Algeria is far behind North African neighbours Morocco and Tunisia, which have started to develop legislation for Islamic Finance and S*ukuk* bonds, overseen by a central religious board.

Islamic Banking System is defined as those banks that claim to follow *Shari'ah* (Islamic law) in their business transactions, *Shari'ah* requires these transactions to be in lawful (*Halal*) form and prohibits transactions that involving interest (*Riba*) (Maali, Casson and Napier, 2006).

It promotes profit sharing in the conduct of banking business as well as prohibiting paying or receiving interest on any transaction (Salleh and Hassan, 2004).

According to (Haron, 1997, 2000), the foundations of the philosophy of Islamic Banking are principles that have been revealed in the *Qur'an* and *Hadith*. The philosophy of Islamic Banking acts as the backbone of its establishment. The operations of IBs, as one of the mechanisms for the development of the Islamic economic system, are based on the said philosophy. The philosophy is also used as the benchmark/indicator in guaranteeing that the IBs are upholding the true Islamic principles in their operations (Haron, 1997, 2000). *Shari'ah* Law governs the fundamental principles of Islamic Banking and finance. *Shari'ah* Law is based on four sources: the *Qur'an* (the revelation of *Allah*), the *Hadith* (the sayings and actions of the Prophet *Muhammad* (pbuh) during his lifetime), *Ijma'* (consensus of Muslim scholars) and *Qiyas* (analogical deductions from other three sources for contemporary issues). In addition, the fundamental principles of Islamic Banks are the prohibition of *Riba* (i.e. interest), the promotion of trade and commercial activities as the fundamental principles of products and services in Islamic Banks, the profit and loss sharing framework, the prohibition of *Gharar*, and payment of *Zakat*. Thus, the Islamic Bank provides the solution for Muslims in terms of principles, instruments, and issues involved in banking business activities, since the operations of the activities are based on the principles of the *Shari'ah* (Rosly 2005; Kettell 2002).

The establishment of Islamic Banking and finance emerged due to the growing interest and demand for Muslims to engage in Islamic Banking activities. In the early stages, the establishment of IB was designed to meet Muslims' needs to deposit their money and to ensure that was managed according to *Shari'ah*. Therefore, the development and growth of Islamic Banks increased over time to meet the increasing demand of Muslims and non-Muslims customers. The Islamic Banking Industry has grown and developed rapidly since it was launched. This rapid transformation and growth from an industry striving to satisfy the Muslim community needs, to a multibillion dollar industry upholding Islamic principles and operates in many Muslims and non-Muslims countries around the world.

Nonetheless, Islamic finance faces a number of challenges. For example, despite the efforts of Islamic Finance standard setters, in many countries the industry is governed by a regulatory and supervisory framework developed for conventional finance. Therefore, it does not fully take account of the special nature of Islamic finance (Al-Maraj 2014).

Some Islamic countries still have an inadequate infrastructure in operating IBs, while some IBs have had difficulties in their operation and management due to unclear explanations in their legal and regulatory frameworks. The industry is still largely a nascent one, lacking economies of scale, and operating in an environment where legal and tax rules, financial infrastructure, and access to financial safety nets and central bank liquidity are either absent or, if available, do not appropriately take into account the special characteristics of Islamic finance (Askari, Iqbal, and Mirakhor, 2010; Ernst and Young, 2014; IFSB, IsDB, and IRTI 2010). Furthermore, the IBs started to internationalize in North Africa, Europe, North America, South Korea, Japan, China, Singapore and elsewhere. These countries operate under the conventional economic system or under the Conventional Banking system as the case of Algeria. Each IB is dynamic and unique based on the economic and financial system of the individual country.

The Islamic Banks are expected to fulfil the following objectives of *Shari'ah*: (1) providing banking services of the highest standards in conformity with Islamic *Shariah* without dealing in *Riba* (Interest); (2) managing wealth and carrying out banking operations based on Islamic law; (3) ensuring that the innovation and implementation of products and services are *Shari'ah* compliant; (4) contributing towards economic development and prosperity within the principles of Islamic justice; (5) Another important objective of Islamic Banking is to ensure equitable distribution of incomes and resources among the participating factors: the bank, the depositors and the entrepreneurs. This is done through its built-in mechanical arrangement as well as other welfare activities pursued through *Zakat* fund.

The fulfillment of the *Shari'ah* objectives in IBs operations is a result of the adherence to the *Shari'ah* principles. The Islamic Banking that operates under Conventional Banking system such in Algeria faces difficulties in operating in accordance with *Shari'ah*. Since the underlying regulatory and financial infrastructures are based on the conventional economic system, they cannot fully support the overall operations of IB in full *Shari'ah*-compliance. This can also affect the development and innovation of more products and services based on *Shari'ah*. These findings are a deviation from the values of Islamic Banking activities described previously and thus may raise issues and difficulties that may delay the accomplishment of *Shari'ah*'s goals.

Motivation of the Study

IBF's credibility can be explained by the legitimacy of its practices and the accountability of its market players. The legitimacy of the IBF is also clarified by its adherence to the *Shari'ah* and the legal and regulatory framework. The credibility of Islamic Banking and finance is important in ensuring the sustainability of the Islamic Banking system. Furthermore, market players in the industry ought to exercise adequate accountability (Abdul-Rahman 1998) in ensuring that the management, operations, products and services are *Shari'ah*-compliant.

The literature on the performance of Islamic Commercial Banks in Algeria begins with the performance of Al-Baraka bank in 1991. Currently, it consists in two foreign Islamic Banks and few state-owned and private Islamic Windows, which already offer *Shari'ah*-compliant products in some form. Islamic Finance has not developed as rapidly in Algeria as in the neighboring countries and elsewhere. However, IF experienced growth in terms of assets and deposits, its improved profitability remained lagging behind the Conventional Banks. Although, Islamic Finance represents less than 4% of all assets, a small portion of Algeria's banking sector.

In addition, studies on the technical efficiency of Islamic Banks have shown that fully-fledged Islamic Banks have generally performed below the optimum level. This indicates the inefficient use of resources detected that its findings reflected lower productivity and managerial efficiency. Furthermore, studies on efficiency were carried out by Yahaya (2005), Mokhtar et al. (2008), Sufian (2007) and Mohd-Zamil and Abdul-Rahman (2007) for the periods between 1990 to 1997, 1997 to 2003, 2001 to 2004 and 2001 to 2004, respectively. Mohd-Zamil and Abdul-Rahman (2007) discovered that in Conventional Commercial Banks (CCBs) managerial effectiveness is greater than in Islamic Commercial Banks (ICBs). They also concluded Islamic windows less effective than Conventional Commercial Banks. They also found that managerial efficiency in Conventional Commercial Banks (CCBs) is higher than in Islamic Commercial Banks (ICBs). Several factors supporting the lower level of managerial efficiency of ICB are the management structures of ICBs (Saaid et al., 2003), the capital structures of ICBs (Sarker,1999), less expertise and unskilled labour in ICBs (Saaid et al., 2003) to improve the management in the process of mobilization of inputs into outputs (i.e. inefficient use of resources) (Saaid et al., 2003; Amir and Azmi, 2004; Yahya et al., 2001; Hamid and Ahmad 2001), less capability to develop attractive and innovative products and to market the products to customers (Sarker, 1999), the volume of operations of CCBs (Samad, 2004), the technological advancement of CCBs (El-Gamal and Inannoglu, 2002; Okuda and Hashimoto, 2004), networking created by CCBs, changes in economic conditions and policies (Amir and Azmi, 2004), and government interference.

The development of technology and the effect on the financial services industry of globalization and liberalization will lead to a more competitive setting. Moreover, to ensure better efficiency in the future, measuring the efficiency of Islamic Banks and Windows is essential. As a result, the performance level will serve as an early warning system for various parties, such as the management of the bank, the depositors and the investment account holders, and the government. In order to ensure that the financial institution is prepared to face the difficulties ahead, further action must be taken accordingly. In fact, Islamic Banks and Windows are facing difficulties from their clients in order to provide better options for Islamic Banking business operations in the future.

Studies of the factors behind the patronization of Islamic Banking reveal that while the establishment of Islamic Banks is due to a religious impetus, the patronage of clients in the banking company was not driven exclusively by religious purposes. Customers' choice of bank is based on other reasons such as fast and efficient service (Haron et al., 1994; Metawa and Almossawi, 1998; Gerrard and Cunningham, 1997; Erol et al., 1990; Al-Sultan, 1999), the bank's reputation and image, confidentiality (Haron et al., 1994; Gerrard and Cunningham, 1997; Erol et al,. 1990), social responsibility profitability, cost (Metawa and Almossawi, 1998), socioeconomics, and demographic characteristics (Metwally, 2002).

Islamic Banks face both externally and internally problems and challenges in multiple parts of the bank's activities. Externally, the Islamic Banks are engaged with local government and legislative authorities, Islamic Banking Industry regulators and supervisory and international regulatory bodies. Local government and legislative authorities are involved in the national legal infrastructure and the powers of industry regulators and supervisors. The Islamic Banking Industry regulators are concerned with the requirements of the supervision of *Shari'ah* compliance. International regulatory bodies refer to international organizations such as the Islamic Financial Services Board (IFSB), the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI), the Basel Committee on Banking Supervision (BASEL) and others. Variances in governance framework, SSB presence, accounting regulations and standards, legal and regulatory authorities, and supervisory authorities have resulted in variations in the implications of Islamic Bank accounting principles and procedures. Moreover, Islamic Banks are required to comply with legal and regulatory frameworks at local and international level.

In investigating Islamic Banks' problems and challenges in Algeria, this study concentrated on four issues: *Shari'ah* compliance, legal and regulatory frameworks, audit and accounting procedures, and management. While the first three issues were clear, the fourth addressed the institution's operational and administrative elements of human capital, the system, and inner procedures. This study addressed the problems and challenges regarding various aspects within the establishment, operations and products and services of IBs.

Problem and Objectives of the Study

The problem statement of this study is to investigate the theoretical and practical aspects of problems and challenges facing Islamic Banks and Windows in Algeria. The study emphasizes aspects of four issues: *Shari'ah* compliance, legal and regulatory framework, accounting and auditing, and management.

The objectives of the main questions of this study is to investigate what are the legal and technical obstacles and challenges facing the Islamic Banks and Windows in Algeria and the barriers that slowdown their implementation and development. Questions are aimed:

1. To assess whether the process and current practices of ensuring *Shari'ah* compliance in the Islamic Banking and finance industry are being implemented effectively in Algeria.

2. To identify the problems and challenges facing Islamic Banking and Finance industry related to the legal and regulatory framework, *Shari'ah* compliance and management and accounting.

3. To detect the existing practices of *Shari'ah* advisory boards, *Shari'ah* auditing and financial accounting, ensuring the reliability of financial reporting, compliance with relevant laws and regulation together with the efficiency and effectiveness of *Shari'ah* compliance in Islamic Banking in Algeria.

4. To define and discuss the problems and challenges faced by SSB, *Shari'ah* auditing, financial auditing, and financial accounting, and reporting to provide accurate data on the effective distribution of resources and to ensure compliance with *Shari'ah* in Islamic Banks.

Research Questions

To tackle these issues, this research surveys various groups of senior staff engaged in Islamic Banking and finance operations, using semi-structured interviews to investigate the above questions. The key respondents are *Shari'ah* Committee members, *Shari'ah* Officers, Senior Managers, Chief Executive Officers (CEOs), and Heads of Departments. The study also aims to respond to several specific research questions as follows:

***Shari'ah* compliance:**

1. What are the problems and challenges faced by Islamic Banking and finance in maintaining that *Shari'ah* complies with its transactions in Islamic Banks, governing the conduct, business ethics, transactions guided by contracts authorized by *Shari'ah* (i.e., contract validity and permissibility) and *Shari'ah* as the governing legislation of all corporate affairs?

2. What are the problems and challenges facing SSB in Islamic Banks or Windows?

3. What is the effort or interaction in the Islamic Banking system and finance in establishing the *Shari'ah* compliance in the IB/Windows?

4. How can the process be addressed in order to improve the level of compliance in Islamic Banks or Windows?

Legal and regulatory framework:

1. What are the problems and challenges related to the legal and regulatory framework of Islamic Banks or Windows?

2. What are the problems and challenges in complying with the current national and international legal regulatory framework?

Accounting and auditing practices:

1. What are the problems and challenges facing Islamic Banking and finance industry in terms of accounting practices, accounting standards and auditing?

3. Is there a need for standardization and harmonization of accounting practices and accounting standards among Islamic Banks and Windows? What efforts have been made to standardize and harmonize practices?

4. Is staff in Islamic Banks and Windows capable and competent to carry out their duties and responsibilities?

Management:

1. What are the management problems and challenges (i.e. human capital, system, and internal process)?

2. How can Islamic Banks or Windows guarantee that management elements are in position and are well accomplished to achieve their goals?

3. How can Islamic Banks or Windows improve management aspects to ensure that they are well performed?

Hypotheses of the Study

H1: The political and economic environments affect the *Shari'ah* compliance in Islamic Banking.

H2: The Islamic Banking is operating under specific Legal and Regulatory Framework.

H3: The Islamic Banking has its own Accounting and Auditing System.

H4: The staff of IBs is well trained and informed in Islamic Banking procedure and operations.

Methodology

To achieve the above study goals, firstly, a review has been created of the history and growth of the international Islamic Banking and Finance sector, and the Islamic and Conventional Banking in Algeria, followed by a brief discussion about Islam and Islamic Banking highlighting *Shari'ah* values and objectives, and the theoretical framework on which Islamic Banking and Finance functions has been based.

The literature on the problems and challenges facing Islamic Banking and Finance has also been evaluated. It has addressed the credibility of Islamic Banking system in terms of *Shari'ah* adherence, the legal and regulatory framework, the problems and challenges facing Islamic Banks that focus on some important issues such as human capital and *Shari'ah* standardization. Furthermore, literature on accounting and auditing as a system of accountability in Islamic Banks was reviewed.

As far as a research design is concerned, this study used a qualitative method, and the primary data was collected through semi-structured interviews. The qualitative research is an inductive approach to the relationship between theory and practice (Bryman 2001). It is broadly grounded in a philosophical position which is interpretive (Mason 1996). The semi-structured interviews assisted in fulfilling the aim of the thesis. The researcher conducted interviews between September 2018 and August 2019. Semi-structured interviews allowed the interviewer to inquire about the problems and challenges facing Islamic Banks and windows in Algeria from the perspectives of the interviewees. The interviewees were selected on the premise that their knowledge, experience and involvement in the industry would add more value to understanding the problems and challenges facing the Islamic Banks and windows. The interviewees include *Shari'ah* Committee members, *Shari'ah* Officers, Senior Managers, Chief Executive Officers (CEOs), and Heads of Departments, in foreign Islamic Banks, and state-owned and foreign Windows.

Besides, the use of the semi-structured interview in this study to clarify the problems and challenges facing Islamic Banks and Windows in terms of the *Shari'ah* compliance, Legal and Regulatory Framework, Accounting and Auditing, and Management has helped researchers to understand the theoretical and practical problems and challenges facing this industry. Qualitative methods may have the power to take the researcher into the minds and lives of the social actors and to capture how the social world is interpreted, understood, experienced and produced (McCracken, 1988; Mason, 1996; Bryman, 2001). Furthermore, using semi-structured interviews in this study may inspire other researchers to use this technique to investigate other environments in the Islamic Banking Industry in depth.

Contribution of the Study

North African markets are attractive targets for expansion, for both Islamic Banks and Conventional Banks offering Islamic products or opening subsidiaries. Islamic Banking is an attractive business because it is generally highly profitable. Algeria is one of an untapped market in North African region. In the recent years, Algeria is taking a different attitude toward recognizing and regulating Islamic Banks and Windows, and that is due to the recent economic crisis, drop in oil products prices and the lack of the liquidity.

However, Algerian government is taking slow pace in issuing regulation of Islamic Banks and Windows. Thus, the Islamic Banking and Finance are still relatively small scale in Algeria, about 4% of all assets across the banking system. There are two foreign Islamic Banks, about five private operating Islamic Windows, and six own-state Islamic Windows waiting for agreement in Algeria. Algerian Islamic Banking and Finance has grown steadily in the last decade due to the demand and need of Algerian people to save and invest their money in interest-free banks.

Despite the moderate development, Islamic Banks and Windows are facing problems and challenges in Algeria. Some of them are a result of the absence of regulations or specific provision that recognizes Islamic Banks and Windows. The only regulation concerning Islamic Banking and products in the Algerian law, the recent text, concerning "Participatory Finance", issued in December 2018 but is still ink on the paper. In addition, there is a competition between Conventional Banks, Islamic Banks and Windows.

Studying the problems and challenges facing Islamic Banks that involve the *Shari'ah* compliance, legal and regulatory framework, accounting and auditing, and management is important in building a better IBF industry that will be a point of reference to other interested countries with Conventional Banking system. This will further support the aspiration of IB in Algeria to be at the forefront of the international IBF industry.

This study makes a number of contributions to the literature. First, it is intended to provide comprehension and explanation of the problems and challenges faced by Islamic Banking and Finance in its *Shari'ah* Compliance, Legal and Regulatory structure, Accounting and Auditing, and Management in order to ensure that the objectives of the establishment are met. In this respect, Islamic Banking focuses on achieving the *Shari'ah* objectives and then maximizing its profits, but also; which are mainly concerned with realizing the complete welfare of the Muslim nation through the promotion of well-being and the prevention of corruption and vice. Hence, it describes the significance of upholding the institutions' responsibility and legitimacy in maintaining their credibility.

Second, this research examines *Shari'ah* accounting and auditing experts' perceptions in Islamic Banks. This will help to understand and explain accounting and auditing practices in Islamic financial institutions. Accounting practices illustrate how religious organizations use their resources to meet social needs. Third, by embracing a qualitative methodology, this study will answer requests for more field-based research in Islamic Banks by exploring *Shari'ah* governance in general and accounting and auditing practices in particular.

From a practical and methodological point of view, it is hoped that a better understanding of the problems and challenges facing Islamic Banking, the existing Legal and Regulatory Framework and its enforcement, the operation, and implementation of products and services and the Accounting and Auditing system will lead to a better approach for regulators and bank Management; concerning the configuration of an enhanced system to ensure *Shari'ah*'s Compliance, Accounting, and Auditing systems are in place to ensure that a system of accountability is in place.

Study Plan

The thesis comprises two parts structured as follows:

General Introduction, that aims at the study's context and goals. It also gives a short overview of the research issues, research questions, and theoretical and methodological methods used in this study, as well as the significance of undertaking such research and the research contribution.

Part One: Theoretical Aspects of Problems and Challenges Facing Islamic Banking and Finance in Algeria

Chapter One provides a review of the philosophy and theoretical framework of Islamic Banking and Finance. The chapter begins with a short overview of Islamic Banking and Finance institutions, followed by a discussion on the developments of Islamic and Conventional Banks in Algeria. This is then followed by a discussion about Islam and Islamic Banking highlighting *Shari'ah* values and objectives, and the theoretical framework on which Islamic Banking and Finance functions has been based.

Chapter Two provides a review of the literature on the problems and challenges facing Islamic Banking and finance in relation with the Legal and Regulatory Framework, Management, *Shari'ah* Compliance, Accounting, and Auditing. The chapter starts with a review of the literature on the operations and products in Islamic Banking system, than discusses the risk management in Islamic Banks. Furthermore; it reviews literature on the problems, challenges and risks in Islamic Banks and Windows. In addition, it focuses on the Islamic Banking and its Legal and Regulatory framework. Finally, the literature on Accounting and Auditing as a system of accountability in Islamic Banks is reviewed.

Chapter Three addresses the objective of this study, describes the selection of Islamic Banks and Windows in Algeria (which are the topic of studies), as well as the methodology that was developed within the ontological and epistemological context of the researcher. The layout of this research includes the use of information gathered mainly from primary sources through semi-structured interviews. In this research, semi-structured interviews were conducted to gain a more accurate understanding of the problems and challenges confronting Islamic Banks and Window in Algeria.

Part Two: Practical Aspects of Problems and Challenges Facing Islamic Banking and Finance in Algeria

Chapter Four introduces the results of the *Shari'ah* compliance problems obtained from the semi-structured interviews. It starts by outlining some *Shari'ah* issues such establishing and harmonization SSB, *Shari'ah* interpretation and implementation, then examines *Shari'ah* compliance consideration and commercially feasible in Algeria's Islamic Banking and Finance including *Shari'ah* non-compliance and other issues . Next, it deals with the paradigm between Islamic Banking's theoretical structure and its application. The chapter continues with the emphasis on resolving certain cases of *Shari'ah* non-compliance. Finally, the chapter ends with a summary of the findings and discussion.

Chapter Five continues to discuss problems and challenges facing Islamic Banks and Windows in Algeria. It highlights and analyzes results on legal and regulatory frameworks issues and challenges. It begins with a brief Overview of Legal and Institutional Structure in Islamic Banks, than it focusses on observations concerning the existing of regulatory and legal framework environment under which Islamic Banks and Windows operate in Algeria today. Next, it highlights the need to have independent or specific legal and regulatory structures to Support the *Shari'ah* Operation; it also discusses the debate about the Need of Standardising and Harmonising the Accounting Standards. The chapter concludes by summarizing the findings and discussions.

Chapter Six focuses on the results of the semi-structured interview and analyzes them in regards to the Islamic Bank's accounting and auditing scheme. This chapter is divided into three sections besides the introduction; the first section outlines the lack of impact of accounting practices and reporting on the disclosure of reliable and credible information. It begins by highlighting the role of accounting and financial practices and reporting in the communication of reliable and credible information. It then describes the current accounting situation and practices in the Islamic Banks and Windows of Algeria. The section continues to underline the lack of *Shari'ah* expertise among SSBs and scholars and concludes with the issue of having separate SA standards for Islamic Banking; the second section analyzes and discusses the findings of the *Shari'ah* audit. It discusses the lack of *Shari'ah* audit experts and the lack of external *Shari'ah* auditors; the final section summarizes the findings and the discussion of the chapter.

Chapter Seven in this part outlines the findings and discussions on management issues in the Islamic Banking system in Algeria. It begins to discuss the findings in Human Capital (HC), highlighting certain issues related to human capital; the role of the players in ensuring the direction of IB; The lack of expertise of IBs and Windows; the lack of awareness among staff; the negative perception of the public. Next, it analyses the result from the implementation of *Shari'ah* approval procedures including pre and post-compliance processes; then, discussing the knowledge gap between scholars of *Shari'ah* and technical people concerning product approval. Finally, the section examines the results and analyses identified in management area.

General Conclusion, it focuses on the contribution and limitations of the research. It begins with a summary and review of the case findings. The theoretical and practical conclusion of the study is then presented. Next, it shows the hypotheses results, and then offers some suggestions to enhance the development of IBs. The thesis ends by underlying the limitations of the study and providing some suggestions for future research.

Theoretical Part:

Theoretical Aspects of Problems and Challenges Facing Islamic Banking and Finance in Algeria

Theoretical Part

Introduction of the Part

This part highlights the theoretical aspects of problems and challenges facing Islamic Banking and Finance in Algeria. It provides a review of the philosophy and theoretical framework of Islamic Banking and Finance.

The first chapter provides background information on the history, development and growth of international Islamic Banking and Finance industry (IBFI), in general, and Algerian Islamic Banking and Finance industry, in particular. Firstly, it presents an overview of the global historical background of the Islamic Banking and Finance Industry, followed by the historical of Algerian banking system, than a discussion of the recent development of Islamic Banking and Finance Industry in Algeria. Next, it explains the objectives and principles of the establishment of Islamic Banking and Finance. Finally, the chapter then discusses the theoretical framework of Islamic Banking and Finance.

Chapter two provides a review of the literature on the problems and challenges facing Islamic Banking and Finance in relation with the *Shari'ah* compliance, Legal and Regulatory Framework, Accounting and Auditing, and Management. The chapter starts with a review of the literature on the operations and products in Islamic Banking system, than discusses the risk management in Islamic Banks. Furthermore, it reviews literature on the problems, challenges and risks in Islamic Banks and Windows. In addition, it focuses on the Islamic Banking and its Legal and Regulatory Framework.

Finally, last chapter of the first part is concerned with the Research Methodology, describing the research objectives and the processes used in this study. It presents in detail the rationale for the adoption of a semi-structured interview and the issues related to data collection. Regarding the in-depth interviews, negotiating access and interview strategies are discussed. In addition, the relevant analysis to be employed is also highlighted.

Chapter One: Philosophy And Theoretical Framework of Islamic Banking And Finance Industry (IBFI)

Chapter One: Philosophy And Theoretical Framework of Islamic Banking And Finance Industry (IBFI)

1.1 Introduction

This chapter provides background information on the history, development and growth of international Islamic Banking and Finance industry (IBFI), in general, and Algerian Islamic Banking and Finance industry, in particular. Firstly, it presents an overview of the global historical background of the Islamic banking and Finance Industry, followed by the historical of Algerian banking system, than a discussion of the recent development of Islamic Banking and Finance industry in Algeria. Next, it explains the objectives and principles of the establishment of Islamic Banking and Finance. Finally, the chapter then discusses the theoretical framework of Islamic Banking and Finance.

Chapter One: Philosophy And Theoretical Framework of Islamic Banking And Finance Industry (IBFI)

1.2 Historical Background of Islamic Banking and Finance Industry (IBFI)

Even though it was not until the mid-1980s that Islamic Finance started to become widespread step by step. The first financial *Shari'ah* model was introduced in Egypt in last century and the project was designed by Mit Ghamr. The Mit Ghamr Saving Bank based on profit-sharing in the town of Mit Ghamr was made under cover because the government in power did not welcome a manifestation of Islamic activism and lasted until 1967, by which time there were nine other banks in the country operating in the same way as the Mit Ghamr Saving Bank (Ariff, 1988).

Later, in 1971, the Mit Ghamr Saving Bank was incorporated into a new government controlled institution, the Nasser Social Bank, which had the responsibility of collecting zakat (i.e. the Islamic wealth tax). It was the first recognised interest-free commercial bank and was established in Cairo with the objective of developing a social security system in Egypt.

A pilgrimage fund known as the Pilgrims' Savings Corporation (PSC) was established in Malaysia at the end of 1962. It became the first non-bank Islamic financial institution. Its objective was to mobilize the savings of Muslims intending to make a pilgrimage and to channel the funds to eligible investments in accordance with the principles of *Shari'ah* (Aziz, 2005). The government merged the PSC with the Pilgrims' Office (PAO) in 1969 to form the Pilgrims' Management and Fund Board (PMFB), better known as Tabung Haji.

Major expansion of Islamic banking activities began in the 1970s, partly as a result of the Gulf oil revenue boom and the growing economic influence of the more conservative Muslim Gulf states (Wilson, 2000). In December 1973, the Organisation of Islamic Countries (OIC) established the Islamic Development Bank (IDB). The IDB is an international government-funded Islamic bank that was established by 22 Muslim countries in 1973. Currently, 56 countries are members of the Islamic Development Bank. The IDB's primary role was to provide assistance for *Shari'ah*-compliant projects in the form of equity capital and loans, member countries ' financial growth and social progress, and to enhance Islamic banking globally.

Chapter One: Philosophy And Theoretical Framework of Islamic Banking And Finance Industry (IBFI)

The first commercial Islamic bank in the UAE, Dubai Islamic Bank was created in 1975. Then, in 1977, Egypt's Faisal Islamic Bank, Sudan's Faisal Islamic Bank, and Kuwait Finance House were set up. The Jordan Islamic Bank was then set up in 1978.

The first Islamic Banking System in the western countries was created in Luxembourg in the same year with a global holding. The presence of Islamic banking system with global holding demonstrates that Islamic banking expansion was not only restricted to the Middle East but attracted the attention of its global counterparts as well. An Islamic bank was set up in Bahrain in 1979, namely the Islamic Bank of Bahrain.

Because of the huge development of Islamic banking operations, some commercial banks have begun to offer Islamic banking services (e.g. Egyptian state-owned banks and Saudi Arabia's National Commercial Bank) (Wilson, 2000). In early 1980s, the cooperation between IBs and conventional banks started, when Kleinwort Benson, Citibank and Saudi International Bank were the pioneers in this process (Smith, 2000; Wilson, 2000). Such developments showed that the Islamic financial instruments were increasingly being accepted internationally, even in non-Islamic countries, and the basic principles were understood (Wilson, 2000). As asserted by (Smith, 2000, p: 98), this cooperation was based on the following reasons:

- IBs increasingly worked with conventional banks to find profitable, low-risk investment vehicles through which to deploy funds;
- There was a continuing focus on the use of Islamic funds to finance raw commodities and international cross-border trade;
- Had its base not only in religion (which it did) but also had the overriding need for efficiency and competitiveness;
- To enable the commercial IBs to compete with conventional banks in their own markets and to build a retail market share;
- For the large multi-national Islamic groups, the cooperation was useful not only in terms of efficiency but also because it was through conventional banks that routine banking transactions needed to be executed.

Chapter One: Philosophy And Theoretical Framework of Islamic Banking And Finance Industry (IBFI)

Certain international players included Citibank, Merill Lynch, Kleinwort Dredner, ANZ, ABN Amro, Goldman Sachs, HSBC, etc. large regional organizations, ABC, GIB, as well as many Saudi Arabia and Malaysia commercial banks and specialized companies, such as the United Ba nk of Kuwait's Islamic Investment Banking Unit (Smith, 2000). The establishment of the first Islamic banking subsidiary of Citibank in Bahrain was expected to result in substantial cooperation, accompanied by a possible realization of substantial benefits from both Western and Islamic banks (Pomeranz, 1997).

In the 1980s, IB development and expansion continued. Dar al-Mal al-Islami was founded in Switzerland in 1981, followed in 1983 by the inception of Denmark's Islamic Bank International. Bank Islam Malaysia Berhad was set up in the same year due to the fast growth of PMFB in Malaysia. In order to attract Muslim savers, the Malaysian government felt the need to establish IBs in Malaysia. Moreover, in early 1983, three Muslim countries decided to transform their economies and financial sectors, namely Iran, Pakistan, and Sudan. In 1984, the Qatar Islamic Bank was established in Qatar.

In 1987, the Dallah Al Baraka Group established Al-Tawfeek Co. The Group made its first offers in the certified form of medium-term investment assets with market-making or repurchase guarantees. Next, in 1990, IDB launched its Unit Investment Fund, where again the sponsor provided liquidity for an offering invested in essentially illiquid assets. This fund now has its shares listed on the Bahrain Stock Exchange. Then, in 1993, the International Investor, quickly followed by the International Investment Group, set the pace (Smith, 2000). Also, in 1993, Dallah Al Baraka Bank gave up its banking licence and moved to investment banking due to a number of challenges faced by the bank (Karbhari et al., 2004).

In 1992, Islamic banks continued to develop in the South-East Asia region. The Indonesian government took the initiative to set up Bank Mu'amalah Indonesia, an Islamic bank. In 1993, 2002 and 2007 the development of Islamic banks also took place in other countries, such as Brunei, Singapore and Thailand, respectively.

Islamic banking is now a well-known term and has emerged as one of the most important industries worldwide. Islamic banking and finance has undergone rapid transformation and growth from an industry striving to satisfy the Muslim community needs, to a multibillion dollar industry upholding Islamic principles and operates in many countries including Bahrain, Pakistan, Jordan, Iran, Sudan, United Kingdom, Singapore and Malaysia. IB growth is not focused in the Middle East, South Asia and Southeast Asia, but also reaches the Africa (i.e. Sudan, Morocco, and Algeria) and the Europe (Bosnia, Denmark, France, Germany, Holland, Luxembourg, Russia, and Switzerland) along with other Western markets (i.e. Australia, UK, US and Canada). Among financial institutions in the US involved in Islamic finance are: Al Baraka Corp., Al Manzil Islamic Financial Services, Lariba Bank, Goldman Sach's Islamic banking subsidiary and the Muslim Credit Union. Although each country's economic operations may vary, the interest in engaging in the market for Islamic Finance is highly encouraging. In addition, the existence of Islamic banks has drawn the attention of Western central banks such as the Federal Reserve Board and the Bank of England, international financial institutions such as the International Monetary Fund (IMF) and the World Bank. Over recent decades the Islamic banking industry has emerged as one of the fastest growing industries and has spread to all corners of the globe, receiving wide acceptance from Muslims and non-Muslims (Iqbal and Molynex, 2005). Nowadays Islamic banking and finance manifests itself in five ways:

1. Banks and financial institutions operate in countries where the promotion of an Islamic financial system receives active government support;

2. Islamic banks and financial institutions operate in the private corporate sector competing with conventional (Western) institutions;

3. Islamic banking is practiced by conventional commercial banks (via Islamic Windows), traditional Islamic banks as well as non-bank financial institutions;

4. Multinational financial institutions (like the Islamic Development Bank in Jeddah) operate on *Shari'ah* principles;

5. Islamic capital market instruments (mutual funds, *Sukuk*), and insurance (*Takaful*) are becoming more important, for instance, *Sukuk* issuance partly funded London's Olympic Village and 'Shard' building. (Abedifaret al., 2015).

Table 1.2.1 Modern History of Developments in Islamic Finance

Time Period	Development
Pre-1950s	• Barclays Bank opens its Cairo branch to process financial transactions related to construction of the Suez Canal in the 1890s. Islamic scholars challenge the operations of the bank, criticizing it for charging interest. • This criticism spreads to other Arab regions and to the Indian subcontinent, where there is a sizable Muslim community. • The majority of *Shari'ah* scholars declare that interest in all its forms amounts to the prohibited element of *Riba*.
1950s – 60s	• Initial theoretical work in Islamic economics begins. By 1953, Islamic economists offer the first description of an interest-free bank based on either two-tier *Mudharabah* or *Wakalah*. • *Mit-ghamr* Bank in Egypt and Pilgrimage Fund in Malaysia start operations.
1970s	• The first Islamic commercial bank, Dubai Islamic Bank, opens in 1974. • The Islamic Development Bank (IDB) is established in 1975. • The accumulation of oil revenues and petrodollars increases the demand for *Shari'ah*-compliant products.
1980s	• The Islamic Research and Training Institute is established by the IDB in 1981. • Banking systems are converted to an interest-free banking system in the Islamic Republic of Iran, Pakistan, and Sudan. • Increased demand attracts Western intermediation and institutions. • Countries like Bahrain and Malaysia promote Islamic banking parallel to the conventional banking system.
1990s	• Attention is paid to the need for accounting standards and a regulatory framework. A self-regulating agency, the Accounting and Auditing • Organization of Islamic Financial Institutions is established in Bahrain. • Islamic insurance (*Takaful*) is introduced. • Islamic equity funds are established. • The Dow Jones Islamic Index and the FTSE Index of *Shari'ah*-compatible stock are developed.
2000 – the present	• The Islamic Financial Services Board is established to deal with regulatory supervisory and corporate governance issues of the Islamic financial industry. • *Sukuk* are launched. • Islamic mortgages are offered in the United States and United Kingdom.

***Source**:* Greuning and Iqbal (2008, p: 13)

Chapter One: Philosophy And Theoretical Framework of Islamic Banking And Finance Industry (IBFI)

1.3 Development of Algerian Conventional and Islamic Banking and Finance Industry

1.3.1 Historical Background and development of banking system in Algeria

Modern banking began in Algeria in the mid-nineteenth century (Ernest-Picard, 1930, cited by Benamraoui, 2008). The French authorities established many commercial and merchant banks to facilitate the financing of commerce (Rossignoli, 1973, cited by Benamraoui, 2008). Banking system was composed of; the Bank of Algeria (1851) (La Banque d'Algérie) that was an annex of bank of French (Banque de France), in which its role was the issuance of money, providing loans for financing the colonial economic activities and assuring the services of currency exchange (Latrach, 2001, cited by Hacini and Dahou, 2018). Those banks operated only in major cities; they did not serve rural areas. Some projects acquired credit through issuing, deposit and merchant banks; people's banks funded small firms; and the Caisse de Crédit Agricole Mutuel served the financial needs of the colonist agricultural sector.

In addition, there was a vast network of commercial banks, financial institutions operating in Algeria. In reality, the majority of the banks operating in Algeria were branches and subsidiaries of French banks such as (Société Générale, Le Credit Lyonnais, etc.). The French authorities set up the Algerian Credit Council to organize and supervise the banking activities that had a task of setting regulations and legal framework and providing propositions and consultations concerning the development of the banking system. In fact, Algerian banks were just an extension of the French banking system; they were created to guarantee the financial needs of the colonial economy.

After independence in 1962, the Algerian authorities embraced a socialist economy; many European investors left Algeria. This had negative implications on the national economy as whole and on the banking sector in particular. Credit to the public and private sector declined dramatically because of the fall in the amount of deposits held at French commercial banks and credit institutions. The Algerian financial authorities established several state-owned banks and nationalized almost all foreign banks to improve the mobilization of financial resources and to obtain control over the national banking sector. Both initiatives led to the creation of a state-owned banking sector and to the absence of foreign players. (Benamraoui, 2008)

In August 1962, the treasury was created. The principal role of the treasury was collecting deposits at low interest rates and financing government expenditures and state-owned enterprises. This meant that interest rates on deposits and loans were negative in real terms. Banks were also forced to lend to particular sectors of the national economy such as agriculture and real estate.

In December 1962, the Central Bank of Algeria (CBA) was established, in which its main function was to guide and protect the Algerian economy in a way that guarantees the country's overall interest. To this end, CBA was in charge of the creation and maintenance of money (Algerian Dinar) as Algeria moved out of the Franc, creating and controlling currency exchange, and directly and indirectly financing the economy through commercial banks and financial institutions. Also, CBA was in charge of providing loans and advances for financing the state-owned enterprises and the agriculture sector. In short, CBA plays different roles; Bank of Banks, Bank of State and Bank of Exchange (Naas, 2003, cited by Hacini and Dahou, 2018).

In May 1963, “Caisse Algérienne de Développement" was created, as the first investment bank created by CBA. CAD task was in financing the state-planned development programs by providing the medium and long term loans. In addition, CAD contributed to the creation and financing of state-owned enterprises in different sectors (El-hassar, 2000).

In August 1964, the “Caisse National d’Epargne et de Prévoyance” (CNEP) was created to generate savings. CNEP was responsible for financing the housing programs through promoting and encouraging the households’ savings. In fact, CNEP has ensured the financing of construction, local community operations and private operations of general interest (Latrach, 2001, cited by Hacini and Dahou, 2018).

In 1966, as a consequence of the nationalization process of overseas banks operating in Algeria since the colonial period, the Algerian banking network expanded by establishing three commercial banks. Hence, as a national corporation, "Banque Nationale d'Algérie" (BNA) was established in 1966. BNA provided all bank's services, collecting savings from the public as deposits, providing all types of loans to private individuals and businesses, and ensuring exchange operations. In addition, the government had forced public sector companies to deal

only with BNA. In the same year 1966, the "Crédit Populaire d'Algérie" (CPA) was established as a national corporation. CPA activities covered hotelier, tourism, fishing and craft operations.
Followed in 1967 by the establishment of the “Banque Extérieure d’Algérie” (BEA). BEA's mission is primarily to facilitate and develop all transactions between Algeria and overseas countries (Ben Halima, 1996, Hacini and Dahou, 2018).

Later in 1982, in order to relieve BNA in funding the agricultural sector, La Banque de L’Agriculture et du Developpement Rural (BADR) was established. Beside agriculture development programs, BADR was also responsible for agro-industrial programs industries.

In 1985 La Banque de Dévelopment Local (BDL) was created to substitute the CPA in financing the state-owned-enterprises and financing the investment plans of the local authorities. In fact, BDL was created to effectuate the local development by ensuring the necessary financing to the local enterprises and the local investment projects (Benhalima, 1996, cited by Benamraoui, 2008).

The establishment of these specialized banks is part of the institutional reorganization of public companies and also to expand the banking sector to cover all sectors across the country. In 1985, the number of the commercial banks reached six banks all of them state-owned banks.

However, from the independence until 1985, the main characteristic of this period was that the main roles of state-owned banks were collecting deposits at low interest rates and financing government expenditures and state-owned enterprises. This meant that interest rates on deposits and loans were negative in real terms. Banks were also forced to lend to particular sectors of the national economy such as agriculture and real estate.

The central bank provided the commercial banks with liquidity by rediscounting their bills at fixed rates. State-owned enterprises were operating according to the government’s plans for employment and consumer prices, and were not concerned about productivity and profitability. This resulted in a decline in state-owned enterprises capital output ratios.

Ben Bitour, in1998, revealed that in this period the principal institution in the Algerian financial system is the treasury in which it managed the state financial resources, while the banking sector is just a channel that distributes capital according to the state plans. (Hacini and Dahou, 2018)

The increase in the state budget deficit due to declining oil revenues led to a fall in the amount of subsidies the government extended to the public sector. State-owned enterprises became unable to service their debts and non-performing loans began to augment. These non-performing loans caused an imbalance in the state-owned banks' balance sheet. The sudden decline in oil prices in 1986 made matters worse, and non-performing loans accounted for a high proportion of commercial banks' assets (Benamraoui, 2008). This, in turn, led to the collapse of the currency reserve and increasing the level of external debt and the debt service.

Therefore, radical changes in the banking sector were necessary. As a result the law of bank and credit of 1986 was issued. Algerian authorities also sought to determine the legal framework that defines the activities of the different financial institutions.

Some of the reforms were; structuring the various relationships between the bank and its clients and creating a new supervisory and advisory body; correcting the banks ' mission in which the bank credit policy was to be determined on the basis of economic goals rather than social goals; also these reforms allowed the Central Bank to re-establish its traditional position as a bank of the banks, regulate the allocation of loans and determine monetary policy. However, certain issues of this law were not implemented. Therefore, this autonomy didn't have a great impact on bank sectors because the enterprises owned by the state were not autonomous and they still managed by a centralized system (Hadj-Nacer, 1990, cited by Hacini and Dahou, 2018).

Due to the deficiency of the 1986 reforms, the 1988 law of banks autonomy came to complete and modify the law of 1986. The objectives of this law were to provide the autonomy of the public enterprises including the financial institutions. Following to International Monetary Fund (IMF) recommendations, Algeria had worked to reconstruct the economy to sustain long- term growth by creating a favourable macroeconomic environment (Oufriha, 2008). Thus, programs of macroeconomic stabilization and structural reform were launched early in 1988. The objectives of these programs were correcting macroeconomic imbalances, attracting foreign direct investment, and promoting the private sector by encouraging privatization (Saad, Meliani, and Benosman, 2005).

In 1990, the issuing of the Law on Money and Credit was the first step to be taken by the Algerian government to remove many barriers towards domestic and foreign banks.

The law for the first time enabled both private banks and foreign banks to operate in parallel with state-owned banks. It also allowed state-owned banks to select their borrowers and to finance other businesses, which were not their speciality. Because of the small size of the private sector and delays in privatization, state-owned banks continued to fund public projects. In 1996, the government established the first inter-bank foreign exchange market. Since then, foreign exchange rates have been determined by market mechanisms. Conventional and Islamic banks were given the autonomy to trade both local and foreign currencies. However, the revenues generated from foreign exchange activities are insignificant due to the small size of the trading.

After 1994, the authorities initiated further financial restructuring to improve commercial banks' accounting standards. All banks, conventional or Islamic, were required to meet the capital/risk-weighted asset ratio. In 1995, the government introduced new financial regulations for provisioning, risk concentration, and loan classification (Nashashibi et al., 1998). The new rules obliged banks to record overdue interest payment as income and to make provisions for off-balance sheet items.

On the other hand, authorities supported the privatization of some state-owned banks by negotiating the sale of these banks to the foreign investors. However, no privatization has been made to date regarding several obstacles that have prevented the process of privatization. Among the obstacles is the high level of non-performing loans that characterized the state-owned banks; the heavy bureaucratic system of the evaluation procedures in Algeria; in addition, the insistence of the Algerian government for maintaining 51 percent of bank's capital as public ownership hindered the process of the banks' privatization (Aghrout, Bouhezza, & Sadaoui, 2004). Therefore, the authorities have conducted the process of banks recapitalization during the period of 1992-1993 and after in 1997, where the treasury bought these debts by substituting them with Treasury Bonds). Hence, in the early year of 1990s the private banks; Baraka Bank which is a joint venture between banks from Algeria and Saudi Arabia; Banque du Maghreb Arab (BAMIC), a Joint Offshore between Libya and Algeria were established. After 1997, several international banks started to operate in Algeria such as; B.N.P Paribas Bank, Société Générale, Natixis Bank, Arab Banking Corporation…etc.

The process of opening the banking sector to the private and foreign investment had continued with increased pace, in 2001, the Algerian banking system was composed of more than twenty banks and financial institutions vary between public, private, and foreign.

The haste in liberalizing the banking sector and the insufficiency of laws devoted to controlling the banks' activities have exposed the Algerian banking system to a violent shake represented in the failure of three national private banks; Banque Commercial et Industrielle (BCIA), EL-Khalifa Bank and Union Bank (Tlemçani, 2008). Thus, by issuing the banking ordinance in 2003, the Algerian authorities accelerated the strengthening of the legislative environment and regulations of the activities of banks.

Today, Algeria's banking sector has held up relatively well despite recent macroeconomic weakness. Credit growth remained in positive territory through the first three quarters of 2017, albeit having slowed from the double-digit rates seen prior to 2016. Lenders are capitalised well in excess of Basel III norms, while profitability remains high, particularly among private sector banks. However, a sharp reduction in liquidity has been one of the biggest challenges facing Algerian banks in recent times, with reserves, deposits and liquid assets all on the wane and, as a result, interest rates on the rise. Long seen as a closed system dominated by state-run banks and characterised by moderately unsophisticated products and technology, there are signs that the sector could be on the cusp of profound change. E-payments were introduced for the first time in late 2016, and if mobile banking was to be introduced in 2018. However, 2018-2019 Algeria is surviving a political and economic crisis which refrained all banking system development and plans.

They are six government-run banks that dominate the sector, accounting for 88.3% of the market in 2015 and holding a similar share of the sector's total assets of AD12.9trn (€106.8bn) at the end of 2016. These banks are:

1. Banque Nationale d'Algérie (BNA) is the largest, with some AD2.8trn (€23.6bn) in assets in 2016.

2. Banque Extérieure d'Algérie (BEA) with AD2.6trn (€21.3bn) worth of assets, according to the latest financial statements available.

3. Banque de Développement Local (BDL) posted assets of AD846.9bn (€7bn) in 2016.

4. Banque de l'Agriculture et du Développement Rural.

5. Crédit Populaire d'Algérie (CPA).

6. Caisse Nationale d'Epargne et de Prévoyance (CNEP).

These state banks are the main financiers of public and private investment, including the operations of state-owned enterprises (SOEs).

The private banks held the remaining 11.7% of sector assets in 2015. The local subsidiaries of France's BNP Paribas, having been established in 2002, and Société Générale, which began operating in Algeria in 1987, are the leading private players. These two banks accounted for AD248.9bn (€2.1bn) and AD297.1bn (€2.5bn) of assets, respectively, in 2016 (The Report: Algeria 2017).

Bahrain-headquartered Al Baraka Bank, with $1.9bn in assets in 2016, has operated in Algeria since 1991 and is the country's leading provider of Islamic banking products. Gulf Bank Algeria also has a major market presence, but its parent company, Burgan Bank of Kuwait, does not report country-by-country financial results. There are 14 foreign-owned private banks in total, composed of 10 subsidiaries, three branches of international banks and one joint venture.

Partly due to formal restrictions on the financing of SOEs, as well as continued reluctance among SOE executives to engage them, the private banks mainly focus on the private sector and the external sector in particular. Together, they account for a share in excess of 50% of the trade finance segment, for example.

According to the central bank – the Bank of Algeria – assets across the sector reached AD13.5trn (€112bn) as of June 2017, up 8.7% over the same month of 2016.

Algeria's two largest banks figured among the top ranked banks in Africa for 2016, with BNA in 13th place in terms of assets, closely followed by BEA in 14th, according to annual rankings by *Jeune Afrique* magazine. Both were down one place on 2015.

Table 1.3.1.1 Algerian Banks

State-Banks	Assets	Private-Banks	Assets
BEA	**AD2,6trn (€21,3bn)**	BNP Paribas	**AD248,9bn (€1.8bn)**
BNA	**AD2,8trn (€23,6bn)**	Societe Generale	**AD297,1bn (€2,5bn)**
BDL	**AD846,9bn (€7bn)**	Al-Baraka	**$1,9bn**
CPA	**N.A**	As-Salam	**AD1,08trn ($10,25m)**
CNEP	**N.A**	HOUSING	**N.A**
BADR	**N.A**	AGB	**AD256.9bn (€1.9bn)**

Source: Elaborated by the researcher from the Report: Algeria 2017

1.3.2 Islamic Banking in Algeria: Background and Recent Developments

In the 1990s, the political conflict in Algeria and the subsequent reluctance of the authorities to be seen as empowering political Islam and still mostly refers to the industry as “participation banking” rather than Islamic banking have postponed national development in *Shari’ah*-compliant finance. In addition, the long slide in international energy prices caused financial slowdown that was a major factor behind the banking system's drying up of liquidity. This, in turn, motivated the government to enquire alternative financing sources for both the banking system and its own activities.

Most of Algeria's commercial operations remain outside the official banking system, not least because of the cultural preference of the majority Muslim population to undertake cash money transactions and avoid economic products that are contrary to their belief. Mohamed Boudjelal, an Islamic finance expert and university professor in Algiers, said introducing *Shari’ah*-compliant systems would help, since "part of the population refuses to deal with the conventional banking system." Thus, there is significant untapped potential for the provision of a wider range of *Shari’ah*-compliant products. Experts estimate that the pool of savings in the informal economy could amount to $90bn.

The new law on Money and Credit of 1990 allowed the creation of the first Islamic Bank in Algeria. Techniques adopted by the bank differ from those of state-owned banks as *Shari'ah* guidelines are followed in accepting depositing and granting loans to individuals and businesses. The rules governing Islamic Banking in Algeria are similar to those adopted in other markets across the globe. Profit and loss sharing mode of financing is used in the allocation of funds.

While Islamic Finance has not developed as rapidly in Algeria as elsewhere, it is far from a new phenomenon. Although private banks represent a smaller portion of the country's banking sector, many already offer *Shari'ah*-compliant products in some form. Islamic Banking in Algeria's approved banks was limited to foreign banks, mainly from the Gulf, which started in the 1990s.

The first Islamic bank to open its doors in Algeria is Banque Al Baraka d'Algérie in 1991 and is based in Ben Aknoun, Algeria. Banque Al Baraka D'Algerie, S.P.A., operates as a subsidiary of Al Baraka Banking Group B.S.C. The bank's operations are still limited in scale and scope. However, there is steady increase in the number of savers and borrowers using the bank. Bank Al Baraka D'Algerie S.P.A. provides retail and commercial banking services in Algeria. The company offers Islamic banking and financial services such as deposits, including Takaful, Umrah savings, and youth savings accounts; and loan products, and has a 30-branch network in the country. In 2006, As-Salam Bank, also an institution in Bahrain, started activities as the second Islamic bank in Algeria. It has six locations in the country. It operates primarily in the sections of business and commercial finance, but aims to boost its presence in consumer and housing finance considerably by 2020.

Beside the only two Islamic banks in Algeria, some conventional banks in the private sector opened windows offering Islamic Banking services. Jordan's Housing Bank, ABC, Trust Bank and Gulf Bank of Kuwait have opened Islamic Windows, while France's BNP Paribas created its own *Shari'ah* board in 2012 and has been offering *Shari'ah*-compliant products since 2014. In July 2017 another French bank, Société Générale, said it was planning to follow suit by providing participatory deposit accounts and it now offers the Tawfiri 0% account with no interest or fees. These and other entities have also provided *Shari'ah*-compliant leasing products for a number of years.

In 2017, the government launched a new campaign (after the former Algerian governments failed to bring money into the parallel and home-fuelled market through the voluntary commitment process and the Sindhi loan) by opening up public banks to operate in accordance with Islamic *Shari'ah*, while continuing to deal in a classic way to encourage money holders to deal with banks and opening accounts and bank balances, without falling into the legal records and mixing their money with *Riba*-based interest. The objective is to attract funds from a huge pool of cash held outside the formal banking system as Algeria looks for more ways to offset the sharp fall in oil prices and its energy revenues.

Finance Minister Hadji Baba Ammi has already announced plans for the country's first local bond that is interest-free, complying with *Shari'ah* law which forbids interest payments - although he called the scheme "participative" rather than Islamic.

Broadly speaking, the Algerian authorities in the past has been at odds with *Shari'ah*-compliant financial services and banks for political reasons and still mostly refers to the industry as "Participatory Banking" rather than Islamic Banking owing to perceived sensitivities related to political Islam. However, the attitude of officials could be beginning to shift. The Algerian government planned to issue an unspecified number of *Sukuk* in the period between 2019 and 2022.

Algeria's Prime Minister Ahmed Ouyahia announced in 2017 that by the end of 2018 at least six state-owned Algerian banks would be approved to offer Islamic finance services, a concession which was so far granted only to two foreign banks, namely Al Baraka Bank of Algeria, as well as Gulf Bank Algeria, a local branch of the Kuwaiti bank. "Three major public banks – Banque de l'Agriculture et du Développement Rural (BADR), Banque de Développement Local (BDL) and Caisse Nationale d'Epargne et de Prévoyance (CNEP) – will launch Islamic products before the end of 2017, and the rest will follow in 2018. This will allow the sector to meet existing needs of customers and increase financial inclusion rates," Boualem Djebbar, CEO of BADR, told OBG. "2018 will be the year of Islamic finance generalisation in Algeria," he added.

It is expected that the banks' expanded services will include *Murabahah* (cost-plus financing), *Ijarah* (leasing services) and *Musharakah* (joint-venture) partnerships.

To oversee implementation of the new offerings, the government aimed to establish a national *Shari'ah* board by the first quarter of 2018. This represents an important step forward for the Islamic Finance segment, which has lacked a specific regulatory structure to date. Indeed, while banks appear willing to tap fresh sources of funds by providing *Shari'ah*-compliant products, there is still no extensive experience outside the two devoted Islamic Banks in the country, or an appropriate legislative environment. “Public banks opening Islamic Windows is an important development, but we still don't have a devoted Islamic finance regulatory framework,” Sofiane Djebaili, commercial director of Al Salam Bank Algeria, told OBG. “This will be important in order to guarantee the full development of the segment.”

However, despite this hesitation, Algeria slowly strives to offer banking services to more religiously conservative investors. Though accurate plans have not yet been introduced, there are indications from the authorities that they are considering opening up the banking sector to more private sector and international competition, particularly by relaxing the limitation of majority stakes in local banks on foreign ownership.

In addition to these issues, heavy bureaucracy and inertia often delay any kind of reform in Algeria, but bankers are eager to move the concept forward. “Financial institutions must be more dynamic and aggressive in the market by allowing Islamic products to grow,” said Nasser Haider, head of Bahrain-owned As-Salam Bank Algeria. “Regulation has not been a hurdle for Islamic finance in Algeria, but a legal framework would help its development.”

As a consequence, Bank of Algeria as the country's central bank released its long-awaited Islamic Banking regulatory framework in December 2018 (OFFICIAL JOURNAL OF THE REPUBLIC ALGERIAN NO. 73, Aouel Rabie Ethani 1440, 9 December 2018, 18 Regulation No. 18-02, 26 Safar 1440 corresponding to November 4, 2018, with conditions for the exercise of Bank operations under participatory finance by banks and financial institutions) in order to equip the unregulated industry with tools, rules and policies which would allow it to grow. However, until today August 2019 it is still ink on paper.

Today, all government campaigns and plans are informally frozen because of the political crisis that began in 22/02/2019 and has persisted to this day and the removal of the previous government. Algerian people through their peaceful protests are demanding radical changes in all sectors. Meanwhile, Islamic Banks and Windows are still offering services. Hence, Islamic finance was until now more of a shadow industry in the country with no clear-cut regulations, and existing Islamic lenders were operating on their own rules and each being responsible for *Shari'ah* compliance on their own accounts.

Indeed, Islamic Banking services are considered as financing real estate purchases (lands and houses), cars and consumables (furniture and equipment) as well as financing small investment projects with limited amounts of money. "The Islamic Banking sector in Algeria is still modest," said Nasser Haider, general manager of Al Salam Bank. He pointed out that "banking transactions for this sector do not exceed 2% of the total banking market in the country, which is acquired by government banks, and 16% of the private banking sector, which includes 220 banks and private financial institutions." Nasser attributed the modest share of these banks for several reasons; most notably the lack of branches in all centres of activity in the country, and dealing with these banks subject to conditions and mechanisms may be difficult for customers to respond to them, especially in the area of financing. However, there is big potential for Islamic Banks to capture a greater share of household savings that are currently held outside traditional banks," Rachid Sekak, senior consultant at BRS Consultants. "On the lending side, utilising *Shari'ah*-compliant financial products to fund home purchases could be a big growth area."

1.4 Islam and Islamic Banking System

Since the source of Islamic Finance is taken from Islamic religion, we have to shortly highlight about Islam and the reason behind usury prohibition. Islam is monotheism religion and Allah Almighty and Majestic sent the last Prophet (peace be upon him) to the whole mankind for obeying and submitting all issues according the principles of Islam and this term can be understood as "submission" to the Lord. The people who practice Islam are called Muslims.

Muslims believe that *Quran* is the revelation word of *Allah* to His last messenger, *Muhammed* (peace and blessing be upon him) who received and recited the Book and preached to his companions.

Chapter One: Philosophy And Theoretical Framework of Islamic Banking And Finance Industry (IBFI)

Islam has addressed and guided the issues of human life and requires that its principles be followed and implemented in the following aspects: the code of faith, the code of practice, the code of eating and earning, the code of living and the code of ethics. Having defined Islam's scope, action, conduct or permissible dealings, it is called *Halal*.

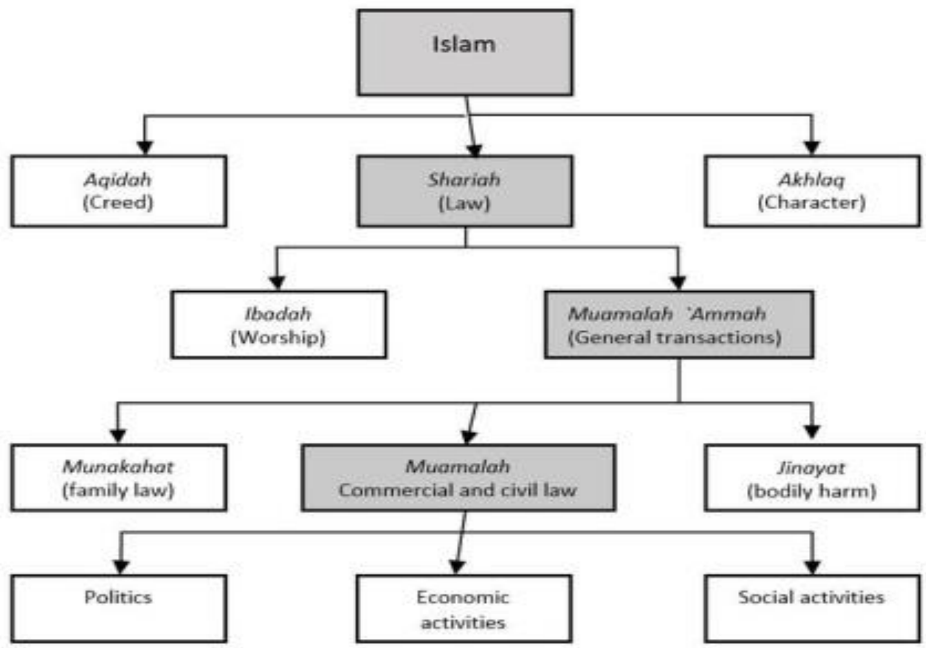
In Islam, illegal behaviours, conduct and dealings are called *Haram*. The principles, codes and categorizations of Halal and Haram are jointly presented as *Shari'ah*. "For simplicity, *Shari'ah* means Islamic Law, and Islamic finance is known as *Shari'ah* -compliant Finance. That's why Islamic Banking and Finance is secured by *Shari'ah* and its interpretation (*Fiqh*). (El-Gamal, 2006, p. 17)". Islamic Finance's objective is to provide financial products and transactions for Muslims not to commit to usury, interest payments and gambling in their business lives.

The source of knowledge is derived from *Qur'an*, *Sunnah* (sayings and actions of the Prophet (peace be upon him)), *Ijma'* (scholarly consensus) and *Qiyas* (deduction by analogy) and the main structure of the market is based on sharing the cost and benefit (El-Gamal, 2006, p. 17). Islamic Banking System is defined as those banks that claim to follow *Shari'ah* (Islamic law) in their business transactions, *Shari'ah* requires these transactions to be in lawful (*Halal*) form and prohibits transactions that involving interest (*Riba*) (Maali, Casson and Napier, 2006). It promotes profit sharing in the conduct of banking business as well as prohibiting paying or receiving interest on any transaction (Salleh and Hassan, 2004).

Chapter One: Philosophy And Theoretical Framework of Islamic Banking And Finance Industry (IBFI)

The relationship between Islam and the Islamic Banking System is explained in Figure 1.4.0.1

Figure 1.4.0.1 The relationship between Islam and the Islamic Banking System



Source: (Noraiza, 2014) Modified by the researcher

The *Shari'ah*, which deals with practices and activities, is divided into '*Ibadah* (i.e. ritual deeds or worshipping Allah such as prayers, fasting), *Mu'amalat* (i.e. business transactions, marriage and crime). The *Shari'ah* is the overall law that governs Muslims. It helps to build the relationship of a Muslim with Allah (God), relationships with other human beings and the relationship with the environment. "*Mu'amalat* provides much of the basis for Islamic economics, and the instruments of Islamic financing, and deals not only with Islamic legality but also social and economic repercussions and the rationale of its prohibitions (Monzer Kahf, p.46, 1999)". Thus, it is explained that Islam does not recognise the separation between spiritual and temporal affairs, considering commerce as a matter of morality and subject to the precepts of the *Shari'ah* (Karim, 2001). The principles revealed in the Qur'an and the business guidelines should not be dealt with separately. Since the guiding principles are deduced from the Qur'an and

Hadith, both sources should be practiced together. Hence, Islamic Banks, like other Islamic business organisations, are established with the mandate to carry out their transactions in strict compliance with Islamic *Shari'ah* rules and principles (Karim, 2001).

1.4.1. The Objectives of *Shari'ah*

Islamic Banking and finance functions are based on *Shari'ah* principles. Therefore, it is intended to accomplish the *Maqasid* as-*Shari'ah*. The *Maqasid* of *as-Shari'ah* (Islamic Law) was revealed for one basic universal purpose: to realize the best interests (*Maslaha*h) that aim to attain the total welfare (*Maslahah*) of the Muslim nation. *Maslahah* in the Arabic language literally translates as benefit or interest, it is defined by Imam al-Ghazali as that which secures a benefit (for man) or prevents harm (from him). It is also described as the promotion of welfare (i.e. *Masalih*, pl. *Maslahah*) and prevention of corruption and vice (i.e. *Mafasid*) (Abozaid and Dusuki, 2007; Abdul-Rahman, 2003). On the other hand, a Muslim jurist defines objectives of *Shari'ah* as seeking benefits and the rejection of harm, as directed by the lawgiver or *Shari'ah* (Abozaid and Dusuki, 2007). Welfare is defined in the Oxford Advanced Learner's Dictionary (2001; p: 1355) as "the general health, happiness and safety of a person". In the perspective of Islam, well-being and happiness is to be achieved in this world and in the hereafter, also known as *al-Falah*, which refers to ultimate success. In addition, the *Maslahah* is meant to preserve the goals of *Shari'ah* where the welfare of the *Ummah* is achieved through the attainment of these goals. Human nature tends naturally to seek happiness, but this cannot be achieved unless people cooperate with each other, but cooperation is impossible unless people strive to live a peaceful life. Peace and security cannot be achieved unless there are rules to protect the rights of all equally. However, rules and legal regulation are useless without a source of authority to enforce them and apply them equally. This was achieved in Islam by educating individuals about the legislation governing their religion in such a manner that some of the study was accomplished by individuals who wanted to follow their Lord and guide others to do the same.

In order to guarantee that the interest of the *Ummah* is protected, Shatibi (Abdul-Rahman, 2003) classified the protection of interest (i.e. protection of *Masalih*) into three interrelated types, namely, the essentials (i.e. *Dharuriyat*), the complements (i.e. *Hajiyat*) and the so-called embellishments (i.e. *Tahsiniyat*). Essentials are the basic needs of people which they depend on to live. The basic needs or necessities are classified into five elements. These five necessities have been labeled as the "Five *Maqasid* of *Shariah*", and there preservation is essential. Three of which were used in the American Declaration of Independence, have been discussed by Imam Al-Ghazali. Al-Ghazali, who argued that *Maslahah* was God's general purpose in revealing the divine law, and that its specific aim was preservation of five essentials of human well-being: religion, life, intellect, offspring, and property (Opwis, 2007, p: 65). Imam al Ghazali said that any measure which secures these values also falls within the scope of *Maslahah* (peoples interest), and anything which violates them is *Mafsadah* (evil), and preventing the latter is also *Maslahah*. More technically, *Maslahah mursalah* (Public Interest) is defined as a consideration which is proper and harmonious (*Wasf munasib mula'im*) with the objectives of the Lawgiver (*Allah*). Because these five necessities are derived from *Shari'ah* as necessary and basic for human existence, therefore, every society should preserve and protect these five necessities; otherwise human life would be harsh, brutal, poor, and miserable, in this world and the hereafter.

It also has the aim of facilitating life or removing hardships and is compatible with the *Shari'ah* (Kamali, 2003). Embellishments refer to attitudes that nourish the current values that an individual has. Therefore, it is a matter of desirability at this level of interest, since they seek to attain refinement and perfection in customs and conducts of people (Kamali, 2003). For instance, is to control excessive desire by practising moderation in life, giving out *Sadaqah* besides paying *Zakah* or performing more prayers in addition to the five obligatory prayers.

Three of the classifications in protecting the interest, are taken as an ethical filtering mechanism that can be used as means to resolve ethical conflicts. They can also be utilised as the basis of setting appropriate priorities for the work to be undertaken (Abdul-Rahman, 2003). In addition, Dusuki and Abozaid (2007) proposed that the classifications are a framework that can be used by the manager when faced with potential conflicts arising from the diverse expectations and interests of a corporation's stakeholders. Thus, these classifications will serve as a checklist in order to direct the decisions made in accordance with the objectives of its establishment.

In addition, to explain the Islamic Banking philosophy, Ali (1988, cited by Haron, 1997, p: 11) was of the view that "The Islamic economic order is based upon a set of principles found in the Qur'an. No matter what aspect of the Islamic Economics order is introduced, for practical operations it has to base itself on the Qur'anic concept of social justice. The Islamic Financial system, therefore, cannot be introduced merely by eliminating *Riba* but only by adopting the Islamic principles of social justice and introducing laws, practices, procedures and instruments which help in the maintenance, dispensation of justice, equity and fairness" Ali (1988, cited by Haron, 1997) emphasised the need of the practical operation of the Islamic Banking operation to be based on Qur'anic concepts of social justice. Justice can be achieved by prohibiting all sources of unjustified transactions. Unjustified transactions will lead to unjustified means of gaining profit and wealth. Thus, in managing the assets of the banks, the management of IBs should spend their accumulated wealth on the needy and for providing well-being for the whole of society (Haron, 1997). The philosophy revealed in the Qur'an and the enterprise guidelines should not be dealt with separately. All revelations that require Muslims to uphold justice and virtue serve as principles, which guide IBs in managing their business dealings (Haron, 1997, 2000; Rosly, 2005; Siddiqui, 2001).

IBs should also function on the basis of Islamic doctrines by engaging in legitimate and lawful business in order to fulfil all obligations and responsibilities, properly execute transactions to help and assist the needy, managing the wealth in a proper and orderly manner and avoiding any overspending and wastefulness (Haron, 1997). In addition, it is important for the players to observe Islamic ethical and moral standards. Furthermore, the business activities of Islamic Banking should also be based on the ethical values of Islam and any investments in unlawful businesses, such as dealings which involve interest, manufacturing and trading of alcohol, trading of pork, drugs, gambling, pornography, etc., are prohibited (Rosly, 2005; Gait and Worthington, 2008; Iqbal et al., 1998; Ali, 2000). Other principles that need to be observed by the players are to manage the business dealings of Islamic Banking with honesty and equity, to carry out trading activities in a faithful and beneficial manner and to perform work with honest efforts (Haron, 1997, 2000).

Furthermore, any enterprise activities aimed at making a profit by hoarding, profiteering, short weighting and hiding the defects of merchandise or any unlawful profit from business activities are forbidden. The IBs had a good monitoring mechanism in screening prospective investment portfolio involve in unlawful business (Ullah et al., 2014).

In 1990, The International Association of Islamic Banks (IAIB, p: 27; Al-Omar and Abdel-Haq, 1996) issued statement clarified the purposes of Islamic Banks as follow:
"The Islamic Banking system involves a social implication, which is necessarily connected with the Islamic order itself, and represents a special characteristic that distinguishes Islamic Banks from other banks based on other philosophies. In exercising all its banking or developmental activities, the Islamic Bank takes into prime consideration the social implications that may be brought about by any decision or action taken by the bank. Profitability--despite its importance and priority is not therefore the sole criterion or the prime element in evaluating the performance of Islamic Banks, since they have to match both between the material and the social objectives that would serve the interests of the community as a whole and help achieve their role in the sphere of social mutual guarantee. Social goals are understood to form an inseparable element of the Islamic Banking system that cannot be dispensed with or neglected."

In describing the objective of IBs, the IAIB pointed out that Islamic Banks' principal activity is connected to the Islamic order and is related to its particular social implications features. IBs are anticipated to be financial institutions that could play an effective intermediary role betw een financial providers and finance consumers through implementing the Islamic business principles that have been indirectly expressed in the Qur'an. Thus, the operation of IBs should be operated without breaking the law prescribed in the *Shari'ah* and should be directed to the achievement of the socioeconomic objectives of an Islamic society (Ahmad 1991). Therefore, in addition to upholding the Islamic business principles, it should aim to maximize profits within the framework of social and moral conduct.

1.4.2. The Principle of Islamic Banking and Finance

Understanding the philosophy of IBs is of essential interest as the management and regulators of IBs when managing their goals and policies apply it. Therefore, we are going to explain the philosophy of Islamic Banking by looking at the fundamental principles and concepts of IBs. According to (Haron, 1997, 2000), the foundations of the philosophy of Islamic Banking are principles that have been revealed in the Qur'an and Hadith. The philosophy of Islamic Banking acts as the backbone of its establishment. The operations of IBs, as one of the mechanisms for the development of the Islamic economic system, are based on the said philosophy. The philosophy is also used as the benchmark/indicator in guaranteeing that the IBs are upholding the true Islamic principles in their operations (Haron, 1997, 2000).

The following five subsections are intended to discuss the philosophy of Islamic Banking further.
a. *Riba*: Islamic Banking is a growing phenomenon that was established to satisfy the financial needs of devout Muslims who observe the prohibition of interest-based transactions (El-Gamal, 1997). The prohibition of *Riba* is a basic difference between the Islamic and Conventional Banking systems (Al-Saud, 2000). The operations of Islamic Banks are bound by the prohibition of *Riba* that was revealed in the *Qur'an*: 17. *Riba* is prohibited in all forms and intentions; thus, all transactions based on the giving or taking of *Riba* should be avoided (Ahmad, 1991). *Riba* can be classified into two types, namely *Riba al-Nasi'ah* and *Riba al-Fadl*. Muslim jurists define *Riba al-Nasi'ah* as referring to loans bringing to the lender a fixed increment after an interval of time, or an extension of time over the fixed period and increase of credit over the principal (Rosly, 2005). Therefore, this type of *Riba* refers to a deferred payment in excess of the lent principal; i.e., it recognises a time value for money. This type of *Riba* is strictly prohibited in the Qur'an, and it is considered as one of the major sins (El-Gamal, 1997). On the other hand, *Riba al-Fadl* is described as *Riba* by way of excess over and above the quantity of the commodity advanced by the lender to the borrower. *Riba* exists if there is either inequality or delay in delivery of the goods offered. Thus, the barter or the sale becomes usurious (*Riba'wi*) if there is an exchange with an increase of surplus in exchanging one commodity against the other.

b. The prohibition of *Gharar* (uncertainty): The Arabic word *Gharar* is a fairly broad concept that literally means deceit, risk, fraud, uncertainty or hazard that might lead to destruction or loss. *Gharar* in Islam refers to any transaction of probable objects whose existence or description are not certain, due to lack of information and knowledge of the ultimate outcome of the contract or the nature and quality of the subject matter of it. For instance, future contracts and options can be included to this category (Ismail, 2001; Lewis and Hassan, 2007). The prohibition of *Gharar* is found in *Ahadith* forbidding as *Gharar* the sale of such things as 'the birds in the sky or the fish in the water', 'the catch of the diver', the 'unborn calf in its mother's womb' (El-Gamal, 2001, p: 2).

c. Partnership contracts (profit and loss sharing): *Mudharabah* and *Musharakah* contracts are partnership dealing and it can be done either by one (*Mudharabah*; two parties where one partner promises to provide the capital (*Rabb-ul-maal*) and the other one promise to be an investment manager. Profit is distributed on pre-determined ratio while entering into the contract but in case of loss, only the capital investor (*Rabb-ul-maal*) will bear it.) or groups of partners (*Musharakah*; is quite similar to *Mudharabhah* with a small difference that in case of *Musharakah* both parties are the capital owners and manager can participate in management as well as profit and loss. Profits can be distributed on pre-determined ratio but the losses have to be borne in capital investment ratio only) that can role to involve capital and or/skills and make *Shari'ah* compliant business development. Any profit that is earned is shared between partners according to pre-agreed ratio and results a return on capital. However, losses are allocated depending on the capital involvement and its risk (Lewis and Hassan, 2007). Traditionally, this type of contract has been used for financing fixed assets and working capital of medium and long-term duration (Greuning and Iqbal, 2008).

d. *Ijarah* (leasing): Leasing is an agreement that permits one party (the lessee) to use an asset or property owned by another party (the lessor) for an agreed-upon price over a fixed period of time. It is a form of asset finance, which has the benefit of using assets without the requirements of ownership. The lessee acquires the asset he needs without borrowing on interest and receives the benefits of use while the lessor receives the value of regular rental payments for a specified period plus the residual value of the asset. The lease may be written either for a short-term or for a long-term and its rules is similar to those governing sale because in both cases there is a transfer of one thing between two parties for valuable consideration. However, leasing differs from sale as its mechanism allows the separation between ownership and use; in fact, it does not involve transferring the corpus or ownership of an asset, which remains with the lessor. *Ijarah* is regularly preferable by Islamic Finance donors due to facility and asset used. As a result of renting lesser receives periodical rental payments from the lessee on behalf of using of asset (Iqbal and Abbas, 2007).

e. *Sukuk* (investment certificate or bond): A certificate, similar to a bond in Western finance. *Sukuk* were broadly used by Muslims in the middle ages as papers representing financial obligations originating from trade and other commercial activities. However, the present structure of *Sukuk* are different from the *Sukuk* originally used, and may be seen as an equivalent of bond. However, fixed income interest bearing bonds are not permissible in Islam; hence *Sukuk* should comply with investment principles within the Islamic law, which prohibits the charging, or paying of interest. The main condition for issuance of *Sukuk* is the existence of assets on the balance sheet of the issuing entity that wants to mobilise its financial resources (Treasury and Capital Market Operations; IIBI; 2009). The issuer of a *Sukuk* sells an investor the certificate, who then rents it back to the issuer for a predetermined rental fee. The issuer also makes a contractual promise to buy back the bonds at a future date at par value. The claim embodied in *Sukuk* is not simply a claim to cash flow but an ownership claim. A *Sukuk* basically represents either a proportional or an undivided interest in an asset or pool of assets. The degree of asset ownership rights subsequent to ownership interest carries the right to a proportionate share of cash flow or other benefits and risks of ownership.

1.5 Theoretical Framework of Islamic Banking and Finance

The excess expenditure units are collected in the Islamic Banking system in the form of deposits and redirected into the deficit spending unit. The flow of funds is guided by the standards derived from *Shari'ah* principles (Rosly, 2005; Rosly and Sanusi, 1999). Thus, this will uphold the role of IBs as true fiduciary agents that gather the surplus capital of the *Ummah* and allocate it to projects and activities in line with the goals, values, and philosophy of the *Ummah* (Aziz, 2003). The banks will provide clients with a range of products and services to meet the requirements of their banking business requirements. The distinctive connection occurs in the operation of the IBs as a consequence of its particular fundamental values governing its products and services ' underlying agreements. The most important fundamental ideas are *al-Murabahah* (a sale of goods is made at a price, which includes a profit margin agreed upon by both parties. The profit margin and other costs must be stated at the time of the sale agreement. The bank is compensated for the time-value of money by a fixed profit margin. The asset remains in the name of the bank until the loan is paid in full. This is similar to a rent-to-own arrangement, but in the event of late payments an Islamic Bank cannot charge above the agreed upon rates. According to Tarek al-Diwany, *Murabahah* is a form of trust sale since the buyer must trust that the seller is disclosing true costs (Abdel-Haque, 1993), *Mudharabah*, *Salam* (is defined as the forward purchase of specified goods with full forward payment. This contract is normally used for financing agricultural production. According to Hassan (2004), Salam based future contracts for agricultural commodities, supported by Islamic Banks, will offer to overcome the agricultural financial problem.), *Istisna'* (is a new concept that offers future structuring possibilities for trading and finance. One party buys the goods and the other party undertakes to manufacture them according to agreed specifications. Normally, *Istisna'* is used to finance construction and manufacturing projects), *Kafalah* (literally means to take care of one's need. It is the pact between at least two parties agreeing to jointly guarantee one another in the event of a loss, as a consequent of being afflicted by a calamity defines the term *Takaful*.), *Wakalah* (is a financial relationship between principal and agent. The contract of *Wakalah* means designating a person or legal entity to act on one's behalf or as one's representative. It has been a common practice to appoint an agent (*Wakil*) to facilitate the trade operations. A *Wakalah* contract gives a power of attorney or an agency assignment to financial intermediary to perform a certain task. On the surface, there does not appear to be much difference between a *Mudharabah* and a *Wakalah* contract, since both are principal-agent contracts. However, the main difference is that in case of *Mudharabah*, the *Mudharib* has full control and freedom to utilize funds according to his professional knowledge, as opposed to the case of *Wakalah* where the wakil does not have similar freedom (Siddiqi, 1983). A wakil acts only as a representative to execute a particular task according to the instructions given).

These investments can be categorized as PLS-based and non-PLS-based investments. PLS-based instruments are *Mudharabah* and *Musharakah*, while non-PLS-based tools are *Murabahah*, *Ijarah* and *Salam*. There are also mixed kinds of investments that combine PLS and non-PLS tools that pretend to consist of fixed and variable components. In addition, given that the operations of Islamic Banks that are theoretically based on the "two-tier *Mudharabah*" model and "two-windows" model, it involves different parties in operations and transactions (Ahmad, 1994; El-Hawary et al., 2004; Iqbal et al., 1998; Iqbal and Mirakhor, 2011; Kahf, 2005; Venardos, 2005).

The relationships within Islamic Banks involve Islamic Banking depositors on the liability side and investment on the asset side. The liability side shows Islamic Bank deposits, which are divided into non-investment deposits (i.e. demand and savings), restricted investment account holders (IAHR) and unrestricted investment account holders (IAHU). The liabilities and equity side of the bank's balance sheet includes deposits accepted on a *Mudharabah* basis. "Two-tier *Mudharabah*" involves fund mobilisation and fund utilisation based on profit sharing. The fund mobilisation (i.e. first tier) involves the investors and the banks; with the investors acting as a supplier of funds and the banks, acting on behalf of the investors as a "*Mudharib"* to invest the money in profitable projects (Batchelor, 2006; Haron, 1997; Haron, 2000; Nawawi, 1999; Rosly, 2005; Sadeq, 1990). Furthermore, the fund utilisation (i.e. second tier) features a *Mudharabah* contract between the bank as supplier of funds and entrepreneurs seeking funding and sharing profits with the bank according to a ratio stipulated in the contract (El-Hawary et al., 2007).

Sharp distinctions have to be drawn between non-investment deposits and investment deposits. On one hand, the non-investment deposits operate under the contract of *Wad'iah Yad Dhamanah* (i.e. guaranteed custody). As the depositors deposit their money in the banks, the non-investment account holder will be guaranteed the principal amount of the deposits and will receive *Hibah* according to bank's discretion, which depends on the bank's overall profitability (Lewis and Algaoud, 2001; Safieddine, 2009).

Demand deposits will not yield any return and are repayable on demand at par value. They are also treated as liabilities and may be subject to a service charge. In addition, depositors are aware that Islamic Banks will use their deposits for financial risk-bearing projects (Venardos, 2005). In this model, both types of deposits can be used for their financing and investment activities and the bank's assets and liabilities are fully integrated, which is far riskier (Venardos, 2005). In addition, it should minimise the need for active asset/liability management (El-Hawary et al., 2007).

The IAHR and IAHU are governed by the *Mudharabah* contract. The investment accounts are operated under profit and loss sharing (PLS) which has limited-term, non-voting equity in which capital is not guaranteed and there is no predetermined return (Napier, 2007; Maurer, 2005; Lewis and Algaoud, 2001; Sundararajan and Errico, 2002). This is not a liability as their value is not guaranteed and they may incur losses. The IAHR restricts the nature of investment for deposits that they put forward and will actively involve in the decision-making of the investment, while IAHU will leave finding a suitable investment to the discretion of the bank (Siddiqi, 1983). In addition, the IAHU's funds could be commingled with the shareholders' funds. The relationship between IAH and shareholders is unique, drawn from the theoretical framework underlying the operations. Shareholders are those who invest in the Islamic Bank itself and have voting privileges on its boards, while depositors are those who deposit their money into investment accounts (Grais and Pellegrini, 2006; Maurer, 2005). In the event of profit, the IB and IAH will share an agreed percentage of profit (Archer et al., 1998; Napier, 2007; Safieddine, 2009). However, in the event of a loss, the bank does not risks or loses as *Mudharabah*-depositors and bank shareholders share the loss (Safieddine, 2009; Lewis and Algaoud, 2001). The relationship between the parties are unequal, as a loss to one is a gain to the other (Maurer, 2005). In addition, the IAH is closer to shareholder risks. Furthermore, although IAHR and IAHU involve exposure to different degree of risks, their relationship with the management of the bank is subject to the same monitoring arrangement (Archer et al., 1998).

On the other hand, the second-tier involves financing entrepreneurs on the condition that profits accruing from their business shall be shared between the bank and the entrepreneurs in a mutually agreed proportion. However, the loss shall be borne only by the financier. According to (Chapra, 1992), since the Islamic equity of IBs is based on the profit and loss reward sharing system, in such a system, investment and financing allocations are based on the evaluation of the strength of the proposal and the value judgment, and could reflect greater efficiency in allocating resources to both the demand and supply side. This model does not mandate a specific reserve required for either type of deposits (Venardos, 2005; El-Hawary et al., 2007). However, Khan (1986) and Mirakhor (1989) opine that, contrary to investment deposits, demand deposits are liabilities that are not supposed to absorb any loss and therefore, a reserve requirement should be imposed.

In addition, the liabilities in the "two-window" model are divided into two windows, as the name suggests. Contrary to "two-tier *Mudharabah*", "two-window" is in line with the opinion of Khan (1986) and Mirakhor (1989) that 100% reserves should be held in demand deposits. In addition, demand deposits may be chosen where they are assumed as *Amanah* (safekeeping). Demand deposits are considered to belong to depositors at all times. Thus, the bank cannot use the deposits as the basis to create money through fractional reserves (Venardos, 2005). On the other hand, investment deposits may be chosen to finance risk-bearing investment projects with depositor's full awareness. The bank does not guarantee the return from the investment and a reserved requirement is not applied to them. The bank may charge a service fee for safekeeping services, and interest-free loans may only be granted from funds specifically deposited for that purpose (Venardos, 2005).

1.6 Summary

The first part of the chapter reviewed the history of international and Algerian Islamic Banking and finance industry. It continued by explaining the development of Islamic Banking in Algeria. In Algeria, various initiatives and measures must be introduced to IB in order to ensure that IB is being offered a level playing field with the Conventional Banks in order to secure its competitiveness and sustainability. In addition, the importance of the regulators shown through various initiatives and measures is further linked with the underlying principles of the IB.

Furthermore, in an Islamic financial institution, religious values are central to Islamic Banking core values and missions (Rammal and Parker, 2013). The literature reviewed in this chapter shows that the Islamic Banking system is different from the conventional system in terms of the specific philosophy guided by the revelation and the ethical values that lie underneath it. Among others, the religious values being preached in the operations of Islamic Banking and finance are based on *Shari'ah* principles. They are the prohibition of *Riba*, *Gharar* (uncertainty), Partnership contracts (profit and loss sharing), *Ijarah* (leasing), and *Sukuk* (investment certificate or bond). Humans are responsible for managing the resources entrusted to them through applying *Shari'ah* principles. The correct application of *Shari'ah* principles is expected to promote welfare and prevent corruption and vices in achieving the welfare of the *Ummah*. From the individual perspective, managing the resources in accordance with *Shari'ah* principles will ensure achievement of justice and *al-Falah* (i.e. success in the world and hereafter). In addition, as Islamic Banking is guided by *Shari'ah* principles, adherence would fulfil the objective of its existence. However, besides upholding the Islamic economic order, it is important to uphold social justice and support the legal and regulatory framework, practices, procedures and instruments that will promote justice, equity and fairness. Thus, through implementing the Islamic business principles that have been indirectly expressed in the *Qur'an*, IBs are expected to be financial institutions able to play an efficient role as an intermediary between finance providers and finance users. In order to achieve its objectives, Islamic Banks are required to adhere to the *Shari'ah* principles in their dealings and transactions, and therefore adherence to the *Shari'ah* principles in its operations of Islamic Banks is crucial.

In addition, adherence to these principles will lend credibility in the eyes of the public and will increase their trust and confidence in the soundness, stability and competitiveness of Islamic Banks. The chapter also discusses the theoretical framework of Islamic Banking and finance and the agency problems arising from the relationships in IB, which comprise a double agency problem; i.e. the separation of ownership and control of shareholders, and the separation of cash flow rights from the rights to control the investment.

In the operation of Islamic Banking, various products are applied to comply with and fulfil the underlying principles. Different principles of Islamic Banking lead to different sources of funds and uses of funds. Furthermore, different principles lead to different types of contracts being used. As explained in the previous chapter, the main sources of funds are shareholders' equity, current accounts, investment accounts and savings accounts. The financial instruments are *Musharakah, Mudharabah, Murabahah, Ijarah, Salam, Istisna'* and *Qard-Hassan*; which are the alternative underlying concepts provided by Islamic principles. The establishment of Islamic Banks with specific principles has led to various challenges in guaranteeing that the practices are based on the theory laid out. Furthermore, the ability of Islamic Banks to play their role as defined by Islamic law should be assessed by a local statutory body (act) or local regulatory framework that governs the institutions. The different economic, social and environmental conditions of the IBs' operations should be considered.

Chapter Two: Overview of Problems and Challenges Facing Islamic Banking and Finance Industry

Chapter Two: Overview of Problems and Challenges Facing Islamic Banking and Finance Industry

2.1 Introduction

The previous chapter reviewed and discussed the historical background of the international Islamic Banking and Finance, an overview of Islamic, Conventional Banking, Finance development, and history in Algeria. Also, it reviewed the relationship between Islam and Islamic Banking system, then ending with the theoretical framework of IBF.

This chapter examines the problems and challenges faced by Islamic Banking and finance with regard to *Shari'ah* compliance, legal and regulatory framework, management, accounting and auditing. This chapter can also be grouped into several major sections: the operations and products in Islamic Banking system, than discusses the risk management in Islamic Banks. Furthermore, the chapter highlights Islamic Banking and its legal and regulatory framework. Then, it continuous with the problems and challenges facing Islamic Banking and finance. In addition, the chapter focuses on Islamic Banking and Finance and their impact on accounting and auditing practices.

Chapter Two: Overview of Problems and Challenges Facing Islamic Banking and Finance Industry

2.2 Islamic Banking and Finance Operations and Products

Islamic Banking is based on interest free Banking that conforms to the Islamic law or *Shari'ah* that prohibits interest on all types of loans. The principle of interest free Banking is profit and loss sharing. Both the supplier of the capital and the borrower share the risk and both suffer together when returns are poor. Islamic Banks will fit only if one replaces "interest rates paid" with "profit-shares and fees" (Arif, 2007).

The fundamental differences between Islamic and conventional Banking, is not only in the way they practice their business, but also their values which guide Islamic Banking's whole operations and outlooks (Dusuki, 2008). The methods by which funds are generated and used differ from conventional Banks. Each mode of financing in the Islamic Bank is governed by a set of rules and accrues different rights and obligations of the parties, Bank and clients involved (Ismail and Latif 2001). It is clarified by the distinct character of each agreement that characterises its operation. In addition, Mirza and Baydoun (1999) argue that the firm's contracts with its claimants, including the society at large, drive its accounting and reporting policies. In addition to the distinct principles underlying its products and services, Islamic Banking system administration is the same as standard Banking systems, with distinct ethical values and distinct moral behaviour. Thus, distinguish features of Islamic Banking are based on (1) risk-sharing, (2) emphasis on productivity as compared to credit worthiness, and (3) moral dimension (Iqbal et al., 1998). For a clearer understanding on the differences between Islamic Banks and conventional Banks, Table 2.2.1 below provides a summary of the subject matter:

Table 2.2.1 The differences between conventional and Islamic Banks

	CONVENTIONAL BANKS	**ISLAMIC BANKS**
Functions and operating modes	Fully based on man-made principles.	Must be based on *Shari'ah* principles.
Investor assurance	Predetermined rate of interest.	Investor as capital provider and management as entrepreneur share the risk, hence profit rates are only indicators.

Rules of accounts	Governed by product terms and conditions.	Governed by undertaking contracts, determining the terms and conditions.
Fundamental function	Lending and borrowing with compounding interest.	• Participation in partnership business. • Important to understand the customers' business.
Relationship	Creditors and debtors.	Could be: • Partners, • Investors and traders, • Buyers and sellers.
Deposits rate and guarantee	Fixed interest rates and deposits are fully guaranteed.	Non-guaranteed return may be given as *Hibah* (gift) and rate of return must be indicative rate. Only *Wadi'ah* deposit accounts are guaranteed.
Loan / financing rate	Usually based on floating rates, BLR +/- rates.	• Fixed profit mark-up (*Bai Bithamin Ajil*, *Murabahah*) • Floating profit rates (*Musharakah, Ijarah*)

Source: The Journal of Applied Business Research – July/August 2013

Chapter Two: Overview of Problems and Challenges Facing Islamic Banking and Finance Industry

IB's trade and business operations are used to substitute interest-based operations and would be managed through various kinds of agreement and contracts. Consequently, profit-sharing and equity participation are the principles on which Islamic Banks are not allowed to engage in lending operations on the basis of interest-bearing deposits or other forms of interest (Nawawi, 1999). Further, the functions of Islamic Banks can be classified into four that are (1) investment through *Mudharabah* or agency contract, (2) investment using Islamic financial contracts, (3) financial services (e.g. letter of guarantee, money traders) and (4) social services (Mohamed Ibrahim 2007). Islamic Banks' operation is described by Islamic Banks' tools in mobilizing the fund obtained from the excess unit (i.e. depositors) to the deficit unit. The sources of funds are:

a. Deposits

Islamic Banks receive two types of deposits: deposits not committed for investment, which takes the form of current accounts or savings accounts, and deposits committed for investment, which are called Investment Accounts. Whereas Current Account is operated in the same way as it is operated in the Conventional Banking system, the Savings Accounts and Investment Accounts are operated differently as discussed below:

Savings Accounts are an account where the customers can deposit their savings. Though these depositors allow the Banks to use their money, they get a guarantee of getting their full amount Bank from the Bank. In this case, the Bank guarantees their savings but is not obliged to pay any rewards to the savers. However, most of the Banks are still paying either a cash reward from their profits at the end of their financial year or are giving some privileges to the holders of these accounts, e.g. providing financial support for small projects, sale of consumer durables or producers goods by instalments, distributing gifts etc. These rewards are discretionary and not obligatory and are paid only in case the Bank is earning substantial profits. The Savings Accounts share the net profit of the Bank according to some agreed proportion.

Investment Accounts can be of two types: Accounts with authorisation, and Accounts without authorisation. In the accounts with authorisation, the account holder authorises the Bank to invest this money in any one of its projects. After the expiry of a specified period, the account holder will get the profit. In case of investment accounts without authorisation, the account holder may choose any particular project for investment of his deposited money. (The account holder may or may not specify the period of deposit.) The Bank will give share to the account holder from the profit of that particular project which has been chosen by him according to agreed percentage. If the investment accounts are opened for a fixed period, the customer is not allowed to withdraw his money before the lapse of the specified period. If he does so, the customer either is not entitled to the share in profit at all or may be entitled to receive some discounted profit depending upon the duration of the deposit with the Bank. These deposit schemes of Islamic Banks have been able to attract a substantial number of depositors.

Investment accounts are generally popular in these Banks. Savings Accounts are equally popular only in those Banks where these accounts are entitled to share the profits of the Bank. Where the Savings Accounts are not entitled to share the profits, the deposits in these accounts are negligible.

b. Investment Activities

As the Bank cannot earn interest by lending the money, therefore, the Islamic Banks have to undertake investment to earn profit not only for the Bank itself but also for the depositors in the investment account. The investment procedures based on the Islamic principles are: *Musharakah* (Equity Participation); this procedure is also being applied to a few activities other than the investment project. Some of these activities are: **i)** Letter of Credit. If the importer fails to pay the full amount of the letter of credit at the time of the delivery of goods, the Bank will not charge him any interest on postponing the payment and will instead, share in the profits of the importer at a ratio agreed upon in advance. Some of the Islamic Banks, however, charge nothing if the amount is paid in full at the time of the delivery. **ii)** Purchase of Property or Real Estate: the Bank may provide loans for such purchases on the basis of *Musharakah*. The Bank will assess the rent or annual income from the property or real estate and will share it according to the extent to which he is financing and according to the terms agreed in advance. As the client pays up the instalments of the loan, the Bank's share in the income will be reduced till the whole property is transferred to the client. *Mudharabah or Qiradh (*Agencies*), Murabahah, Bai Salam (*Post Delivery Sale), Leasing or Renting the Physical Capital/Equipment.

Islamic Banking products are recognized based on the contracts instead of the commercial orientation. The current Islamic Banking products can be categorized as shown in **table 2.2.2** below:

Table 2.2.2 Deposits

PRODUCT/PROCESS	**MIDDLE EAST**	**NORTH AFRICA**	**MALAYSIA**	**INDONESIA**
Savings Account based on: *Wadi'ah* *Mudharabah* *Qard*	*Mudharabah* and *Qard* are standard offerings	*Mudharabah* and *Qard* are standard offerings	*Wadi'ah* is more popular than *Mudharabah*	*Mudharabah* is most popular, followed by *Wadi'ah*
Current Account based on: *Wadi'ah* *Mudharabah* *Qard*	*Qard* and *Mudharabah* are standard offerings to customers	*Qard* and *Mudharabah* are standard offerings	Only *Wadi'ah* is offered	Only *Wadi'ah* is offered to customers
Fixed Deposit based on: *Mudharabah* Commodity *Murabahah* *Wakalah*	All three are popular products, especially within GCC countries	All three are popular products *Mudharabah* is the standard offering.	*Mudharabah* is the standard offering. Commodity *Murabahah* and *Walakah* are gradually becoming more popular	Only *Mudharabah* is being offered to customers
Recurring Deposits/Saving Plan to increase deposits	Popular scheme offered to customers as a "forced saving plan"	Popular scheme	Slow take-up as *Takaful* unit-linked plan is more attractive to customers	Popular scheme to encourage saving for Hajj and Education

Structured Products	Products are offered to selected customers	Products are offered to selected customers	Products are offered to selected customers	Not offered to public yet
Profit Distribution	Profit Distribution Adopt guideline issued by AAOIFI on *Mudharabah*-based products	Adopt guideline issued by AAOIFI on *Mudharabah*-based products	Adopt guideline issued by AAOIFI but more refined and complex	Revenue-based (instead of profit based) but less complex
Liquidity Management	Standard offering when Banks promote their cash management services to commercial and corporate customers	Emerging requirements	Same as Middle-East and Africa	Emerging requirements in Indonesian market
Fund Management (Allowing Banks to create multiple funds or pools meant for specific target customers)	Very popular arrangement wherein customers can place deposits into various funds based on their risk preferences and expected returns	Popular arrangement wherein customers can place deposits into various funds based on their risk preferences and expected	Low demand from customers. However, non-Bank financial institutions (NBFI) and developmental Banks are using this capability to manage	Emerging requirements but take up from customers is low

		returns	borrowings or "special allocation" received from Banks and government agencies	

Source: Islamic Banking Processes and Products Key Regional Variations (Oracle White Paper-September 2017).

2.3 Risk management in Islamic Banks

It has been argued by proponents of Islamic finance that most Islamic Banking products are less risky than Conventional Banking products because they are based on real assets.

These advocates strongly argue that Islamic Banks are recession-proof and are more resilient to economic shocks than their conventional peers. On the other hand, opponents of Islamic finance believe that most of the conventional risks are also present in Islamic Banking in addition to further risks that are quite specific to the Islamic structure.

However, the risk that Islamic Banks face can be divided into financial and non-financial risks. Financial risks generally include credit, market and liquidity risk. The non-financial risks include operational risk, regulatory risk, business risk, legal risk, strategic risk and *Shari'ah* risk. The most common forms of risks that Islamic Banks are exposed to namely, credit risk, operational risk and *Shari'ah* risk.

The majority of the risks faced by conventional financial institutions (such as credit risk, market risk, operational risk, liquidity risk, macroeconomic risk, etc.) are also faced by Islamic Banks. However, the magnitudes of some of these risks are different for Islamic Banks due to their unique business model. The nature of risks faced by capital owner in an Islamic Bank varies in accordance to the types of financial instruments it uses, the people it hires to manage the Bank and its degree of transparency (Rosly and Zaini, 2008).

Furthermore, various Islamic modes of financing have their own risk characteristics that are unique to the extent that the nature and magnitude of some of the risks are different for Islamic Banks due to the need for compliance with *Shari'ah* (Sundararajan and Errico, 2002; Rosly and Zaini, 2008; Dusuki, 2005; Venardos, 2005).

In addition, IFIs face further risks that stem from the different characteristics of the assets and the liabilities, balance sheet structure, and their compliance with *Shari'ah* principles. Furthermore, the profit-sharing feature of Islamic banking introduces some additional risks. For example, paying the investment deposits a share of the bank's profits introduces withdrawal risk, fiduciary risk, and displaced commercial risk. In addition, the various Islamic modes of finance have their own unique risk characteristics. Thus, the nature of some risks that IFIs face is different from their conventional counterparts.
Sundararajan and Errico (2002) are of the opinion that PLS modes pose a few unique hazards. Using PLS and non-PLS methods involves complicated problems such as risk measurement, revenue recognition, adequacy of collateral and disclosure index. The particular nature of investment deposit in Islamic Banks leads to other risks. Other risks include few risk-hedging tools and methods, underdeveloped or non-existent interbank and monetary and government securities markets, restricted availability and access by central banks to lenders of last resort equipment, and extremely varied regulatory and supervisory procedures in Islamic Banking (i.e. access to any systemic liquidity arrangement operated by central banks, risk weights for capital adequacy calculations and legal recognition granted to Islamic Banking). Islamic Banks are excluded from the lender of last resort function in many traditional banking systems in Muslim countries (except Malaysia) (Dudley, 1998 and Naughton, 2000; as quoted by Zaher and Hassan, 2001). Also, there is lack of liquidity and safety in the application of Islamic finance (Kammer et al., 2015). These may be due to restricted set of short-term traditional tools, lack of products for medium-to-long-term maturities and deficiency of alternative option for public debt financing. Lack of security product being designed in line with *Shari'ah* and nature of the products offered that are more motivated by the CB's products (Mat-Rahim and Zakaria, 2013). Lack of markets in which to sell, trade, and negotiate financial assets of the bank is another reason for these shortcomings. In addition, the security market is lack depth and breadth where there are no venues for securitizing inactive assets and taking them off the balance sheet (Iqbal, 2007).

Hence, Islamic liquidity solutions should be emphasized. Lender of last resort should be provided on a non-interest basis for Islamic Banks. Products such as *Sukuk* should be promoted to enable Islamic Banks to hold marketable securities that can be liquidated with ease and speed and without much loss when needed (Hassan and Dicle, 2005).

Poor support of institutional infrastructure exposes Islamic Banks to systemic risks comprised of business environment risk, institutional risk and regulatory risk (El-Hawary et al., 2004). Business environment risk is due to the lack of standardised contracts for Islamic financial instruments and the absence of effective litigation and dispute resolution systems. Institutional risk is due to the lack of consensus among *Fiqh* scholars on contractual rules governing financial transactions. Various interpretations of the fundamental *Shari'ah* rules resulting in differences in financial reporting, auditing and accounting treatments by Islamic Banks, will create confusion among the customers. Also, this risk will raise the IBs' exposure to counter-party risks arising from the unsettled nature of contracts, and may lead to potential litigation problems. Regulatory risk is resulted from negligence or mistakes in complying with regulations that would lead to penalties. This could result from a high degree of discretion on the part of the supervisor or from limited transparency in the regulation (Khan and Ahmed, 2001). In the effort to achieve compliance in regulation, IBs that are subject to the dual banking regulation, may face confusion due to uncertainty in choosing the rules to be followed, as there are differences between SSB of individual IFI within each country and differences between the regulatory bodies in various countries.

Mohd Ariffin (2005) discusses the banking risks. She classified banking risks into 4 categories, they are: credit risk, market risk, operational risk and liquidity risk. According to her, credit risk is expected to be high under *Mudharabah* and *Musharakah* because of the asymmetric information problem (Mohd Ariffin, 2005). It is where the entrepreneur does not provide sufficient information to the financier on the actual profit of the bank. This form of credit risk is referred to as 'capital impairment risk', as the obligor has no contractual obligation to return the financier's capital intact (Mohd Ariffin et al., 2009). Other unique risks are fiduciary risk and displaced commercial risk. Fiduciary risk is a category under operational risk, namely the risk of breach of the *Mudharabah* contract, or misconduct or negligence on the part of the bank as *Mudharib*, with the result that the *Mudharabah* fund becomes a liability of the bank. Operational risk, which arises due to the failure of systems, processes and procedures, is another area of concern. Weak internal control processes may present operational risks and expose an Islamic Bank to potential losses. In addition, governance issues are equally important for Islamic Banks, investors, regulators, and other stakeholders. The roles of *Shari'ah* boards bring unique challenges to the governance of

Islamic financial institutions. Similarly, human resource issues, such as the quality of management, technical expertise and professionalism, are also subject to debate (Iqbal, 2007).

It is important to establish an understanding and awareness of the risks inherent in Islamic Banking activities. Emphasis should be given on achieving the operational efficiency, strengthen risk management infrastructure and institution of sound and dynamic risk management. Furthermore, it has increased the need for strengthened risk management capabilities by the industry, and for greater attention to this aspect of regulators and supervisors in promoting the stability and integrity of the financial system. The Islamic financial market is experiencing underdeveloped risk management and diversification with weak management and lack of proper risk-monitoring systems that exposed the market with high risks (Iqbal, 2007).

According to Sundararajan and Errico (2002), innovative solutions and appropriate adaptations of availability risk management frameworks are needed to reflect the special characteristics of Islamic financial products. The risk management in Islamic Banking involves addressing the special risks of IBs by strengthening the regulatory and disclosure framework, while addressing other general risk factors in an Islamic environment and institutional development approach. In assessing the special risk of IBs, CAMEL is involved along with main elements of suitable information disclosure requirements.

The Basel Capital Accord, Basle II covers three pillars that are the calculation of capital adequacy ratios, supervisory processes and market discipline, respectively. A key issue relates to the implementation of Pillar 1 of the Basel II Accord (i.e. capital adequacy requirements) that was established to measure different types of risks faced by Conventional Banks. Thus the provisions do not include specific risks related to Islamic Banks (Ariss and Sarieddine, 2007). Furthermore, Basle II is a welcomed development for Islamic Banking as it’s an on-going effort to strengthen the international financial architecture, with the guidelines by IFSB and AAOIFI to provide better CAR framework to account for risk profile of IBs (Sundararajan and Errico, 2002; Ariss and Sarieddine, 2007).

Although the Basel II is fairly suits the IBs, modification need to be done towards risk measurement and risk management in line with its specific characteristics (Abdullah et al., 2011). In addition, AAOIFI issued statement on ‘The Purpose and Calculation of the Capital

Adequacy Ratio for Islamic Banks' which is similar to suggestion by BASLE II except difference related to liabilities side of IBs. Further, IFSB considering the used of fund and assessing appropriate risk weights to each asset item.

Also, Ariss and Sarieddine (2007) highlight issues associated to nature of risks arising from the uses of funds and its implication on the banking books of IFIs and lack of international regulatory bodies that provides to types of risk that are unique to IFIs. Islamic finance faces issues in developing risk mitigating or hedging financial instruments that comply with *Shari'ah* requirements. However, a study by Tafri et al. (2011) imply inadequate risk management tools and systems where they found significant differences in the level of extensiveness of the usage of most standard risk tools such as market value at risk (VaR), usage of stress testing results, the usage of credit risk mitigation methods and usage of operational risk management tools between Islamic and Conventional Banks. Furthermore, formulating a strategy for risk management in Islamic financial markets will require holding comprehensive and detailed discussions of the scope and role of derivatives within the framework of the *Shari'ah*; expanding the role of financial intermediaries with special emphasis on facilitating risk sharing; applying Takaful (*Shari'ah*- compliant mutual insurance) to insure financial risk; and applying financial engineering to develop synthetic derivatives and off-balance-sheet instruments (Iqbal, 2007).

Realizing the significance of risk management, the Islamic Finance Services Board (IFSB) issued a comprehensive standards document on risk management in December 2005: IFSB-1: Guiding Principles of Risk Management for Institutions (other than Insurance Institutions) offering only Islamic Financial Services (IFS). This complements the Basel Committee on banking Supervision (BCBS) standards to address the specificity of Islamic products. Islamic Banks' balance-sheet structures indicate that there is a great diversity of classifications on both the asset and liability side. Such variety affects the ease of comparison both between differing Islamic institutions and between Islamic institutions and their conventional peers, making it difficult to apply just one appropriate risk management approach. Therefore, the IFSB has prudently adopted a principles-based approach. The IFSB standard lists 15 guiding principles for risk management in IFIs.

There is a general requirement followed by those covering credit, equity investment, market, liquidity, rate-of-return and operational risks (IFSB, 2005a). Overall, the main differences between these principles and those appropriate for a Conventional Bank relate to five key areas:

(i) The range of asset classes found in Islamic Banks;

(ii) The relatively weak position of investment account holders;

(iii) The importance of the *Shari'ah* supervisory board and the bank's ability to provide the board with adequate information as well as abide by its rulings;

(iv) Rate-of-return risk; and

(v) New operational risks

2.4 Islamic Banking and its Legal and Regulatory Framework

Llewellyna (1995) summarizes the ultimate objectives of regulation of the following five categories: to achieve a high level of efficiency in the financial system, to promote the safety and soundness of financial institutions, to insure systemic stability, to maintain the integrity of the payment system, and to protect the consumers. However, the main concern of regulatory authorities should be directed to protect the depositors' interests, to maintain financial stability, to preserve an efficient and competitive financial system and to protect consumers. The role of regulators is to take the necessary measures to regulate, monitor and supervise a bank's risks, through imposing certain measures such as minimum standards on capital requirements, asset quality, management and liquidity. (Abdel Al, 2004)

The attempt to construct Islamic Banks' legal and regulatory structure and prudential supervision is essential, as Islamic Banks have distinctive features compared to their conventional counterparts. The development of regulatory and supervisory framework that would address the issues specific to Islamic institutions would further enhance the integration of Islamic markets and international financial markets (Iqbal, 1997). The regulation and the supervision framework of the banking industry is important to increase the information available to investors (transparency), to ensure the soundness and stability of the financial system, and to improve monetary and for *Shari'ah* supervision of IBs (Gambling et al., 1993). The growth of the Islamic Banking system through the history can be concluded that, there is a growing amount of developments in the Islamic Banking system linked to the implementation and establishment of regulatory and supervisory structure.

However, Dudley (1998) and Naughton (2000), as quoted by Zaher and Hassan (2001) and Iqbal (1997), address the fact that uniformity, regulatory and supervisory framework that is supportive of an Islamic financial system has not yet been developed. Different regulatory and supervisory frameworks will lead Islamic Banks to adhere to their national regulatory and supervisory framework, which is obviously different to each other. This will lead to difficulties in comparing the financial statements and practices of the IBs. Given that IBs operate across countries in very different legal environments that reflect diverse legal traditions and divergent views on the *Shari'ah* as source of law, jurisdictions have adopted different approaches when developing the legal framework that allows the operation of IBs (Song and Oosthuizen, 2014).

Currently, the Islamic Banks that operate in the dual banking system face some provisions of conventional laws that may limit the scope of products and services offered by Islamic Banking (Iqbal et al., 1998). Furthermore, the IBs face difficulties operating in non-Islamic countries or non-Islamic legal and regulatory systems (as the case of Algeria) owing to the absence of a regulatory body that operates in accordance with Islamic principles (Iqbal, 1997). In the time being, although the IB can structure their Islamic contract, they may face difficulties in terms of enforcement of the agreement in court, which may require extra effort and cost (Iqbal et al., 1998). Also, Iqbal et al. (1998) proposed that in order for the industry to allow Islamic institutions to operate according to Islamic rules and to encourage financial market for Islamic financial transactions, the industry needs law in terms of the Islamic Banking law and laws concerned with financial intermediation. Furthermore, a uniform regulatory and legal framework supportive of an Islamic financial system is required and has not yet been developed (Iqbal, 1997). As mentioned earlier IBs face different challenges in the regulatory and supervision framework, the following points discuss them further.

a. The Legal Framework

Almost all of IB cases are treated under non-*Shari'ah* court (i.e., civil court) jurisdiction as in the case of Malaysia, Kuwait, UAE, Turkey, Jordan and Bahrain. However, in Saudi Arabia's case, it relates to banking Dispute Settlement, and in the case of Indonesia, it refers to

Shari'ah court. Based on this interpretation, Islamic law has no particular application to other individuals or legal entities such as banks and financial institutions. Since the civil court hears Islamic Banking matters, those matters will, undoubtedly be governed by the principles of common law or civil law.

The other part of IB-related legislation is that most legislation does not indicate or include a clause on a definite and particular point of view for distinct fatwas (legal decision) that constituted a dispute and affected institutional advancement such enforceability (as in the situation of Pakistan). In analysing the enforceability problems under the *Shari'ah*, contract regulations in the *Shari'ah*-compliant operation, a range of variables needs to be considered according to McMillen (2007): i) Existing law including case law in common law jurisdictions; ii) Current transactional practice relating to the construction and drafting of contracts in *Shari'ah*-compliant transactions in different jurisdictions; iii) Current transactional practice with respect to legal opinions; and iv) Matters of certainty and predictability in *Shari'ah*-compliant transactions in different jurisdictions.

For IB's safe development, the main requirement is a sound legal framework. General banking rules (or specific IB laws) have to define the nature of these banks and their connection (if applicable) with the central bank and other Conventional Banks in order to provide the legal foundation for IB oversight. Jurisdictions have embraced distinct strategies in creating the legal framework that enables IBs to function. These strategies are adopted because IBs function across nations in very distinct legal settings that represent distinct legal traditions and differing opinions on the *Shari'ah* as a source of law. In particular as stated by Song and Oosthuizen (2014):

- *Shari'ah* incorporated jurisdictions: have aimed at developing harmonized *Shari'ah* standards for IB, although variations reflecting local standards persist. As a result, these jurisdictions have different approaches to the type of institutions that are permitted to conduct IB;
- Purely secular jurisdictions: have aimed at enacting legislative changes to ensure a level playing field for IF products, while not necessarily incorporating *Shari'ah* elements in the substantive law of the land.

b. Corporate Governance

The aspect of the IB business model creates distinctive governance challenges, including safeguarding equity account holders' interests and defining *Shari'ah* compliance governance's function. As mentioned previously, the divergence of interests must be acknowledged in the governance framework of the bank between holders of investment accounts and shareholders. To that effect, the 2006 guiding principles of the Islamic Financial Services Board (IFSB) on corporate governance of IBs advocated: i) transparency in policies and performance related to the investment accounts to help ensure adequate monitoring by their holders, and ii) the establishment of an internal board-level governance committee that will be empowered to oversee the governance policy framework, including protecting the interests of investment account holders.

However, important gaps still need to be addressed including: i) it is impractical for IBs to provide to investment account holders with all relevant information to alert them on the risks facing the bank, and ii) since the governance committee reports directly to the bank board, any conflict of interests between investment account holders and shareholders will likely be disclosed ex-post, if at all. In order to address this issue a potential avenue would be to mandate that one or more of the directors of the bank are accountable for enforcing the rights of investment account holders. *Shari'ah*-compliance is a unique feature of IB and is key to help ensure the integrity of IBs (McMillen, 2008).

The IFSB emphasised the need for IBs to establish a mechanism to obtain and apply *Shari'ah* scholars' rulings and to supervise *Shari'ah* adherence. The governance of *Shari'ah*-compliance in IBs anticipate, in accordance with IFSB guidelines to include: i) a *Shari'ah* supervisory board (SSB), composed of qualified scholars appointed by shareholders and reporting to the board of directors, and with the responsibility of approving products and services and conducting reviews to ensure *Shari'ah* -compliance (among others); ii) an internal *Shari'ah* review process, carried out by an independent department to monitor, evaluate and produce reports on compliance; and iii) periodic *Shari'ah* reviews covering policies and transactions, which form the basis of the report of the SSB (McMillen, 2008).

The key decision to be made (in relation to SSBs at a bank level) is to establish a centralized SSB to oversee the governance framework of the *Shari'ah* in IBs. A centralized SSB has the advantage of harmonizing *Shari'ah* rulings, decreasing *Shari'ah* and IB compliance costs. The regulator may put up a centralized SSB, or IBs may be encouraged to set up such a board together (which is applicable in secular countries where the substantive land law of the regulator prevents immediate participation in *Shari'ah* issues). In some jurisdictions (e.g., Sudan, Turkey, the United Arab Emirates) the centralized SSBs has been set up as an independent public institution, while in others (e.g., Afghanistan, Bahrain, Malaysia, Pakistan, and Palestine), the SSB has been set up at the central bank (Song and Oosthuizen, 2014). SSBs also tend to differ in their mandate and accountability to the IBs' board of directors.

While some SSBs that have been set up at the central bank have legislative and adjudicative powers on *Shari'ah* issues, other SSBs are simply consulted on proposed amendments to the regulatory framework. On accountability, a key challenge is whether SSB members are accountable to the IBs' board of directors. In most cases, it seems that the relationship of an IB's SSB with the bank is of an advisory type as the ultimate responsibility for *Shari'ah* compliance appears to lie with the bank's board of directors. While this is in line with IFSB standards on *Shari'ah* governance, transparency about the mandate, accountability and independence of the SSBs could be enhanced further to reduce reputation and legal risks associated with *Shari'ah* compliance (Song and Oosthuizen, 2014).

c. The Regulatory Framework

The authorities should ensure the regulatory structure for IBs and thus allow them to be on a level playing field with CBs. Ensuring also that the legislative structure is properly aligned with the standard setter rules is critical to resolving the major hazards associated with IB operations. The standard framework in most nations where IBs are present is the Basel Committee on Banking Supervision's (BCBS) fundamental legislative framework.

Nevertheless, to implement *Shari'ah* law, several jurisdictions supplement it with the standards of the Islamic Financial Services Board (IFSB) and the Islamic Financial Institutions Accounting and Auditing Organization (AAOIFI). Around 65% of countries that allow IBs have adapted their standard finance laws for IB activities. Several elements of the regulatory structure need to acknowledge the distinctive characteristics of IB. These characteristics will be addressed below.

Licensing: Appropriate licensing processes in Islamic Banking structure are as essential as in Conventional Banking. Jurisdictions enforce various licensing criteria on candidates who wish to set up Islamic Banks. These processes assist supervisory authorities guarantee sound management of new banks. Licensing conditions in non-*Shari'ah* law states (where Islamic and Conventional Banks are present), do not specifically and clearly tackle the problem of *Shari'ah* adherence. Nevertheless, in the endorsement process, the problem of *Shari'ah* adherence plays a significant indirect and explicit part. Compliance with *Shari'ah* is a main precondition (where *Shari'ah* law constitutes or is part of the country's fundamental law) for whether a suggested Islamic Bank authorization application would be positively regarded. As part of the registration system, the supervisory agency should guarantee that suitable corporate governance structures and procedures are in place, including the right of investment account owners to monitor the efficiency of their assets and the transparency of financial reporting of investment reports. Various countries grant Islamic Banks distinct types of licenses. According to a survey conducted by Song and Oosthuizen (2014), 17 jurisdictions a stand-alone Islamic Bank will be issued with an Islamic Banking license. In the remainder 12 jurisdictions a single (generic) banking license is issued to a bank, irrespective of whether the bank is an Islamic or a Conventional Bank (in some of these jurisdictions the authorities are empowered to issue only an Islamic Banking license).

Liquidity: A mixture of BCBS and IFSB liquidity regulations can usually address the liquidity hazards that IBs face. Implementation of key elements of the newly internationally agreed liquidity framework, that is Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) are probable to present important difficulties for IB-strong jurisdictions. This is especially the situation with regard to the handling of equity reports, determination of run-off rates on deposits in many nations in the absence of Islamic deposit insurance systems, and limited availability of short-term liquid tools. The IFSB anticipates introducing LCR level for IBs in the close future in this regard. Implementation of LCR will require thorough scheduling and devoted resources (e.g., the creation of a dedicated unit in the supervisory agency). The objective for areas where there is no LCR rule and cross-border operations are minimal should be to switch gradually to the LCR structure in order to allow banks time to enhance their ability. Meanwhile, thought should be provided to whether the LCR parameters are adequately stringent or need to be adjusted to appropriate the local context. Furthermore, evaluating the therapy of PSIAs (Profit Sharing Investment Account) from a liquidity view would be crucial. In the event of licensing an Islamic baking window, the CB applying for it should guarantee efficient segregation of resources in each window (conventional and Islamic), including a suitable inner systems and reporting procedures. For example, the LCR requires banks to hold a diversified portfolio of High Quality Liquid Assets (HQLA), but the room of diversification is constrained in many jurisdictions, with limited access to other HQLA than sovereign debt. In an effort to address this issue the latest Basel LCR rules promote *Shari'ah* compliant instruments, such as *Sukuk*, as HQLA. Improving the liquidity legislative structure will need to address the accessibility of short-term resources efficiently. Jurisdictions with a greater IB presence have produced some advancement, but many difficulties remain. Jurisdictions, in fact, have:

- Developed special liquidity management instruments, including commodity *Murabahah*. This instrument has spread rapidly based on its reliance on existing financial infrastructure (i.e., international commodity markets) and is being used in about 45 percent of jurisdictions with IB presence (Song and Oosthuizen, 2014);
- Developed interbank markets for IBs. Significant progress has been achieved in few countries (e.g., Malaysia, Sudan and Bahrain) including through the development of *Shari'ah*-compliant government bonds (*Sukuk*). Interbank markets are spreading to other countries and now operate in about 45 percent of jurisdictions with IB presence. However, the development of these markets has been affected by a chronic excess of liquidity in several jurisdictions, and concerns of IBs to deal with CBs out of concern of *Shari'ah* noncompliance (Song and Oosthuizen, 2014);
- Achieved less progress in developing liquidity facilities with the central bank, particularly those that would assist banks faced with liquidity shortages. This largely reflects the aversion of central banks (often reflected in their mandates) to engage in transactions involving real assets, which is the basis of Islamic finance. In this context, the legal and operational frameworks of central banks need to be enhanced by allowing the development and use of Islamic liquidity management instruments. This would help ensure financial stability and increase the effectiveness of monetary policy in jurisdictions with sizable IB presence (Mejía et al., 2014).

Capital: In most countries where Islamic Banks are present, the BCBS's regulatory minimum capital adequacy requirement applies. Consequently, most countries endeavor to abide with the BCBS capital structure (either Basel I or Basel II and Basel III). The Islamic Banking survey disclosed that the recommended minimum general Capital Adequacy Ratio (CAR) for Islamic Banks varies from 8% to 12% (Song and Oosthuizen, 2014). Jurisdictions have adopted distinct methods to the implementation of capital requirements. In some countries (e.g., Bahrain, Jordan, Malaysia, and Sudan), legislative capital adequacy conditions comprise prescriptions that are often based on IFSB prudential norms and guiding values on necessary modifications to the BCBS capital structure, to accommodate for certain Islamic Banking characteristics. In other countries (e.g., Ethiopia, Kazakhstan, Turkey, the United Arab Emirates, and the United Kingdom), the selected BCBS capital structure refers to all banks, including IBs.

The regulatory framework in these jurisdictions contains a single set of capital adequacy provisions that are relevant to all banks. Therefore, there is no difference between the capital requirements that apply to Islamic Banking Banks and Conventional Banking Banks. It may therefore be hard to compare capital ratios among Islamic Banks in distinct nations. There appears to be little consistency in the modifications made by Islamic Banks to the selected BCBS investment structure to accommodate for certain characteristics of Islamic Banking. For instance, as proposed by the IFSB, some jurisdictions use an alpha factor to detect the difference in risk exposure between a risk-sharing product for Islamic Banking and a Conventional Banking product. The authorities In Turkey did apply a risk weight of 70% to Islamic Banking risk-sharing products. These modifications appear to be based on expectations as to the magnitude of the risk arising from the specific transaction and/or resulting asset. And/or whether an efficient transfer of risk to or from a third party has occurred.

Transparency and disclosure: Enhancing disclosure is essential to provide regulatory officials and the public with a stronger understanding of the policies and appropriate hazards of banks. Disclosure requirements should aim at providing sufficient information to assess: i) the appropriateness of policies regarding portfolio diversification and investment objectives (including with respect to concentration); ii) the degree of exposure to illiquid assets, which could be the case particularly in banks operating under a two-tier *Mudharabah* arrangement; iii) the main risk factors associated with the investment portfolio and the quality of the internal procedures, organization and infrastructure for monitoring and handling these risks;

iv) the adequacy of arrangements for internal controls, which is a complex issue given the need to determine PLS ratios on projects financed by the bank; and v) the methodology used by the bank to calculate its performance to help investors choose well managed institutions when placing their investment deposits (Song and Oosthuizen, 2014).

In this sense, transparency of IB's steading policies (e.g. appropriations made to PER and IRR, the level of these reserves, and the amount used to smooth income over the period) would help minimize uncertainty about the loss-absorbing nature of investment accounts and reduce potential systemic risks. IB's formal integration into legal and regulatory frameworks has progressed at a slow rate, despite the significance of a transparent accounting and financial reporting structure adapted to it. Moreover, AAOIFI accounting standards are compulsory only in a few countries (Bahrain, Botswana, Iraq, Jordan, Qatar, Sudan, Syria, and Yemen), with most countries implementing International Financial Reporting Standards (IFRS) or domestic accounting norms. The nature and extent of information disclosed to the public varies across jurisdictions, partly depending on whether *Shari'ah* law is the fundamental law of the land and the coexistence of IBs and CBs (Song and Oosthuizen, 2014).

Deposit insurance and bank resolution: The key to promote the stability of IBs is the accurately dealing with the issue of deposit insurance. The main challenge for IB concerning deposit insurance is to identify its scope, comprising whether it covers benefit sharing investment accounts (IFSB, 2013). To this end, the presence of a sound strategy to determine the importance of the alpha factor would be essential in determining the amount of coverage required by equity account owners. In reality, the security of deposits in Islamic Banks has little consistency between countries. Deposit security arrangements vary from single systems applicable to all banks to distinct systems in which Islamic and Conventional Banks are protected individually. Since there is a distinct deposit security system for Islamic depositors (shareholders), this system typically invests its money only in Sharia-compliant investments from ex ante deposits.

Comprehensively addressing bank resolution in the context of IB is also important. While international principles for good bank resolution are applicable to IB, regulatory work needs to be developed further, including clarifying whether there should be a separate resolution framework for IBs, the priority of claims by investment account holders, and the nature of the resolution process, particularly if it involves a takeover by a CB. Few countries have comprehensively addressed these issues (Song and Oosthuizen, 2014).

An important decision to be made by jurisdictions allowing IBs is whether to maintain a unified core set of banking laws or regulations for IBs and CBs. Some jurisdictions relatively new to IB seem to have preferred issuing separate laws and regulations (e.g., Lebanon, Morocco and Oman), probably to increase transparency and compensate for lack of experience, whereas some mature markets (e.g., Malaysia) have maintained the separation for development purposes. However, most jurisdictions have adopted a unified core set of banking laws and regulations covering IBs and CBs. This has the advantage of avoiding duplication of legal and regulatory provisions that are equally important for IBs and CBs (Song and Oosthuizen, 2014).

2.5 Problems and Challenges facing Islamic Banking and Finance

Islamic finance has expanded rapidly over the last decade, and its banking segment has become systemically important in a dozen countries across a wide range of regions. In reaction to economic growth in countries with big and relatively unbanked Muslim communities, Islamic finance is expected to continue to grow. It is also fuelled by the large savings accumulated by many oil-exporting countries that are seeking to invest in *Shari'ah*-compliant financial products. The growing reach of Islamic finance promises a number of possible benefits. For example, it is often argued that Islamic finance is inherently less vulnerable to crises because its risk sharing feature lowers leverage, and motivates better risk management on the part of both financial institutions and their clients. It is also argued that Islamic finance is more stable than conventional.

Nonetheless, Islamic finance faces a number of challenges and obstacles. The obstacles of Islamic Banking and finance could be related to financial, practical, or technical problems. Financial problems are problems related to money and finance (i.e. financial services). Practical problems are related to real situations rather than ideas or theories.

Technical problems are related to problems in: the practical use of accounting, finance and technology in the operations of Islamic Banking and finance, skills needed in the operation of Islamic Banking and finance, the understanding and application of *Shari'ah* law (i.e. the extent of understanding of the *Shari'ah* matters and the implementation of *Shari'ah* in Islamic Banking products and services) and the details of a law or set of rules.

For example, despite the efforts of Islamic finance standard setters, in many countries the industry is governed by a regulatory and supervisory framework developed for conventional finance. Therefore, it does not fully take account of the special nature of Islamic finance (Al-Maraj 2014). The industry is still largely a nascent one, lacking economies of scale, and operating in an environment where legal and tax rules, financial infrastructure, and access to financial safety nets and central bank liquidity are either absent or, if available, do not appropriately take into account the special characteristics of Islamic finance (Askari, Iqbal, and Mirakhor 2010; Ernst and Young, 2014; IFSB and IRTI, 2010). Furthermore, the legal issues of Islamic finance did not go without any critiques. The need of Islamic Banks is rooted from the critiques of Conventional Banking systems that are based on interest. Also, there is a perception that the conventional system is not geared towards achieving the goals of *Shari'ah* (i.e. justice and fairness and general welfare of the people) (Siddiqi, 2006). The challenges faced by Islamic Banks are new and difficult tasks that test their ability to operate and uphold the Islamic *Shari'ah* principles and achieve the objectives of *Shari'ah*.

In addition, the expectations of stakeholders in the governance of IB as a financial institution established on the basis of religious motivation are to ensure compliance with *Shari'ah* and business performance. The realization of these components will lead to *Shari'ah*'s goals being achieved. However, in the current IB's practices, researchers are highlighting various problems that begin at the late 1990's. In the financial market that is becoming more liberal and global, the banking institutions face higher competitions that result in various challenges confronting the IBF industry.

However, the development of research on IBF includes of various aspects of its establishment and practices. The growing stakeholder's interest towards its unique underlying features led to more researches in the field that is still at its infancy. Various fields of research are being explored. Most early researches explored the underlying theoretical principles of Islamic Banking and finance and its socioeconomic objectives (Kahf, 2006; Siddiqi, 2006; Chapra, 1979; Chapra, 1984, 1991). The validity and permissibility of the contracts and the different nature of products and services underlying Islamic Banking operations are also being explored (Dusuki, 2005). Researchers have also explored multiple scopes in Islamic Banks' operations and corporate governance.

Consequently, researchers started to show their interest in various areas of research and so the research of Islamic Banking and finance began to emerge. As a result, Islamic Banking and finance research began to emerge due to researcher's interest in different fields of studies. In parallel continuous studies on the development and growth of the Islamic Banking institutions and Islamic finance, researches in this area started to explore the theoretical and practical aspects of *Shari'ah* compliance of its products and services (Aggarwal and Yousef, 2000; Archer et al., 1998; Archer and Karim, 2006; Bashir, 1983; Chapra and Khan, 2000; Chowdhury 1999; Karim and Ali, 1989; Samad et al., 2005; Kahf and Khan, 1992).

2.6. Problems in Islamic Banking and Finance

This subsection will review literature regarding the problems faced by Islamic Banking and finance. The issues that will be discussed in this chapter are: inconsistency of *Shari'ah* interpretation, reliance of debt-based products, product innovation and development, human capital management, lack of training and research and development and finally public awareness.

2.6.1 *Shari'ah* Interpretation and Standardization

The *Shari'ah* interpretations are the legal rulings applied in today's Islamic Banking and finance, arrived at by using one or the other of four different techniques, namely: interpretations of the revealed sources (*Ijtihad*), choice (*Ikhtiyar*), necessity (*Dharura*), and artifice (*Hila*) (Venardos, 2005). The selections of one technique over another are used to obtain more *Fiqh* rulings (Venardos, 2005). Different schools of thoughts would have different methods of interpreting the *Shari'ah* laws. Besides numerous techniques to derive the *Fiqh* rulings, the different interpretations may occur to accommodate *Shari'ah* principles to the existing legal system and custom of a particular country (Venardos, 2005).

Islamic Banks are fundamentally governed by their *Shari'ah* boards – the religious scholars that deem a product *Shari'ah* -compliant. But the challenge is that there is no central authority promulgating *Shari'ah* law, and the understanding of what is hence permissible and what is not varies among Islamic scholars and jurisdictions. However, to achieve a successful introduction and sustainable IBF there is the need to establish Sharia Boards and Sharia scholars who will provide guidance on compliance with Sharia law for IBF (Alam Choudhury and NurulAlam, 2013; Aldohni, 2011; Muhamad, 2015). Muhamad (2015) noted that, The *Shari'ah* compliance requirement is unique to the Islamic Banking operations, and, hence, it is pertinent that a comprehensive and rigorous mechanism is implemented to ensure *Shari'ah* compliance, and an effective and reliable *Shari'ah* review process is in place as part of the overall corporate governance for IB institutions (p.46).

Thus, some researchers have questioned the role of *Shari'ah* scholars and *Shari'ah* Boards for the lack of transparency in their relations with Islamic financial institutions (e.g., El–Gamal 2008). In this regard, Islamic scholars and other researchers have discussed fatwa shopping or regulatory arbitrage as a major threat to Islamic Finance (Malik et al., 2011; Uppal and Mangla, 2014). Fatwa shopping arises from differences in interpretation between Shari'ah scholars about what is permissible and what is not. Islamic scholars do not fully agree on the true meaning and boundaries of *Riba* (Farooq, 2009; Uppal and Mangla, 2014). 66 Journal of Islamic Banking and Finance, Vol. 4(1), June 2016

Furthermore, Ibrahim Warde (2000) raised A question of whether boards are "rubber stamping" sharia compliance of the banks that pays their salaries. Differences between boards as to what constitutes *Shari'ah* compliance may eventually present difficulties by "raising doubts in the minds of clients" over whether a given bank is truly *Shari'ah* compliant, according to Munawar Iqbal and Philip Molyneux. "If Islamic Banking is not perceived to be 'Islamic', it will not be long before the existing Islamic Banks lose much of their market" (Iqbal and Molyneux, 2005, p:190).

The inconsistency of *Shari'ah* interpretation given by the SSB related to principles governing products and services is due to the diversity of opinion as to whether particular practices or products are *Shari'ah* compliant (Ainley et al., 2007; Wilson 2007). Variant *Shari'ah* advisory boards may differ over details such as the legal status of the rulings and internal supervision. The differences in the *Shari'ah* interpretation may involve numerous rulings on similar practices between SSB of different banks and SSB of different jurisdictions (Ainley et al., 2007; Mohd Ariffin, 2005). This results in some products and services to be approved as being Shari'ah compliant by some *Shari'ah* scholars but not by others (Ainley et al., 2007; Errico and Farahbaksh, 1998). Furthermore, the issue of different interpretation of *Shari'ah* advisory board is also highlighted by (Dudley (1998) and Naughton (2000), cited in Gambling et al., 1993; Karim 2001; Iqbal, 1997; Karbhari et al., 2004; Khan, 2007; Iqbal et al., 1998; Chapra and Khan, 2000; Kahf, 1999; Maniam et al., 2000; Zaher and Hassan, 2001).

In different jurisdictions, there are a lack of mutual recognition on the validity of respective rules, practices and underlying *Shari'ah* interpretation (Errico and Farahbaksh, 1998). The current scenario of IB practice shows that IBs in Malaysia have different interpretations of *Shari'ah* rulings and product permissibility from the gulf countries. It was found that the Middle East is stricter with the interpretations of *Shari'ah* as compared to Malaysia (Mohd Ariffin, 2005). Grais and Pellegrini (2006) quoted from the proceedings of the Fourth Harvard University Forum on Islamic Finance that CIBAFI sampled about 6,000 fatwas and found that 90% were consistent across banks. Although the discrepancies in interpretations only occur to a certain concept, there are many issues which arise and result in contradictory practices because of differences in the interpretations of the application of *Shari'ah* principles (Banaga et al., 1994).

Inconsistency in the interpretation of *Shari'ah* is also the result of various *Fiqh* rulings, regulatory systems and customs in a certain jurisdiction and issues and difficulties in the application and execution of products and services at domestic and global level. According to Karbhari et al. (2004) the disadvantages of the difference in *Shari'ah* interpretation are time-consuming and costly and it construes what IB really is, and that hinders widespread acceptance. However, consolidating what occurs in different jurisdictions always presents problems (Wilson, 2007). Furthermore, it hinders rigorous product development and innovation and results in slow development of globally accepted financial products, which leads to variations in the Islamic financial products offered.

In addition, of facing difficulties in understanding the unique underlying principles of IB products, the differences in *Shari'ah* interpretation may raise doubts and confusion in the minds of clients at the national level (Iqbal et al., 1998). It is becoming more crucial due to the development of IB in one jurisdiction, in other jurisdictions and the wake of Western Banks in Islamic Banking (Iqbal et al., 1998; Karbhari et al., 2004). Consequently, it will lead to problems in integrating national markets with international markets of Islamic Banks. Although the global growth of IBF's industry is taking advantage of the diversity and flexibility in *Shari'ah* opinions, it may soon become a constraining factor in the global growth of the industry if the challenges arising out of the use of diversity and flexibility in *Fiqh* are not properly recognised and regulated (Khan, 2007).

Regulators do not always have the capability (or willingness) to ensure that banks have in place a sound framework for *Shari'ah* compliance—nor do they take responsibility for assessing whether *Shari'ah* advisors are fit and proper. Moreover, differences of opinion and interpretations of classical Islamic texts. This leads to different practices and policies adopted across different jurisdictions. This could affect trust in the industry. The IFSB and AAOIFI recommend the establishment, at the bank level, of an independent *Shari'ah* Supervisory Board (SSB), a well-resourced internal *Shari'ah* review process, and periodic external *Shari'ah* reviews. However, Islamic finance laws, policies and practices should be standardized and harmonized in order to create more unification and consolidation within the industry. This would strengthen the industry from a *Shari'ah* perspective and root out weak and rejected views. An increasing number of jurisdictions (Bahrain, Indonesia, Malaysia, Morocco, Nigeria, Oman, Pakistan, and Sudan among others) are moving in this direction. Furthermore, *Shari'ah* scholars should adopt these policies and procedures to prevent and mitigate *Shari'ah* non-compliance risk.

The differences in the interpretation of *Shari'ah* advisory board further challenged the standardization of products and services offered by the IBs (Wilson, 2007). Though the infrastructure for standardizing the supervision and monitoring of the global expansion of the IFI is rapidly growing, institutional arrangements for a regulated use of diversity and flexibility in *Shari'ah* rules are still a missing link (Khan, 2007). Institutional arrangements are needed to further prepare the industry to play a bigger role in the development of the global economy and also to ensure the adherence to the very specific element that makes the industry an Islamic industry (Khan, 2007). According to Grais and Pellegrini (2006c), in the effort to establish adequate consistency of interpretation and enhance the enforceability of contract before civil law, the Islamic Banks will depend on internal and external arrangements that will emphasize the market discipline. Internal and external arrangements are put in place by IIFS to protect stakeholders' financial interests (Grais and Pellegrini, 2006c). The standardisation of interpretations are expected to clarify the functions of Islamic Banking and may assist in clearing the way for more coherent regulation, and better understanding and acceptance of Islamic Banking as a serious competitor to Conventional Banking systems (Karbhari et al., 2004; Ainley et al., 2007).

Muslim and Zaidi (2008), on the other side, noted that in regards to full and total harmonisation of *Shari'ah* standards, the *Shari'ah* scholars are in the view that the harmonisation would prevent the dynamism of *Shari'ah* law to ensure its suitability in applying the ijtihad procedures. Furthermore, since each religious board may have its preferences or adhere to a different school of thought (Iqbal and Mirakhor, 1999), the harmonisation of *Shari'ah* rulings may mean the precedence of one school of thought over the other; which cannot be universally acceptable.

2.6.2 Reliance of debt-based products

We have already discussed various types of trade in Islamic Banks such as *Mudharabah*, *Salam*, etc. The ideal model of IB proposed that both sides of the balance sheet apply PLS model to ensure that the industry would fully utilise the benefits that the IB system has to offer (Rosly, 2005; Haron, 1997; El-Hawary et al., 2004; Iqbal et al., 1998; Haron, 2000; Kahf, 2005; Ahmad, 1994; Sadeq, 1990; Siddiqui, 2001; Venardos, 2005; Iqbal and Mirakhor, 2011). Meanwhile, the macroeconomic implications of Islamic Banking were still being worked out on the assumption that it would be largely based on profit sharing (Siddiqi, 2006). It was argued that financial intermediation based on profit sharing rather than lending will contribute to more efficiency and greater stability in the economic system in general, and the financial market in particular (Siddiqi, 2006).

Although many Islamic Banks made an early effort to offer PLS-based products, they eventually converge to use products utilising debt and lease as the main models of operation (El-Gamal, 1997). Proponents of Islamic Banking argue that the profit-sharing contracts are superior financial instruments of debt for a variety of reasons, including the risk-sharing properties of equity (Ebrahim and Safadi, 1995). Furthermore, Islamic Banking advocates such as Chapra (1992) and Siddiqi (1983) asserted that Islamic Banks will promote development in Islamic countries by offering long-term finance for a growth-oriented economy (Aggarwal and Yousef 2000). The shift away from profit and loss sharing (PLS) activities reflects the divergence of practice from theoretical principles (Errico and Farahbaksh, 1998; El-Hawary et al., 2004). The degree of divergence varies from country to country, which results in different focus of banking supervision (Errico and Farahbaksh, 1998).

Islamic Banks have a lack of comprehensive institutional infrastructure and support needed to direct it to behave in accordance with the theoretical framework (Errico and Farahbaksh, 1998). Therefore, preference and popularity of mark-up instruments over PLS is contributed by various reasons. The industry experiences a lack of legal and institutional framework to facilitate appropriate contracts, as well as mechanisms to enforce them; it also experiences a lack of appropriate products containing a broad range and a variety of maturity structures of financial intermediation (Iqbal and Mirakhor, 1999). Further regulations are needed to endorse innovation and product development on the basis of PLS. In addition, the need for well-defined property rights for efficient PLS function and fairer treatment in taxation, are considered to be a major obstacle in the use of PLS and secondary markets for trading in Islamic financial instruments; *Mudharabah* and *Musharakah* are particularly non-existent (Dar and Presley, 2000).

Preference may also lead from liability-side risk aversion in the performance of asset allocations as well as vulnerability owing to liquidity. As a result, the dominance of short-term asset portfolios, low profit and safe trade related transactions limited the funds that can be invested in longer-term and more profitable but riskier assets. Severe competition from Conventional Banks and other financial institutions led the IBs to offer less risky modes of financing (Dar and Presley, 2000; El-Hawary et al., 2004; Dusuki, 2005; Iqbal and Molyneux, 2005; Rosly and Zaini, 2008; Sundararajan and Errico, 2002; Venardos, 2005; Lewis and Algaoud, 2001) and priority of short-term project over long-term project (Lewis 2001; Iqbal and Mirakhor, 1999; Dar and Presley, 2000; Siddiqi, 2006; Chapra, 1992; Hassan, 1999; Aggarwal and Yousef, 2000; El-Hawary et al., 2004).

In addition, the existence of the economies that are characterised by agency problems will be biased toward debt financing (Aggarwal and Yousef, 2000; Iqbal and Mirakhor, 1999; Mirakhor, 1987; Lewis and Algaoud, 2001; Hassan 1999; Samad et al., 2005; Dar and Presley, 2000; El-Gamal, 1997; Ibrahim, 2009). As agency problems become more severe, debt becomes the dominant instrument of finance (Aggarwal and Yousef, 2000). Although traditional finance literature shows that debt contracts are superior to equity contracts, equity contracts can be superior to debt contracts in an economy where informational asymmetries resulting from adverse selections and moral hazards are smaller (Hassan, 1999). The abundance of short-term funds compared to long-term funds available for lending is a rational response on behalf of banks to solve informational asymmetries prevalent in the credit market (Hassan, 1999). In addition, Iqbal and Mirakhor (2012) found that adverse selection can result in the use of debt-like instruments by Islamic Banks. Informational asymmetry is due to inefficient markets resulting in costly delegated monitoring. Also, in the banking operation, the IB experience imbalance between management and control rights where restrictive roles of shareholders (investors) in management and the dichotomous financial structure of PLS contracts make them non-participatory in nature (Dar and Presley, 2000).

There may also be a lack of PLS due to huge unresolved issues with Islamic Banking services, in particular, *Mudharabah* accounts. (Satkunasingam and Shanmugam, 2004). It is evident that the equity principles (i.e. Profit-sharing basis) has yet to be operationalized and reflected on the return of *Mudharabah* deposits and shareholder's funds (ROMD) and returned on bank capital (ROE) (Rosly and Zaini, 2008). This is explained by the large discrepancy between ROMD and ROE, which imply that *Mudharabah* deposits have been treated in a similar fashion as fixed deposits, where banking risks are entirely borne by the bank's capital (Rosly and Zaini, 2008). Rosly and Zaini (2008) opine that Islamic Banking may not be able to find its competitive edge in profit sharing or commercial ventures as stipulated by the Qur'an under the pretext of al-bay'. The debt-based products and services that are being offered by the Islamic Banks have gone through thorough discussions and deliberations in ensuring that the substance and form of the contracts are in compliance with the *Shari'ah*. Although debt-based instruments are widely in use, its acceptability under Islamic law is disputed because it can imply a fixed return on investment for the bank (Aggarwal and Yousef 2000; Rosly 2005; Dusuki, 2005). However, the debt-based instrument does not go without critics.

The non-conformance of mark-up instruments is experienced through the fictitious dealings of banks that do not actually buy, possess, sell or deliver the goods as stipulated by the *Shari'ah* (Dusuki, 2005). The contract is concluded through signing a number of legal documents of purchase, sale and transfer without actually dealing in goods or sharing any real risks (Dusuki, 2005). In addition, the operationalization of the mark-up instruments have not fully conformed to the spirit of the *Shari'ah* (Rosly, 2005a; Dusuki, 2005) due to limitations in terms of legal and regulation in the process of concluding the contract. In most jurisdictions, IFI is still required to comply with the regulations governing conventional financing and to use accounting standards that may not fully adapt to the substance of their business activities (El-Hawary et al., 2004).

Also, this type of instrument gives rise to delinquency problems where late payment cannot be penalized, costly repossessions may occur and essentially fixed rate financing when finance companies apply high charges and fixed selling price are practised (Lewis and Algaoud, 2001). Furthermore, due to the over dependency of the Islamic Banks on fixed rate asset financing namely BBA, Islamic Banks are exposed to potential interest rate risks (Rosly, 1999; Yap and Abdul-Kader, 2009; Lewis and Algaoud, 2001; Rosly, 2005). In addition, through the implementation of this instrument, the bank will be exposed to declining profit when market interest rates increase (since the return are fixed) and it will face pre-payment risks when market rates decline (Lewis and Algaoud, 2001).

2.6.3 Islamic Banking Product and Innovation Development

Most Islamic products are introduced as an alternative to conventional products. In order to compete with conventional finance, IBFs and regulators need to innovate, develop and cater, on a regular basis and according to customers' needs, the markets with more sophisticated *Shari'ah* -compliant instruments. The new products should be flexible, cost-effective, diversifiable, lower transaction costs, enhance liquidity, and designed to meet the risk and return requirements of issuers and investors. Also the products must be attractive and appealing to individual and corporate clients. The banking sectors can be categorized into individual and corporate, which require different products to fulfil their needs.

As the IBF adopts the Conventional Bank's products and services by still maintaining the *Shari'ah* characteristics, the products and services are limited and confined to the development of Conventional Bank's products and services. The IBF's industry face financial engineering innovations in driving the global financial system toward greater economic efficiency by expanding the opportunities for sharing risks, lowering transaction costs and reducing asymmetric information and agency costs. Financial engineering involves the design, development and implementation of innovative financial instruments and processes as well as the formulation of creative solutions. Financial engineering may lead to a new consumer-type financial instrument, or a new security, or a new process or creative solution to corporate financial problems; such as the need to lower funding costs, manage risks better or increase the return on investments (Iqbal, 2007; Iqbal et al., 1998). Thus, developing IBF, definitely, attracts more investors to the industry.

2.6.4 Shortage of *Shari'ah* experts and human capital resources

Qualified human resources play a crucial role in the development and success of any industry. There is a shortage of skilled bankers and professionals with deep knowledge of Islamic laws as well as modern economics and finance. Khamis et al (2010) emphasize that there is still an acute shortage of skilled human resources in Islamic Banks and inadequate training is given to staff on how to incorporate fundamental *Shari'ah* - complaint Islamic Banking principles. Notably, there is an obvious shortage of qualified Sharia specialists in the Islamic Banking sector, with a tiny number of experts serving on several *Shari'ah* boards of Islamic Banks around the world. In the Islamic Banking and finance industry, there is a severe shortage of scholars with dual specialization; having simultaneous working knowledge of modern finance and *Shari'ah* (Iqbal et al., 1998; Imam and and Zubairu., 1999). Furthermore, in terms of safeguarding invested funds and realized profits, sufficient supply of trained banking staffs that are skilled in investment and Islamic Banking practices are needed (Venardos, 2005). Skilled human capitals are needed as Islamic Banks are more dependent than Conventional Banks on the existence of an adequate and appropriate set of policies and infrastructure for portfolio diversification, monitoring and control (Venardos, 2005).

Also, the human capital is inadequate in regards to knowledge and experience on the part of both management and personnel regarding Islamic Banking, due to their experience in Conventional Banks which resulted in lack of creativity (Kahf, 1999). In terms of Islamic Banking human resource needs, there are very few fresh graduates, many have backgrounds in Conventional Banking and lack a deep understanding of *Shari'ah* requirements. This affects institutions at all levels, from front-line staff that may not be able to properly articulate *Shari'ah* banking concepts, to senior management who may be able to make decisions without fully appreciating religious or ethical ramifications. Furthermore, since Islamic Banks are forced to derive their employees from Conventional Banks, this causes problems in the performance, understanding of *Shari'ah* ruling and advising bank's customers on the characteristics of different types of new Islamic techniques of banking relationships and services, etc. (Kahf, 1999). Therefore, the gap in skills and knowledge would cause delays or problems with certain Islamic Bank operations. The problem is disclosed in the implementation of Islamic finance to the Islamic Banking industry. It lacks the technical staffs that are familiar with the system and have adequate knowledge to enhance the implementation of the moral and social values of the system (Imam and Zubairu, 1999).

2.6.5 Lack in Training and Research and Development

One of the main goals of Islamic Banking training is to build the knowledge and human resource skills base that enhances the abilities of staff working in this industry with real realization of the severe need to take morality and professionalism into consideration in all business transactions. However, many training efforts have to be undertaken; the main factor to be regarded is the training fields. In the case of Islamic Banking, training is not just involving matters on operational factors, products knowledge or other soft skills, but most importantly are the knowledge on *Shari'ah*. In this regard, there is a need for Islamic financial players to intensify efforts in the training and development of expertise in the various specialized areas of Islamic finance. The existence of training in the human capital in Islamic finance is extremely important in order to have the people with the right kind of skills and commitment (Iqbal et al., 1998). According to Iqbal et al. (1998) training programs designed to overcome the scarcity of human capital is still lacking. Kahf (1999) believes that the insufficient training for the personnel is further caused by the fact that (1) the process of establishing Islamic Banks and their growth happens to be a lot faster than allowing them to adequately train their personnel and fully acquaint them with their new techniques, (2) IBs is forced to derive their employees from Conventional Banks, thus causing problems in the performance, understanding *Shari'ah* rulings and advising bank's customers on the characteristics of different types of new Islamic techniques of banking relationships and services etc., and (3) IBs are still new so they did not accumulate sufficient historical experience (Kahf, 1999). Furthermore, the lack of training aimed at enlightening directors and executives on their roles in promoting corporate governance would prevent them from performing their responsibilities effectively (Safieddine, 2009). This indicates that the absence of practice in Islamic financial institutions is not only about the principles of *Shari'ah* relating to product innovation and growth, morality and behaviour and activities; there is also a lack of training in terms of CG as distinct features and values are required to really comprehend corporate governance procedures.

Shari'ah knowledge is the fundamental and imperative prerequisite prior to embankments of Islamic Banking activities that creates differentiation of Conventional Banking. Gait (2009) confirms the quintessential of *Shari'ah* knowledge by defining Islamic Finance or Banking as financial service or product that is principally implemented in compliance to the main tenets of *Shari'ah*. In other words, an understanding on *Shari'ah* is needed to gauge all scopes of the corporate governance in Islamic financial institutions, both general expertise and *Shari'ah* knowledge. According to Farag et al. (2017), the lack of training is reflected on the lack of clarity, or at least, the lack of consistency in relation to the main roles of the BOD.

For Islamic community, Islamic Banking is not merely having an account or loan that is Islamic in nature but the people of relevant institution should be well versed in *Shari'ah* knowledge as well. *Shari'ah* is define as a system of ethics and values covering all aspects of life i.e. personal, social, political, economic, and intellectual with unchanging bearings as well as major means of adjusting to change as inseparable from Islam's basic beliefs, values and objectives (Mohd Ali et al., 2018).

Khan and Bhatti (2008), Al-Gazzar (2014) and Jamal et al. (2018) argue that Islamic Banks have a very unsatisfactory record for R&D and innovation, which has lately led to a mounting pressure on them to develop genuinely Islamic and productive products that differ substantially from conventional practice. Abdul-Rahman (2008) highlights that the industry is still lacking in research and development in critical review of the current SSC practices; and to evaluate the sufficiency and the limitations of the present governance framework, research and development could also unfold other potentials to ensure that the development of the Islamic Banks is at par with their conventional counterparts. However, the Islamic Banks, neither individual nor as a group, spend enough amount on research and development (Iqbal et al., 1998; Mirakhor, 1997). This resulted in a lack of opportunities to intermediate the funds from Islamic communities in Islamic permissible portfolios, which could open up opportunities for Western financial institutions to discover or offer this market niche. It also resulted in a lack of availability of authentic information (i.e. Consistent data series on the activities of Islamic Banks for a reasonable number of years) accessible anywhere (Iqbal et al., 1998).

Furthermore, Mathews (2008) and Tett (2009) declared that *Shari'ah* experts earn as much as $88,500 per year per bank and in some cases, charge up to $500,000 for advice on large capital market transactions. On the other hand, *Shari'ah* scholars at small Islamic Banks have little insight into the complexities of present-day financial markets. Nonetheless, Islamic Banks are urged to build a strong research and training base to develop a body of Sharia experts with high moral and professional integrity. They should also set up a central *Shari'ah* Board and an external audit committee to provide a truly independent evaluation of their adherence to the principles of *Shari'ah*. Also, the human capital is inadequate in regards to knowledge and experience on the part of both management and personnel regarding Islamic Banking, due to their experience in Conventional Banks which resulted in lack of creativity (Kahf, 1999). Furthermore, since Islamic Banks are forced to derive their employees from Conventional Banks, this causes problems in the performance, understanding of *Shari'ah* ruling and advising bank's customers on the characteristics of different types of new Islamic techniques of banking relationships and services, etc. (Kahf, 1999). Although, IB experience growth annually, the extent of innovation is still very little (Kahf, 1999; Mohd Ariffin, 2005).

Today, numerous universities and training institutions are providing courses in Islamic finance, but they also face a lack of qualified human resources to carry out these courses. There also remains a huge lack of human resources on the expert level and a significant shortage of *Shari'ah* scholars who are well versed in Islamic finance. Business schools and religious schools should offer Islamic finance qualifications in co-operation and conjunction with industry experts to create the next generation of *Shari'ah* experts and professionals. It is also important to encourage academic institutions to set up centers of excellence for the Islamic finance industry.

2.6.6 Lack of Public Awareness

There remains a low penetration rate and lack of critical mass in the Islamic finance industry. This is due to mainly a lack of public awareness and knowledge of Islamic finance. Islamic Banks, regulators and governments should undertake mass awareness programs to drive the growth of Islamic finance and create critical mass for the industry.

Adherence to Islamic principles and rate of return were found as the most important determinants for the selection of bank among Bahrain customers (Metawa and Almossawi, 1998). However, reputation of bank and *Shari'ah* compliant products were considered the main reasons for selection of banking institution among customers in Jordan. Similarly, most of the customers were found satisfied except banking hours and opening timings of Islamic Banks (Naser et al, 1999). Imran et al. (2011) explored the level of awareness of Islamic Banking among customers and found that they were satisfied with operational services of Conventional Banking and they did not have complete awareness about products of Islamic Banking. It was reported that there was positive association between customer satisfaction and honesty. The trust was the only issue that influenced the customer using the system of electronic banking (Rexha, 2003). Moreover, the views of Malaysian corporate customers were examined regarding Islamic Banking system. Findings reveal that Islamic Banks are neither educating the customers nor marketing the Islamic Banking product and services properly, so majority of respondents have very limited knowledge about IBIs (Ahmad and Haron, 2002). However, another study was undertaken in Thailand to document the perception of customers regarding attributes of Islamic Banks. It was concluded that customers were aware of special characteristics of Islamic Banking system, i.e. prohibition of interest but they had low level of awareness towards products and services of IBIs (Lateh et al., 2009). Awan and Bukhari (2011) concluded that there were two prominent aspects for selection of Islamic Bank that included service quality and features of product in Pakistan. However, religious aptitude and *Shari'ah* principles could influence the selection criteria but religion was not the only reason to choose Islamic Banking. Khattak and Rehaman (2010) examined the awareness level for Islamic Banking products and services and reported low level of awareness among customers about financial products like *Murahabah* and *Ijarah* etc. except basic products like current account and time deposits. Moreover, it is reported that religion or *Shari'ah* compliance was considered main motive but not the most important factor.

2.7 Islamic Banking and Finance and Their Impact on Accounting

2.7.1 Islamic Accounting Definition

Financial accounting plays an important role in Islamic Banking in regulating and establishing a harmonious integration among different parties involved in banking transactions. Islamic accounting can be defined as the 'accounting process' which provides appropriate information to stakeholders of an entity which will enable them to ensure that the entity is continuously operating within the bounds of the Islamic *Shari'ah* and delivering on its socioeconomic objectives (Ibrahim, 2003). Hence, Islamic accounting provides the information which users of the financial statements of Islamic Banks depend on in assessing the Islamic Bank's extent of compliance with *Shari'ah* and determining rights and obligations of all interested parties in accordance with the principles of *Shari'ah*. Thus, the accounting process supports the banking activities in providing appropriate information (i.e. financial and non-financial data) to stakeholders and giving assurance that the entity is continuously operating within the ambit of *Shari'ah* and is able to deliver its socioeconomic objectives (Kasim et al., 2009). Also, it is a means in communicating IB players' accountabilities to their stakeholders and, ultimately, to God (in respect of inter-human/environmental transactions) (Abdul-Rahman 2003; Kasim et al., 2009).

2.7.2 Islamic and Conventional Accounting

There are many similarities between Islamic and conventional accounting, as both are about providing useful economic information to permit users to make rational decisions by facilitating comparisons and thereby minimizing the cost of assessing alternatives investments. Conventional accounting as it is known is defined to be the identification, recording, classification, interpreting and communication of economic events to permit users to make informed decisions. However, the nature of transactions in Islamic organisations which deal within a *Shari'ah* framework is different as Islamic organisations have a duty to contribute to socioeconomic justice and stability.

The objectives of accounting information of Islamic Banks are different from those of Conventional Banks for two main reasons: (i) Conventional Accounting is based upon modern commercial man-made law; Islamic accounting is based upon ethical law originating in the Qur'an and Sunnah which ultimate purpose is to ensure that Islamic organisations abide by the principles of the *Shari'ah* in their dealings. As a result, the nature of their transactions is different from that of Conventional Banks; (ii) The differences lies also in the type of information needed in both types of accounting, and how is it measured and valued, recorded and communicated. The users of the information generated by Islamic Banks have different needs from the users of the information published by Conventional Banks (Khan, 1994). Conventional accounting is based on economic events and transactions, while Islamic accounting is based socioeconomic and religious events and transactions.

In fact, conventional accounting mainly uses historic cost to measure and values assets and liabilities; which restricts this model due to assumptions of the monetary unit and its inflation.

Al-Mehmadi (2004) outlined the following reasons taken from Omar (1997) to describe the need for special accounting standards for Islamic Banks. The relationship between investors and the Islamic Banks that they invest in is different from that of Conventional Banks. In relation to Islamic Banks, the relationship is based on profit and loss sharing instead of the interest rate. Therefore, investors in Islamic Banks may need to be more concerned about the accounting methods used for revenue recognition. In Islamic law, there are details about when the revenue should be recognised and when the title of the assets should be transferred. These details might be measured differently in conventional accounting, and therefore may have to be taken into account when preparing an Islamic Bank's financial statements.

The type of information that Islamic accounting is required to provide is different from the information provided by conventional accounting. For example, holders of the investment account need to know their exact investment returns and the banks' efficiency and effectiveness in managing their investments. If negligence or misconduct can be proven on the part of the bank or the losses are more than the capital then the bank is liable for the investors' capital and all debt over the capital. It might also be important for them that the accounting information shows the bank's compliance with *Shari'ah*. Unlike Conventional Banks, Islamic Banks have to comply with *Shari'ah*, which has a complete code for running a business; therefore, their accounting standards need to reflect that law. The Qur'an also requires Muslims to record all contracts in writing as well as all their daily business transactions to ensure the society is free of personal problems. Nonetheless, Islamic Banks face problems when attempting to record some transactions according to Shari' ah, where there is no consensus among Islamic Banks on accounting methods that should be used (Al-Mehmadi, 2004). As a result, there are some difficulties when comparing the performance of different Islamic Banks.

Furthermore, there are three main areas of difference between financial accounting standards developed for Islamic Banks and Conventional Banks: i) the treatment of investment account; ii) the concept of substance over form; and iii) the time value of money (Ajili and Bouri, 2017).

(Haniffa and Hudaib 2007) mentioned five distinctive features that differentiate Islamic Banks (IBs) from their competitors (Conventional Banks), they are (a) underlying philosophy and values; (b) provision of interest-free products and services; (c) restriction to Islamically acceptable deals; (d) focus on developmental and social goals; and (e) subjection to additional reviews by the *Shari'ah* Supervisory Board (SSB) (Haniffa and Hudaib, 2007). The different underlying features of the IB's operations give different implications in accounting for Islamic Banks, such as compliance towards *Shari'ah* law and regulatory framework, disclosure and transparency, accounting information system, accounting treatment and accounting measurement and valuation.

2.7.3 Accounting Standards

A major problem that challenged the growth of Islamic Banking was the absence of recognised guidelines on prudential, supervisory, accounting, auditing and other corporate regulatory practices. This resulted in ineffective accounting standards and created considerable difficulties when it came to be comparing financial statements issued by Islamic financial institutions and those of conventional financial institutions.

Islamic institutions play an essential role in promoting economic prosperity as a basis of social stability where people live with good values and religious faith (Vinnicome, 2010). This prompts the need for the IFIs to deliver high quality financial statements since Muslim society expects them to adhere to the principles of *Shari'ah*. The resurgence of IFIs which offer a wide range of products that differs from Western financial products demand Islamic accounting standards in a manner that is consistent with Islamic financial products (Vinnicombe, 2010; Kamla, 2009). Developing IFI accounting standards will satisfy Muslims' intention to apply Islamic values in all parts of their life including their banking operations. This particular set of Islamic accounting standards is needed to tackle the distinction in transactions between IFIs and Conventional Banks. Accounting standards prepared especially for Islamic Banks will provide better accounting practices that are in-line with Islamic financial products (Hassan and Dicle, 2005). Well-defined principles and standards are crucial for ensuring efficient resource allocation, information disclosure, building investor's confidence, monitoring and surveillance (Zaher and Hassan, 2001; Ismail and Abdul-Latiff, 2001; Iqbal, 1997). Besides enhancing user's confidence in the information of the Islamic Bank's financial statement and thus ensuring efficient resource allocation, it should also reflect on the precepts of the *Shari'ah* (Ismail and Abdul-Latiff, 2001; El-Din, 2004; Ariffin et al., 2007).

At present, the IFIs have subjectively chosen IFRS standards which, in their thought, correspo nding to the contracts governing the underlying transactions. This has resulted in the auditor to interpret those norms even though they do not cover the specificities of IFI transactions where interest and cash speculation are prohibited and physical assets must support trades. The different interpretations by various national regulators, institutions and scholars leads to different rules and practices which in turn generate confusion among users. Asset ownership is the most vital conflict aspect between Islamic finance and conventional accounting rules. Islamic Banks purchase an asset on behalf of a client and rent it out until the client can obtain possession in order to prevent interest but also guarantee that banks can produce some profits. The IFRS standards require the accounting treatment for such a transaction as finance lease, where the lease is recorded as an interest-earning loan, which is contradictory to *Shari'ah* law. The application of IFRS accounting means there is no difference between the Conventional Banking system and Islamic financial institutions. An appropriate regulatory framework must, therefore, place greater emphasis on accounting standards and disclosure of information. Also, there is a growing concern for the need to have a set of financial reporting standards to facilitate IB's in the preparation of financial statements (Ismail and Latif, 2001). Hence, the disclosure and transparency of accounting and auditing play a crucial role (El-Hawary et al., 2004; Ariffin et al., 2007; Mohd Ariffin, 2005; Al-Omar and Abdel-Haq, 1996; El-Din, 2004; Iqbal et al., 1998; Solomon, 2007). This is because to the fact that it is essential that all parties should have full access and information to their transactions, covered by agreements (Ariffin et al., 2007). It also provides an assessment of the degree of risk associated with participation. Regulation should be underlined by measurement and comparison of risk exposure (El-Hawary et al., 2007). The growing need for transparency in the bank's financial investments and statements required regulators to regulate and standardize regulation. However, disclosure of accounting results may not be an adequate instrument for risk assessment because, as a structure, accounting is directed toward value, not risk allocation (Merton, 1995, cited in El-Hawary et al., 2004). This situation gives additional importance to other services, such as the allocation and dissemination of financially relevant information and credit rating (El-Hawary et al., 2004). Furthermore, it also raises the need for committee (i.e. IIRA, IFSP and LMC) to regulate and standardize regulations in order to make investing more attractive to creditors.

Moreover, the growing need for transparency in financial investment and bank statements is a challenge facing IBs. The current environment of the operation of IBs results in incorrect corporate governance influencing market psychology where IBs must embrace transparency, accountability, and effectiveness. In referring to transparency, the present situation of IBs leaves a lot to be desired (Iqbal et al., 1998) such as knowing most essential information, as in the exact way of calculating the share of profit of different types of deposit holders to be made public; details of the use of funds by the banks are not declared and various aspects of the activities of the IBs will increase the confidence of clients and will help avoid panics.

Although there have been accounting standards developed by the AAOIFI for IFI which complement the IFRSs, these standards seem to be difficult to enforce. The relevance of AAOIFI accounting standards is discussed below.

2.7.4 Accounting Standards in Islamic Banking

IFIs need regulatory supervision much like Western institutions (Islam, 2003). The unique characteristics of IB have been addressed by specialized Islamic standard-setting bodies. Conventional standards apply in all banking systems. However, taking into account the unique nature of IB, special standards have been developed through dedicated standard-setting bodies. The industry has two key standard setters: the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the IFSB.

Financial Accounting Organisation for Islamic Banks and Financial Institutions (FAOIBFI) was registered in March 1991 in Bahrain as an international autonomous non-profit making corporate body. The Islamic Development Bank (IDB) established FAOIBFI as a private standard-setting body to address the issues related to accounting in Islamic finance (Abdel-Karim, 2001, 1995; Al-Omar and Abdel-Haq, 1996). Later, FAOIBFI was known as Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) when auditing standards are added. The organisation is composed of a Financial Accounting Standard Board and a supervisory committee. The Financial Accounting Standard Board is responsible for setting accounting standards and consists of unpaid part-time members representing Islamic Banks, users of financial statement of these banks, practicing accountants, academics, *Shari'ah* scholars and regulatory bodies. Supervisory committee responsible for fund raising are represented by same categories as the Financial Accounting Standards Board.

AAOIFI developed 60 standards covering accounting, auditing, governance and ethics that IFIs need to apply by the end of 2012. AAOIFI has issued 26 financial accounting standards, five auditing standards, seven governance standards and two codes of ethics. It has also issued a Statement on the Purpose and Calculation of the Capital Adequacy Ratio for Islamic Banks. AAOIFI also takes part in efforts to achieve harmonization with the concepts and applications among the different *Shari'ah* supervisory boards of Islamic financial institutions in different jurisdictions through the preparation, issuance and interpretation of *Shari'ah* standards for Islamic financial institutions. In this respect, AAOIFI has successfully issued 45 *Shari'ah* standards by the end of 2012, including standards for *Istisna'* and parallel *Istisna'*, *Musharakah*, *Mudharabah*, *Salam*, *Ijarah* and *Murabahah*.

Other than the conventional accounting standard, AAOIFI stated ethics in its standard on the Code of Ethics for Accountants and Auditors of Islamic Financial Institution. The code of ethics in AAOIFI was divided into three sections. The first section describes the *Shari'ah* foundations into seven basic foundations: integrity, vicegerency, sincerity, piety, righteousness, Allah fearing conduct and accountability. From these basic foundations, the standard further developed six ethical principles: trustworthiness, legitimacy, objectivity, professional competence and diligence, faith driven conduct and professional conduct and technical standard. AAOIFI then further elaborated on the rules of ethical conduct based on the six basic principles. In the process of performing career as an accountant, ethical accounting is essential. Having said that, the accounting standards in this industry that exist today without failure, have included the code of ethics. Besides the conventional accounting standard, AAOIFI mentioned about ethics in its standard on Code of Ethics for Accountants and Auditors of Islamic Financial Institution.

AAOIFI works are a lot based on the current reporting system. The approach began with objectives established in contemporary accounting thought, and then testing them against Islamic *Shari'ah*; in short, accepting those consistent with *Shari'ah* and rejecting those that are not (Lewis, 2001). This approach avoids redundancy in the current reporting system and is seen as harmonizing the accounting standards so that consistency with globally accepted accounting standards is attained. The Deloitte Islamic Finance Knowledge Centre (IFKC) finds that 79% of the industry leaders surveyed support a convergence initiative of the AAIOFI standards with IFRS, while 7% did not support the convergence. An alternative approach is to establish objectives based on the spirit of Islam and its teachings and then consider these established objectives in relation to contemporary thought (Lewis, 2001). This approach adopted by AAOIFI is acceptable in the short term while in the long term; an Islamic accounting model should focus on developing accounting standards based on Islamic concepts (Archer and Abdel-Karim, 2007). AAOIFI's adoption of this second approach resulted in accounting standards that were very much based on IFRSs (Kamla, 2009). Some Islamic accounting scholars support IFIs to comply the accounting standards promulgated by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) to reflect the unique transactions of IFIs (Archer and Abdel-Karim, 2007; Vinnicombe, 2012). Employing AAOIFI accounting standards would not only improve the comparable, relevant, reliable, transparency and efficiency of the countries' financial institutions but would also expedite the processes of globalization (Abdel-Karim, 2001; Hussain et al., 2002).

The adoption of AAOIFI standards is useful as there are areas of differences in reporting IFIs and likewise, the IFIs need to be sustained in this global financial market dominated by Conventional Banking transactions. Although AAOIFI managed to develop a set of accounting standards for IFIs, this body lacks the power to enforce regulations. AAOIFI also works towards persuading regulatory authorities to adopt its standards. AAOIFI's standards are currently mandatory in Bahrain, Sudan, Jordan and Qatar. They are also being implemented as guidelines by the Monetary Agency of Saudi Arabia and are being used as the basis on which the Malaysia Accounting Standards Board (MASB) develops its domestic Islamic accounting standards. The implementation of the standards is aimed to (1) render the financial statements of Islamic Banks comparable and transparent (Abdel-Karim, 2001; Solé, 2007) and (2) provide relevant and reliable information to user of financial statements of Islamic Banks (Abdel-Karim, 2001). In addition, there is growing need for a body of accounting standards purposely designed to cater the specificities of Islamic products (Solé, 2007) that are being introduced through financial innovation.

However, AAOIFI accounting standards have not been fully accepted by regulatory regimes and a range of political, economic, and social circumstances because of the lack of appreciation of the benefits of these standards (Abdel-Karim, 2001; Vinnicombe, 2010). The choice of whether to adopt AAOIFI accounting standards depends on national regulators. There are a few factors influencing the decisions to adopt AAOIFI standards. AAOIFI was established in the early 1990s, the era before the move to IFRS. With the whole world moving towards a single set of accounting standards, many regulators are reluctant to have a separate set of accounting standards. Since IFRS is becoming the lingua franca of financial reporting, it is costly for IFIs to prepare two sets of financial statements. Additionally, comparing financial statements will be affected by having two sets of accounting standards. Some scholars argue that there is not much difference between AAOIFI accounting standards and IFRSs. The financial accounting standards issued by AAOIFI are basically compatible with IFRS except in only one or two cases (Mohammed et al., 2015). Since AAOIFI standards have mainly been based on IFRS, this approach has been criticised as embracing the spirit of dominant capital and free market ideology (Kamla, 2009). This approach has endured due to the challenges faced by IFIs that operate in a competitive and risky industry. The growth of Islamic finance has seen many products offered that are copied from the Conventional Banking industry (Mohammed et al., 2016). It is argued that rather than fulfilling religious duties, the real aim of IFI has been seen by some as creating secular goals and not religious ones (Haniffa and Hudaib, 2010). This has led national regulators including the Malaysian Accounting Standards Board (MASB) to believe that IFRS follows the *Shari'ah* principle and appropriate to IFIs.

Moreover, IBs motivated to mandate their accounting policies because of the fear that the national regulatory agencies, in which IBs operate, may interfere in regulating the financial reporting of these institutions and to allow an appropriate degree of comparability between these banks (Abdel-Karim, 1990, 2001; Iqbal et al., 1998). The decision to regulate IB’s financial reporting is further due to arguments that are in support of the disclosure of regulations because of market failure and the development of accounting standards, which would be perceived by potential investors as a sign of an industry in the process of becoming mature (Abdel-Karim, 1990). In order to ensure that the establishment of AAOIFI would gain support, the standard-setters need to convince the regulatory agencies on the need of IB to have accounting standards different from those implemented in their country, and accordingly, to allow the existence of dual accounting standards (Abdel-Karim, 2001). IB is expected to work very closely with the national banking regulators where the Islamic Bank operates, in order to gain their support in encouraging the management of the banks to implement the standards (Gambling et al., 1993). The central bank can ensure that the Islamic Banks follow the guidelines set by them and recommend some measures to improve their performance (Mohd Ariffin, 2005).

Implementing Islamic Banks' accounting norms will rely on statutory law and regulators. Today, countries offering Islamic Banking and finance prefer customized products and services that comply with the approval of their SSB. The approval of SSB will take into consideration *Shari'ah* compliance, compliance with national and international legal and regulatory frameworks appropriate to banking institutions and customs. Specific standards for the Islamic finance industry that play a crucial role in the development and growth of the industry would provide the common basis for *Shari'ah* compliance, facilitate Islamic financial institutions in ensuring that their products and services are fully *Shari'ah* compliant, institutionalize necessary components of the *Shari'ah* compliance and supervision processes, promote harmonization of Islamic finance practices across the world, provide tools for comparing financial performance of Islamic financial institutions across the world and assisting users of IB's financial statement in making informed decisions regarding their dealings with Islamic financial institutions.

Moreover, the industry is faced with a lack of consistency in the accounting treatment of various Islamic Banking operations and needs more effort, support from regulators, standard-setting bodies, and central banks (Mohd Ariffin, 2005; Karbhari et al., 2004; Brown and Skully, 2007). The Islamic Banks faced dissimilarities of accounting practices among other Islamic Banks, resulting in difficulties in making meaningful comparisons between their balance sheets or profit and loss (Iqbal et al., 1998). Also, the concepts used in balance sheets or profit and loss statements are not rigorously defined (Iqbal et al., 1998). Therefore, a further challenge faced by the industry is to develop a uniform regulatory environment and legal framework; which are still yet to be developed (Mohd Ariffin, 2005; Sundararajan and Errico, 2002). Such development will support the global financial stability, conducive to effective prudential supervision of IFI in their home countries and also facilitate and sustain international expansion of Islamic Banking (Sundararajan and Errico, 2002). Furthermore, the development will assist the integration of Islamic markets with international markets.

Therefore, the debate on these standards between standard setters, financial institutions, and regulators must be followed up by the AAOIFI, Islamic financial institutions, regulators, and other relevant institutions. For this purpose, the following may be suggested: i. The concern for risk management should be incorporated into the AAOIFI standards ii. Islamic Banks should keep themselves fully involved, on their own as well as through the platform of the AAOIFI, with the ongoing reviews of IAS 30 and IAS 39. iii. The international standard setters should also include Islamic Banks as concerned institutions while distributing consultation papers during the review process. iv. The relationship between AAOIFI and regulatory and supervisory standard setters for Islamic financial institutions needs to be strengthened for adopting the AAOIFI standards. v. Since subscription to the Special Data Dissemination Standards (SDDS) of the IMF has important implications for IDB member countries, the AAOIFI accounting standards must also take note of these standards. The IAS constitutes the basis of the SDDS and, therefore, while adapting IAS, the AAOIFI may also consider the requirements of the SDDS.

Accounting should make it possible for regulators, auditors, and society to determine whether the institution has made a positive contribution to social justice and whether its money and profits come from fair and honest practices. It should also identify and illustrate whether or not the bank has contributed to raising its clients out of poverty. Internal accounts that go beyond financial growth and efficiency could also provide information about whether they have met their religious and financial commitments to the institution or the management of the Islamic Bank. External and internal accounting should relate to wider social accountability concepts, including details of the types of projects the banks are financing and their social and environmental impacts and assessments. Accounting that improves organizations and society's recognition of the organizational effect on the socio-economic systems as a whole is more in line with Islam's knowledge and principle. It is also possible to change the role of accounting regulators and accountants to adopt a more holistic strategy.

2.8 Islamic Banking and Finance and Their Impact on Auditing

2.8.1 Auditing definition

Auditing is the examination of financial report by an independent third party to provide reasonable assurance and give an opinion on the true and fairness of the financial report.

Chapter Two: Overview of Problems and Challenges Facing Islamic Banking and Finance Industry

The timeliness and credibility of financial report is very important so as to enable the stakeholders especially investors to make important decisions. (Bosi and Joy, 2017)

It is also a mechanism that allows regulators to monitor, control and take action on any IFI if they do not meet the *Shari'ah* (Abdul-Rahman, 2008). In addition to the mechanism, every regulatory structure needs to have adequate enforcement power to ensure that necessary actions can be taken in the event of violation of *Shari'ah* (Abdul-Rahman, 2008). Currently, it relies on the internal corporate structure to ensure *Shari'ah* compliance (Abdul-Rahman, 2008).

Compliance with the operation of Islamic Banks consists of product compliance, transactions, implementations, contracts, and documentation executions and determination of income (Besar et al., 2009). While accounting system is controlled by the management, the independence audit is an act on behalf of its shareholders, depositors, investors and other stakeholders (Archer et al., 1998). Furthermore, the internal review unit may be entrusted to review transactions (Grais and Pellegrini, 2006). SSBs form one of the internal control processes by which Islamic Banks assure users of their financial reporting that the transactions conducted by the bank and the accounting practices do not breach the *Shari'ah* injunctions (Rammal, 2010).

The *Shari'ah* auditing practices stem from the increasing demand of stakeholders that require assurance of *Shari'ah* compliance and accountability (Abdul-Rahman, 2008). According to (N. Kasim & M. Sanusi, 2013), the new expectations and requirements for accountability have led to new demands on the audit function of the institutions caused by drastic development of IFIs globally. Moreover, the IFIs offer Islamic products, which should be in compliance with the *Shari'ah* Law. Yet IFIs currently depend on the current auditing system even though governance structure and the operations are different from the normal financial system (N. Kasim & M. Sanusi, 2013). According to Harahap (2002), conventional auditing is based on a value-free system, which does not take into account the moral and ethical values laid down, by Islam. According to Helal Uddin et al. (2013), *Shari'ah* audit and conventional company audit share similar functions but it focuses more on the compliance of the IFIs to the *Shari'ah* principles and requirements. It was also emphasized by Haniffa (2010) that the conventional financial audit is insufficient to cater the needs of the stakeholders of IFIs. There have been many debates on auditing of IFIs on what ought to be the ideal audit function.

Issues such as *Shari'ah* audit framework, the audit scope, auditor's qualification and independence are among issues that are widely discussed.

Now, as the number of Islamic-based transactions is growing, the implementation of *Shari'ah* audit is on the rise for IFIs as it sets the fundamentals of good governance (Kasim et al., 2009).

2.8.2 Auditing Standard in Islamic Finance

IFI transactions are designed on the basis of numerous accounting standards as reflected in the financial reports, which could threaten the accounting system and financial reporting as a whole. Therefore, the need for specific accounting standards that cater for Islamic or specifically the *Shari'ah* principles possesses the prospective for compatible and comparable accounting system and financial reporting with the conventional financial institutions (Sarea & Hanefah, 2013). Accordingly, the Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) was established in 1991 in accordance with the Agreement of Association, which was signed by Islamic financial institutions. It is an Islamic international autonomous non-profit making corporate body that prepares the accounting, auditing, governance, ethics and *Shari'ah* standards for IFIs. Formally referred as the Financial Accounting Organization for Islamic Banks and Financial Institutions FAOIBFI. Aside from AAOIFI, the Islamic Financial Service Board (IFSB) is another independent standard setter that caters for the IFIs. IFSB acts as international standard bodies of legislative and supervisory organizations interested in maintaining the stability and soundness of the Islamic financial services industry. It also encourages and recommends the growth of a cautious and transparent Islamic financial services sector by implementing new or adjusting current international norms in line with *Shari'ah* values. Following this, in December 2006 the IFSB issued a comprehensive guiding principles paper on corporate governance of IFIs with the objective to assist IFIs in improving their framework of corporate governance and at the same time to assist IFIs regulators (N. Kasim & M. Sanusi, 2013). However, Based on IFSB (2006), the implementation of the corporate governance system would vary from one IFI to another as it depends on the distinct nature of each IFI. AAOIFI and IFSB institutions have developed a wide range of technical standards and guidance notes, working closely with the Basel Committee and similar conventional standard-setting bodies to ensure coherence and consistency with their standards.

However, application of these standards is not uniform across countries because AAOIFI is not mandatory in many countries, thereby raising problems in the context of cross border banking supervision. The absence of coherent implementation of AAOIFI and IFSB norms, particularly in nations where Islamic Banks are active, puts transparency at risk and generates scope for regulatory litigation. Enhanced regulatory clarity – set in banking legislation and regulations and informed by improved dialog between Islamic standard setters and national regulators – is required, as is improved cooperation between Islamic and international standard setters in the development of suitable sector norms.

2.8.3 Differences between Islamic and Conventional Financial Institutions

The distinctions between standard banks and Islamic Banks that influence the auditing process can be categorized into a few features (Bosi and Joy, 2017) as discussed below:

I. **Products:** Products and services provided by conventional and Islamic Banks are mostly homogeneous with the exception of the component of profit sharing and interest in order to benefit the business. The market or sector in which Conventional Banks are operating is highly competitive, so rivalries need to develop strategies to their products to attract more clients. Hanif (2011) enlightens on how Conventional Banks generate their income is by spreading interest rates charges among debtors and the interest rates paid to depositors. Two contemporary approaches that had leveraged the product features of Conventional Banks are deposits and lending activities. The common business activities for these particular product features are such as mortgages dealing institutions or credit card institutions. Selling loans and then earning profit through payment of fees by debtors is one of the ways on how revenues are generated. Contrary to the Islamic ways of banking, the core principles that run within the banks are derived from the Holy Quran, which parallel with the tradition of the Prophet through the understanding of His followers of different *Fiqh*. Although, Islamic Banks prohibit the idea of interest on transactions, they do not reject the time value of money. This is how the financier from the perspective of Islamic Banking generating their income out of *Shari'ah* transactions. Therefore, when auditing the Islamic financial institution, it is essential for auditors to note the distinct kinds of products offered by these two and their impact on the recognition of income.

II. **Standards/guidelines:** Conventional Banks operation is accordance to Financial Service Act (FSA) 2013 and banking and Financial Institution Act 1989

(BAFIA).Whereas for Islamic Banks is bound to followed Islamic Financial Service Act (IFSA) 2013 and the reporting guidance issued by Bank Negara, which is GP8-i. These guidelines must be considered by auditors in order to determine the level of material misstatement and the relevant audit procedures in the audit of the organizations.

III. **Reporting:** Conventional and IFIs have different reporting guidelines. Conventional Banks shall accord to section 41 of BAFIA, in that, banking institution are required to submit audited financial statements within 3 months after the financial year ends. Furthermore, according to section 41 (4), Conventional Banks are not required to publish or present the annual audited financial report at its annual general meeting. Conversely, The *Shari'ah* Governance Framework states that the IFI shall establish formal reporting channel(s) among the key functions to ensure that the reporting on *Shari'ah* matters is carried out effectively and on timely manner. In this regard, the *Shari'ah* Committee shall functionally report to the board of directors. The *Shari'ah* review function shall report concurrently to the *Shari'ah* Committee and management, and the *Shari'ah* audit findings shall be reported to the Board Audit Committee and *Shari'ah* Committee. All *Shari'ah* non-compliance events are to be reported to the board of the IFI and the bank. Moreover, the AAOIFI requires both the SSB and the financial auditors of Islamic Banks to report on the compliance of these banks with *Shari'ah* doctrines. According to Besar et al. (2009), more development and disclosure are needed to provide a greater assurance to stakeholders on *Shari'ah* compliance. Therefore, when auditing in the Islamic Financial Institution, it is essential that auditors also look at the report of the *Shari'ah* commission to guarantee that all regions were examined during the financial statements review.

IV. **Risk management:** features Standard banks bridge financing and long-term loans are not produced on the grounds of capital goods presence. In addition, Conventional Banks only comply with standard regulatory standards. Whereas, the Islamic Banks provide financing which financing due to the assets backed nature results in productive economic activities; hence, it does not result in inflation. Furthermore, the underlying collateralizes the loan transaction provided by Islamic Banks. Apart from that, double audit was happen in Islamic Banks as to comply with conventional standards as well as *Shari'ah* standards. These duals check covers the legal risks, as there is a double check on money laundering and other fraudulent activities. It is therefore essential to know the industry's risk so that auditors can determine the audit risk level and then determine the suitable amount of materiality.

2.8.4 Auditing Challenges in Islamic Financial Institutions

The problems and challenges will be discussed in line with Yaacob (2012) and N. Kasim & M. Sanusi, 2013 research. Few issues and challenges were highlighted such as:

I. **Sufficiency Standard for *Shari'ah* Auditing Practices**: The absence of guidelines from regulators and lack of experience in the area; this is a major challenge encountered by respective sections and units (Abdul-Rahman, 2008; Besar et al., 2009). The IFIs must adhere to the principles of *Shari'ah*, which prohibits interest in business transactions. This shows the need for an integrated *Shari'ah* auditing standard covering all *Shari'ah* aspects. At this stage, the accounting policies and standards adopted by IFIs in the preparation of financial reports are not regulated. Therefore, IFIs are developing their own set of policies and standards for various business transactions based on conferment between the management, *Shari'ah* supervisory board (SSB) and external auditors. For example, a study by Hasan (2010) found that in order to ensure proper monitoring and implementation of *Shari'ah* principles and rulings, Al-Rahji has developed its own *Shari'ah* guidelines and procedures known as *Shari'ah* Monitoring Guide and *Shari'ah* Control Guidelines. However, the inadequacy of auditing standards that comply with the principles of *Shari'ah* may lead to misinterpretation of *Shari'ah*'s rulings and may provide a legitimate platform for any case to be brought against the rules of IFIs.

II. **Independence of *Shari'ah* Auditors:** IFI stakeholders believe that auditors have integrity through the perceived independence of the *Shari'ah* auditors themselves, both in appearance and in act. The integrity of the *Shari'ah* auditors could be further enhanced if they are independent enough to give opinions on the position of the IFIs in being *Shari'ah* compliant (Kasim et al., 2009). In IFIs, the *Shari'ah* Supervisory Board (SSB) oversees the governance in order to bring transactions under strict adherence to the *Shari'ah* principles (Norman et al., 2017). Though with no direct influence to the top management, the function of SSB is seen as being similar to the company auditors as they too conduct audits to ensure compliance to *Shari'ah*.

In other words, the SSB who are paid by the institution that they worked in conducts audit of their own work thus raise the issue of independence and conflict of interest. According to Haniffa (2010), the independence of the SSB is impaired as they are involved in supervising the products and operations of IFIs while at the same time conducting *Shari'ah* review or *Shari'ah* audit. With this in mind, there is no clear line of separation of duties that is fundamental in the practice of good governance. As such, the IFIs will have to reassess the needs for clear separation of duties to avoid the misperception of stakeholders of the SSB or *Shari'ah* auditor independence.

III. **Qualification of *Shari'ah* Auditors:** *Shari'ah* auditors are expected to serve the needs of the Islamic society whose focus and priorities are different from other contemporary views (N. Kasim & M. Sanusi, 2013). As such, *Shari'ah* auditors are not only accountable to maintain the transparency of financial reports but also ensure that funds in the IFIs are appropriately utilized. SSCs are qualified *Shari'ah* scholars, but they have not been subjected to rigorous training or exposed to specific training programmes. Inadequate professional qualifications of *Shari'ah* scholars prevent them to effectively function and express their independent opinion (Abdul-Rahman, 2008). Expertise and knowledge in conducting *Shari'ah* review are currently scarce, as the importance of such a review is not emphasized (Abdul-Rahman, 2008; Kasim et al., 2009; Besar et al., 2009). Also, the *Shari'ah* auditing practice lacks people in *Shari'ah* and accounting qualifications, since indirectly; they are important in determining the vision and mission of Islam and confirm that it is preserved within the IFI (Kasim et al., 2009; Shafiia et al., 2014). In addition, Kasim et al. (2009) found that *Shari'ah* auditors with accounting qualifications often tend to not have *Shari'ah* qualifications at the same time (the higher the qualification in accounting, the lower the qualification in *Shari'ah*). However, *Shari'ah* auditors are expected to be qualified in both *Shari'ah* and conventional auditing and accounting matters. They must have adequate knowledge in all finance and accounting related areas including auditing in order to effectively play the role as *Shari'ah* auditors for IFIs. Empirical finding shows that there are very few audit practitioners that are qualified in *Shari'ah* auditing as well as the conventional auditing. A study by (N. Kasim & M. Sanusi, 2013) found that those practitioners who possess accounting qualification mostly do not have the *Shari'ah* qualification at the same time. The lack of auditing practitioners that is qualified or experienced in both *Shari'ah* and conventional auditing could negatively affect the growth of *Shari'ah* auditing and Islamic Financial Industry as a whole. This subsequently may fail in determining the vision and mission of Islam that preserved within the IFIs. Therefore, this crucial need of the IFIs of having competent auditors that is *Shari'ah* qualified with the accounting and auditing background needs to be address promptly.

IV. Lack of accountability of *Shari'ah* auditors: Either internal auditors or external auditors can perform *Shari'ah* audit provided they have adequate knowledge on principles of *Shari'ah* with sufficient training on conducting such audit. Financial report is then forwarded to the committee of SSB to gather their opinions on *Shari'ah* matters to be tabled to the Board of Directors who will make final decision (ISRA, 2011). In view of this, it is perceived that the roles of *Shari'ah* auditors are limited to preparation of financial report rather than influencing the decision making process of IFIs. Board of Directors holds a greater capacity in making important decisions on the products and services of IFIs. The limitation of power in influencing decision of the Board by the *Shari'ah* auditors indicates that the auditors have lack of accountability. By right, *Shari'ah* auditor should have been more accountable because they have to be accountable to the stakeholders, which include the shareholders, the society and the *Ummah*. Next, they are accountable to *Allah* for every actions and inactions (Mohd Ali et al., 2015).

Therefore, the industry needs to establish audit evidence, *Shari'ah* audit programme and procedures, planning, examination and reporting (Abdul-Rahman, 2008). The collaboration between IFI, BNM, accounting firms, auditing firms and SSCs is crucial in developing *Shari'ah* audit programs and to ensure proper conduct of *Shari'ah* compliance. Kasim et al. (2009) found that the *Shari'ah* audit process is still a highly unstructured task. Apparently, the *Shari'ah* audit practitioners themselves are somehow unable to respond to the *Maqasid as-Shari'ah* agenda, despite their apparent willingness to do so. Kasim et al. (2009) found that a gap exists between the 'desired' and the 'actual' scope of audit. By demonstrating the desire to extend the scope of *Shari'ah* auditing, the lack of expertise, specification and definition on the scope of *Shari'ah* auditing practices concerns the respondent of the questionnaire survey in her study.

Most of the IFI are using the conventional framework of auditing because of the non-availability of *Shari'ah* auditing framework, even though the majority of the respondents' framework perceived that there is a need for *Shari'ah* auditing to be different from the conventional (Kasim et al., 2009).

Rigorous developments need to be enhanced in terms of *Shari'ah* audit education and research and development (Abdul-Rahman, 2008). This is to enable critical review of the current SSC practices, to evaluate the sufficiency and the limitations of the present governance framework. Also, the auditing practice needs requirements for a framework that will detail out policy guidance to properly conduct internal and external *Shari'ah* audit (Abdul-Rahman, 2008). Due to the absence of recognised guidelines and *Shari'ah* auditing standards, there is a major problem facing the current *Shari'ah* auditing framework (Kasim et al., 2009).

2.9 Summary

Although IB earned profits year by year, they still rank lower than their conventional counterparts in terms of profitability and efficiency. Given that their customer preference in patronising IB are not solely due to religious impetus, their preferences are more geared towards other qualities such as profitability, pricing, quality of services, reputation, image and socioeconomics. Thus, due to the current performance of IB and customer preference, more effort needs to be done to attract the confidence of the customers towards IBs products and services.

Furthermore, the general problems and challenges facing Islamic Banking and finance discussed in this chapter are: inconsistency in *Shari'ah* interpretation, reliance on debt-based products, product innovation and development, human capital management and lack of training and research and development. The discussions continue with legal and regulatory framework and risk management of IB industry. Also presented are: the accounting in religious organisations, accounting and Islamic perspectives, the application of the accounting system to enhance the system of accountability in the institutions and auditing practices.

The next chapter discusses the research methodology of this study, which outlines and explains the research design that has been adopted in this study.

Chapter Three:
Research Methodology

Chapter Three: Research Methodology

3.1 Introduction

The purpose of this chapter is to address the objective of this study, to describe the selection of Islamic Banks and Windows in Algeria (which are the topic of studies), as well as the methodology that was developed within the ontological and epistemological context of the researcher. The layout of this research includes the use of information gathered mainly from primary sources through semi-structured interviews. In this research, semi-structured interviews were conducted to gain a more accurate understanding of the problems and challenges confronting Islamic Banks and Window in Algeria.

This chapter on methodology will investigate (1) semi-structured interviews to be conducted in more detail in the studies; (2) the provision of information on the research instruments used; (3) processes pursued and (4) methods tailored to improve the efficiency of semi-structured interviews.

The researcher also used annual reports to explore descriptive information on the organizational inquiry, and the respondents engaged. As a result, this chapter will also define the secondary data sources used in this research.

Details of the research methods used in this study will be described subsequently in this chapter. Finally, this chapter included the discussion on the limitations of following the research method, which is employed in this study.

3.2 Research Aims and Objectives

Since the Money and Credit Act (1990), the Algerian governments have sought to liberalize the bank's industry to enhance the efficiency of the banks. As a consequence, overseas companies were permitted to function, among which are two Islamic Banks (mixt bank: Algerian Bahraini, and foreign bank), four overseas Participatory (Islamic) Windows operating today, and the government is introducing six state-owned Participatory (Islamic) Windows. The opportunities for Islamic Banking in Algeria overshadow the difficulties, and the ground seems to be untapped with a great, yet underexploited, potential in terms of savings. Given that recent state plans to deliver Islamic Finance products have been component of broader initiatives directed at modernizing the underdeveloped banking sector and the economic problem (lack of liquidity), and the high demand for Islamic financial services, both among prospective clients and investors. Algerian Islamic Banking and finance are seen as fresh and, at an early stage, faces problems and challenges in functioning in an environment that is not yet aligned with the needs of *Shari'a*-compliant financial products. Among the main problems is the lack of legislation that is conducive to Islamic Banking. Alternatively, there are other problems and challenges in the operating of Islamic Banks and Windows in Algeria as well as in other areas of the globe.

There is a growing interest in the literature on the problems and challenges facing Islamic Banking and finance worldwide. However, the empirical literature, which focuses on theoretical and practical aspects of problems and challenges facing Islamic Banking and finance, tends to be very limited. Several empirical studies relevant to the present scope of research are included.

This study of problems and challenges facing Islamic Banking and Finance in Algeria is unique because it uses a qualitative research that has not been used before, except for a few papers and a doctoral survey which have not dealt with this problem in detail in our knowledge. Such researches are important, given that Algeria is engaged in promoting Islamic Banking and Finance, so this study may help players to define the main problems and challenges that may slow down the development of Islamic Banking and finance. It also, would give impact on the enhancement of legal and regulatory framework in order to ensure that the Islamic Banks continue to develop and grow. Also, it will contribute to a better infrastructure and architecture of Islamic Banking operations in order to ensure that the benefits of establishing Islamic Banks are fully achieved, and to take IB in Algeria to the global level.

This research aims to investigate and uncover the problems and challenges of the IB Regulation, *Shari'ah* Compliance, and Management in Algeria, by understanding the organizational forces and rational/technical efficiency pressures (i.e. related to the governance of transactions). It also examines the problems and challenges confronting Islamic Banks concerning the management, *Shari'ah* compliance, the legal and regulatory framework and the accounting and auditing structure by analising the implementation of Islamic Banks and Windows in Algeria. This is essential for the development of the more liberalized and globalized sectors in the future. The significant issue emerges from: (1) developments/initiatives in the infrastructure and architecture of the sector that promote Islamic Banking and finance activities; (2) the present activities of Islamic Banking and finance (in particular the *Shari'ah* as the guideline of its activity) which differ from Conventional Banks and (3) the empirical literature on the problems and challenges facing the industry, raise the need to explore the problems and challenges facing IBF in Algeria.

The objectives of establishing Islamic Banks and Windows are not restricted to the provision of banking business activities based on the *Shari'ah* but are also intended to guarantee that the goals of the *Shari'ah* are also accomplished.

Islamic Banking and finance provides opportunity for the Muslims to subscribe to the banking business in accordance with the *Shari'ah* Law. Furthermore, the ultimate objective of establishing the banking business that is based on *Shari'ah* is to achieve the *Maqasid as-Shari'ah* (objectives of the *Shari'ah*). In fact, by offering a banking business following *Shari'ah*, it is anticipated that the community as a whole will appreciate the benefits of reaching *Shari'ah*'s goal and will contribute to an improvement in financial and cultural lives. As a result, the IBs are expected to maintain the interests of the stakeholders by ensuring *Shari'ah's* adherence and the company results of the Islamic Banking and finance sector. The final indicator of achievement of the IBF is therefore assessed in light of enhanced efficiency in maintaining *Shari'ah* adherence, and business efficiency.

The overall aim of this research is therefore to acquire perceptions of senior authorities for the management of the Algerian Islamic Banks and Windows, *Shari'ah* Supervisory Board, academic on the problems and challenges faced by Islamic Banking and finance in Algeria and the impact on their institution of Islamic Banking and finance operations in Algeria in terms of the (1) legal and regulatory framework; (2) *Shari'ah* Compliance; (3) management; and (4) accounting. This research aims, therefore, in accordance with the overall goal:

1. To identify the problems and challenges facing Islamic Banking and finance industry in relation to legal and regulatory framework, *Shari'ah* compliance, management and accounting.

2. To evaluate whether the processes and current practices of ensuring the *Shari'ah* Compliance in the Islamic Banking and Finance industry are being implemented efficiently in Algeria.

3. To discuss and outline the problems and challenges faced by SSB, *Shari'ah* audit, financial audit, and financial accounting and reporting in providing reliable information in terms of efficient allocation of resources and ensuring *Shari'ah's* compliance in Islamic Banks and Windows.

4. To identify the current practices of *Shari'ah* advisory, *Shari'ah* audit and financial accounting and reporting in guaranteeing the reliability of financial reporting, compliance under the current law and regulation, along with the efficiency and effectiveness of *Shari'ah* Compliance in Islamic Banking in Algeria.

3.3 Research Questions

In order to analyze the problems and challenges facing Islamic Banks and Windows in Algeria, the following questions were considered. Questions are divided into two sets of: 1) questions addressed to Islamic Banks practitioners and academicians; 2) questions presented to Islamic Windows.

The following issues were regarded in an attempt to evaluate the problems and challenges of offering infrastructure assistance and ensuring adherence in activities, products, and services. The fundamental topics related to *Shari'ah* compliance are the *Shari'ah* interpretations of *Fatawas* and guidelines, ex-ante *Shari'ah* Compliance (a proposal, deliberate, approved) and ex-post *Shari'ah* Compliance (execution).

1. What are the problems and challenges faced by Islamic Banking and finance in maintaining that *Shari'ah* complies with its transactions in Islamic Banks, governing the conduct,

business ethics, transactions guided by contracts authorized by *Shari'ah* (i.e., contract validity and permissibility) and *Shari'ah* as the governing legislation of all corporate affairs?

2. What are the problems and challenges facing SSB in Islamic Banks or Windows?

3. What is the effort or interaction in the Islamic Banking system and finance in establishing the *Shari'ah* compliance in the IBs/Windows?

4. How can the process be addressed in order to improve the level of compliance in Islamic Banks or Windows?

Islamic Banks should also comply with the legal, regulatory and regulatory framework, guidelines and standards. However, compliance by Islamic Banks and Windows with accounting standards would depend on jurisdiction. At present, different jurisdictions apply different standards.

1. What are the problems and challenges related to the legal and regulatory framework of Islamic Banks or Windows?

2. What are the problems and challenges in complying with the current national and international legal regulatory framework?

The following questions related to the problems and challenges of accounting and auditing practices faced by Islamic Banks and Windows in Algeria.

1. What are the problems and challenges facing Islamic Banking and finance industry in terms of accounting practices, accounting standards and auditing?

2. Is there a need for standardization and harmonization of accounting practices and accounting standards among Islamic Banks and Windows? What efforts have been made to standardize and harmonize practices?

3. Is staff in Islamic Banks and Windows capable and competent to carry out their duties and responsibilities?

Besides, this study will also cover management issues. Management refers to the operational and administrative aspects of the organization, including issues related to human resources, the system, and the internal process.

1. What are the management problems and challenges (i.e. human capital, system, and internal process)?

2. How can Islamic Banks or Windows guarantee that management elements are in position and are well accomplished to achieve their goals?

3. How can Islamic Banks or Windows improve management aspects to ensure that they are well performed?

3.4 Study Population

Algeria is a North African Muslim country and a member of the MENA. Islamic Banking experience is comparatively new in Algeria compared to standard banking. Although this experience, goes back to the establishment of Al Baraka Bank in 1991. Algerians stay outside the formal banking sector, in latest years, significant progress has been made; according to the World Bank, the share of the adult population with an account at a financial institution increased from one third in 2011 to one half in 2014. Still, adults earning low incomes or living in rural areas remain much less likely to become account holders. Digital and Islamic Banking are both in the early stages of development in Algeria compared to neighboring countries, but hold promise to make significant future inroads in financial inclusion as they reach more of the population." Islamic Banking is a niche with growing demand and banks should be well prepared to supply it. "These alternative banking products imply specifications that call for trained knowledge and new commercial approaches," CEO of state-owned bank.

To date, there are 20 licensed banking institutions that have been established in Algeria. The licensed banking institutions consist of foreign and Algerian-owned commercial banks (i.e., 14 foreign and 6 Algerian-owned). In this study, the sample consists of 8 Islamic Banks and Windows that are considered relevant to the present research, ranging from Islamic Banks to national and international Islamic Windows. Since the study intends to explore the regulatory, management and *Shari'ah* compliance problems and challenges of the Islamic IB system, the selection of banks (however, they are only two Islamic Banks in Algeria) and Windows to be used as research topics should be representative of the respective banking institutions of senior officials. This helps obtain practitioners' perceptions (i.e., CEOs and *Shari'ah* officers) as they are engaged and experienced in banks. This research will also examine the opinions of the IBF industry's managers and academics on the problems and challenges that IB faces in Algeria.

The interviewees represent Islamic Banks, Islamic Banking Windows in state and foreign banks. Table 3.4.1 below shows the selected banks and Windows, which are the research subject of this study. Interviews with a sample of staff, in each of the Islamic Banks and Windows in this study, are based on the availability of certain characteristics such as: experience, academic status, and seniority. So, they are considered to be representatives of their banks.

Table 3.4.1 List of Islamic Banks and Windows in Algeria selected for this study

No.	**Bank name**	**Islamic Banks**	**Islamic Windows**	
			State owned	**International**
1	Al-Baraka	✓		
2	As-Salam	✓		
3	CPA		✓	
4	BDL		✓	
5	CNEP		✓	
6	BADR		✓	
7	Housing			✓
8	AGB			✓

Source: Elaborated by the researcher

3.5 Research Design

Research design can be categorized as an exploratory, descriptive or explanatory approach. These approaches will identify how the research problems are being identified (Saunders et al., 2009, p: 358). This study will use the exploratory approach. Exploratory studies are valuable means of finding out “what is happening; to seek new insights; to ask questions and to assess phenomena in a new light” (Saunders et al., 2009, p: 362). If you want to explain your grasp of an issue, it is a particularly helpful strategy. There are three principal ways of conducting exploratory research (1) a search of literature, (2) talking to experts in the subject and (3) conducting focus group interviews. Its great advantage is that it is flexible and adaptable to change. Adams and Schvaneveldt (1991 cited by Saunders et al., 2009) reinforce this point by arguing that the flexibility inherent in exploratory research does not mean absence of direction to the enquiry. What it does mean is that the focus is initially broad and becomes progressively narrower as the research progresses.

The exploratory approach is relevant to this study as the research problem is more or less understood. It may portray that the issue was new or researchers had written little on it. In undergoing this type of research, the researcher is expected to possess the ability to observe, get information, and construct information i.e. theorizing. Also, the researchers are also expected to be someone that are creative, open minded, and flexible; adopt an investigative stance; and explore all sources of information (Lawrence and Neuman, 2014, p: 38). According to Lawrence and Neuman (2014), purposes of exploratory research types are: (1) become familiar with the basic facts; setting, and concerns; (2) create a general mental picture of the conditions; (3) formulate and focus questions for future research; (4) generate new ideas, conjectures, or hypotheses; (5) determine the feasibility of conducting research; and (6) develop techniques for measuring and locating future data.

3.6 Research Method

A researcher has to use a set of procedures or specific techniques in collecting and analyzing the data used in answering the questions that were initially posed (Robson, 2002, p: 72). The research method is simply a set of instruments to be used for data collection and analysis. The research strategy and the techniques employed must be appropriate for the questions to be answered or to the research questions (Robson, 2002, p: 72). That entails the selection of a method or methods to be employed, which must be based on what kind of information is wanted, from whom and under what circumstances (Cohen et al., 2005). While framing the research methods, usually the qualitative and quantitative approaches are used by social science researchers.

3.6.1 Qualitative Research

This study uses a qualitative research method. Generally, qualitative research focuses on the subjective experience and perception of the research subjects. The qualitative method is most often used when the motive is exploration. Data that are treated as qualitative are mainly those, which are written or spoken words or observations, which do not have a direct numerical interpretation. (Schutt, 2001, p: 17). The main research methods associated with qualitative research are participant observation, qualitative interviewing, focus groups, language-based approaches to the collection of data such as conversation analysis, and the collection and qualitative analysis of texts and documents (Bryman, 2004, pp: 97-113). In qualitative research, the researcher is the key instrument of data collection. Tools used in qualitative research include open-ended interviews, field notes, and “conversations” with participants or journal diaries. The focus of qualitative research is not only to describe, but also to analyze: it seeks to look at the why of events, not just the what (Tuckman, 1988).

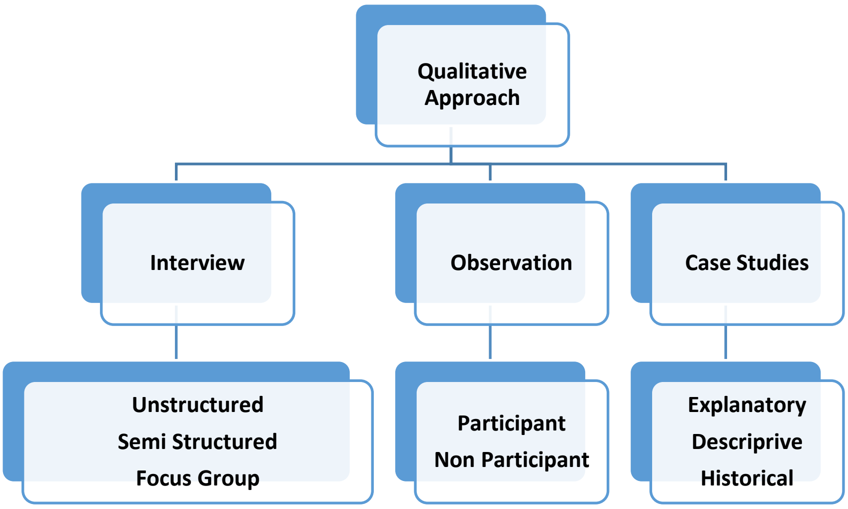
This type of approach may be needed because the topic is new and has never been addressed with a certain sample or a certain group of people (Morse, 1991; cited in Creswell, 2003). Access is also an issue that should be taken into consideration. There is a possibility that few respondents are willing to sit for all the hours it takes to complete the portraits (McCracken 1988). This could be prevented by explaining to the participants in advance the estimation of the duration of the interview.

3.6.2 Nature of Qualitative Research

Qualitative research is an array of interpretive techniques, which seek to describe, decode, translate and otherwise come to terms with meaning, not with the frequency, of certain more or less naturally occurring phenomena in the social world (Van Maanen, J., 1983, cited by cited by Almutairi, 2010). Qualitative research is perceived to be any type of research that generates output, which is not derived, by statistical procedures or means of quantification (Strauss and Corbin, 1998, cited by Almutairi, 2010). It is a research strategy, which usually gives an emphasis on words, rather than quantification in the collection and analysis of data (Bryman, 2012, p: 35). It explores experiences, meanings, perceptions and feelings (Kumar, 2005, p: 50). In essence, the qualitative method attempts to capture and understand individual definitions, description and meanings of events. Qualitative methodology, or qualitative researching, can be implemented through qualitative interviews, participant observation and document analysis.

3.6.3 Types of the Qualitative Method

Figure 3.6.3.1 Types of the Qualitative Method



Source: Elaborated by the researcher

3.6.4 Interviews

The interview is a form of questioning characterized by the fact that it employs verbal questioning as its principle technique of data collection (Sarantakos, Sortirios. (1994, cited by Almutairi, 2010). The interview constitutes generating conversations with people on a specific topic, or a range of topics and interpretations from the resultant data. It gives insights into people's experiences, opinions, values, attitudes and feelings (May, 2001, p: 83). Mason (2002) is of the view that qualitative interviews relates to instructional exchange of dialogue; a relatively informal style; thematic; topic-centered; biographical or narrative approach; and it ensures the right context is brought into the interview to produce situated knowledge.

Qualitative interviewing is the most commonly used qualitative methods. It consists of four types of interviews in qualitative analysis. These are: 1) the structured interview; 2) the semi structured interview; 3) the unstructured interview; and 4) group interview.

3.6.5 Semi-structured Interviews

This research uses semi-structured interviews. The semi-structured interview is the most common form of interviewing people and is a common and useful tool in the exploring phase of a planned intervention. Semi-structured interviews are conducted with a fairly open framework, which allow for focused, conversational, two-way communication. They can be used both to give and receive information. Semi-structured interviews enable the interviewer to investigate the problems and challenges facing Islamic Banks and Windows in Algeria, from the point of view of the interviewer through their experience and involvement in the industry. It also seeks to collect perspectives on the problems and challenges facing the IB in Algeria.

As illustrated in Figure 3.6.3.1 above, the research design was conducted through the use of a series of qualitative semi-structured interviews.

Figure 3.6.5.1 The Qualitative Research Strategy used by the Researcher

Semi-Structured Interviews (March 2018 – August 2019)
►Semi-Structured Interviews →CEO of Islamic Banks → *Shari'ah* Board Members → Heads of Finance Departments in Islamic Banks → Senior Managers in Islamic Banks → Heads of Participatory Finance in Islamic Windows → Department heads in Islamic Windows → Senior Managers in Islamic Windows

Source: Elaborated by the researcher

The semi-structured interview was chosen because it was considered more flexible than standardized methods, such as structured interview. The emphasis was clearly on how the interviewees structured and grasped the problems and activities that were created. The frames were what the interviewees saw as important in explaining and understanding events, patterns and forms of behaviour (Bryman, 2012, p:471). By using a list of topics, it permitted the exploration of evolving topics and concepts, rather than just depending on issues developed before the interview. In a semi-structured interview, interviewers may also use testing questions to achieve in-depth answers to certain problems.

This study aimed to contribute to the need for information on the problems, and challenges facing Islamic Banking and finance in Algeria. The research objective was achieved through the use of semi-structured interviews. The researcher conducted interviews between March 2018 and August 2019. The semi-structured interview allowed the interviewer to investigate the problems and challenges facing Islamic Banks and Windows in Algeria from the perspective of the interviewees through their knowledge, experience, and involvement in the industry. This added significance in knowing the problems and challenges facing IBs and Windows. The interviewees included Shari'ah Board members, Heads of Participatory Finance Departments (or Heads of IBs Departments) and CEOs.

Other qualitative methods include personal observation and analysis of documents. Observation is a method that uses the sense of vision as its primary source. It is commonly used in combination with other techniques. Personal observation involves with a better grasp on social reality and is immersed in a natural setting; this may provide implicit features in a natural setting due to the continued presence (Bryman, 2012, p: 493). The observation study method has many positive characteristics; namely, observations are generally flexible and need not necessarily be structured around a hypothesis. For example, a researcher may make observations to form a research question before conducting a more structured study. This is called descriptive research, it enables a better understanding of the item being investigated, and it also allows the researcher to investigate unanticipated subjects or problems. Observation research findings are considered strong in validity, because the researcher is able to collect a depth of information about a particular behavior. However, just like the other methods of conducting research, there are negative aspects to observation. Continued engagement with human behavior may lead to reactive effects between the researcher and the respondents and may be disturbing, as the researcher will be at the organization for a long time; findings may only reflect a unique population and, therefore, cannot be generalized to others; there are also problems with the researcher’s bias. Often, it is assumed that researchers may “see what they want to see”. Bias, however, can often be overcome with training or through the electronic recording of observations. Hence, overall, observation is a valuable tool for researchers.

On the other hand, handling document analysis does not involve reactive impacts because it does not involve human participants; it can address external criticism and internal criticism. External criticism is defined as assessing the authenticity of the data, while internal criticism is defined as an examination of the document’s contents to establish credibility (Neuman, 2014, p: 218).

In addition, it may be argued that unnatural characters may be encountered in an interview, which may lead to the emergence of reactive effects (Bryman, 2012, p: 54). On one hand, the qualitative interviews attendant’s roles and expectations may well outrage potential respondents for many reasons, such as: the resentment towards the intrusion by a complete stranger, the refusal to be accurate or attentive in their response, the desire to share in the control of the interview and ask questions of the interviewer and the fear of the potential use to which their responses might be put (Oppenheim, 1992; Creswell, 2003, cited by Noraiza, 2014). On the other hand, they may feel enormously flattered at being interviewed at all, engage in elaborate displays of friendship and hospitality, involve the interviewer in personal or family matters and also seek to strike up a lasting relationship (Oppenheim, 1992, cited by Noraiza, 2014). But, the intense reactive effect of the potential outrage of the respondent is not as much as the observation of the participant. Also, as compared to personal observation, the impact of people’s time will probably be less in an interview session (Bryman, 2012, p: 496).

In addition, to avoid criticism that the research may have too much reliance on the researcher’s point of view, the qualitative research need to consider a thorough planning of critical self-scrutiny by the researcher, or active reflexivity (Mason, 2002, p: 7). Also, the researcher should have thorough considerations of the design in order to avoid any misleading outcomes. Furthermore, the researcher needs to be flexible and sensitive to the specific dynamics of each interview and aware of the need to tailor-make it on the spot. Also, the researcher needs to engage with the data to ensure that the data generated from the interview will allow appropriate comparisons to be made (Mason, 2002, p: 199).

3.6.6 The advantages of using Semi-structured Interviews

Research in highly regulated industries would depict a distinct approach and involve multiple incredibly delicate issues. Because of the nature of the banking business operations, it may be hard to inquire about access to observe them or view other different unpublished reports. The semi-structured interview is more important for sharing experiences with the IBF industry's elite groups. Also, it has the advantage of eliciting the opinion of busy people who are used to making appointments and schedules. More focus data can be obtained through semi-structured interviews and can capture issues resistant to personal observation. Also, it leads to the wide coverage of people and situations where it brings breadth of coverage. Therefore, various issues can be understood from the respondents. In addition, semi-structured interviews could entail the reconstruction of events (Bryman, 2012, p: 495). It could be done by telling the respondents to reflect on how a particular issue occurs, and this would give them an understanding of the underlying reasons for how current issues emerge. However, before the interview session, a thorough assessment of the literature, related government documents, the statutory act, and the published documents are vital to a better understanding of the subject matter.

As this study seeks to address the problems and challenges faced by IBF in Algeria under the Conventional Banking system, the qualitative method is considered appropriate to further enhance the perception of the sample through the survey method. Research involving the interaction between researcher and respondent will lead to an awareness of the problems and challenges they are presently facing. It will concentrate on accounting and financing procedures in IBs, shareholders of banks or board of directors, management of the bank, holders of investment accounts (IAH) and other associated technical issues. Other associated problems, such as human skill, marketing, client awareness, and education, etc., will be outlined.

The semi-structured interview employed in this study will be used in the process of gathering data in understanding the conflict and tension of the elite groups in IBs. It typically refers to a context in which the interviewer has a series of questions that are in the general form of an interview schedule but are able to vary the sequence of questions (Bryman, 2012, p: 212).

Also, the researcher will have a list of themes and questions to be covered, although these may vary from interview to interview (Saunders et al., 2009, p: 320).

Moreover, necessary additional questions may be required to explore the research questions and objectives given to the nature of events within particular organizations (Saunders et al., 2009, p: 312).

A study by Karbhari et al. (2004) on the problems, challenges and opportunities of IBF in the United Kingdom (UK) used a series of interviews. Also, a study by Susela (1999) was done using an in-depth interview with 65 actors to understand the conflicts and tensions within the Malaysian accounting profession and the power struggle therein to dominate the accounting standard setting process in Malaysia (i.e. Developing country). Furthermore, a study by Abdul-Rahman and Goddard (1998) used interpretive accounting research to inspect the accounting practices in a cultural setting. It contributes to the need for accounting study to become more explanatory as a social practice on accounting. Semi-structured interviews, unstructured interviews, and analysis of documents were used.

3.6.7 Managing semi-structured interviews

The data collection interviews began in March 2018 until August 2019. They were conducted following the approval of the interview guidelines by the research director. After receiving the approval, the expected interviewees were contacted by e-mail or phone. They were acquired from people approached at the university or during Islamic Finance conferences. An attachment of a covering letter explaining the research goal and questionnaire support was included in the e-mail. After sending the email, a gap of 48 hours was given for receiving any feedbacks or making any subsequent follow-ups. There were different types of feedbacks. The first type of feedback was when the researcher received feedback on the same day that the potential interviewee was identified or made an appointment for the interview. This group of interviewees responded to the email immediately and communicated their willingness to be interviewed. Then, the appointments were arranged. The second type of feedback was when the researcher asked to contact the interviewees at a later date to set up an interview. The follow-up process was carried out in two ways, either by subsequent emails or by telephone calls. However, some interviewees had not responded to the researcher's email. The potential lack of willingness of the interviewees was identified when the researcher made personal calls after sending a second follow-up email. However, some interviewees were approached during the Islamic Finance Conference; their willingness was communicated, and the researcher called them for an appointment at a later date.

In addition to sending emails and having face-to-face approaches, the researcher also used middlemen to gain access to interviewees. The researcher needs to know and communicate with the middlemen to gain access to the right people. Attempts were also made to call the Secretary of the CEO to obtain assistance in making follow-ups or feedback on interview sessions with the CEOs. Moreover, the opportunity to attend conferences, international forums, workshops courses and universities was used to travel, meet and approach potential interviewees accordingly. Usually further phone calls were made for the follow-up process.

The interviews were conducted with Chief Executive Officers (CEO), *Shari'ah* Officers and a several academicians. The interviews consisted of 1 CEO, 5 Head of Participatory Finance, 2 *Shari'ah* committees, 8 Heads of Departments and Senior Managers. The list of the interviewees Table 3.6.7.1 and Table 3.6.7.2 is as follows:

Table 3.6.7.1 Analysis of Respondents of the Semi-Structured Interviews amongst Islamic Banks and windows

Interviewees position	**Islamic Banks**	**Islamic Windows**	
		State owned	**Private**
CEO	1		
Shari'ah Supervisor	2		
Head of Participatory Finance		3	2
Head of Departments	7	8	3
Senior Managers	2	4	2

Source: Elaborated by the researcher

Overall, 34 interviewees participated in the data collection process. The interviewees were representatives of Islamic Banking subsidiaries, and foreign and state Islamic Windows.

The largest group of interviewees consisted of the Heads of Departments who represented 53% of the overall interviewees, followed by Senior Managers and Heads of Participatory

Finance who represented 23% and 15%, respectively. In addition, there was a small number of *Shari'ah* Supervisors and CEOs. They represented 6% and 3% respectively (Please refer to Table 3.6.7.2).

Table 3.6.7.2 Percentage of Interviewees according to Group Percentage Amount Interviewees' Group

Interviewees position	**Amount**	**Percentage (%)**
CEO	1	3 %
Shari'ah Supervisor	2	6 %
Heads of Participatory Finance	5	15 %
Heads of Departments	18	53 %
Senior Managers	8	23 %
Total	**34**	**100 %**

Source: Elaborated by the researcher

The researcher was engaged with the interview respondents who are experienced working with Islamic Banks (IBs) in acquiring the data to investigate the problems and challenges facing Islamic Banking and Finance (IBF) in Algeria, Also engaged in the implementation or establishment of new regulations, norms or guidelines, IBF product, and service creation and IBF researchers and local and international academics.

The researcher used semi-structured interviews when studying the IBF in Algeria, where the data supplied by the interviewee could provide "indirect" data filtered through the interviewee's opinions. The presence of the researcher may lead to biased responses and there is a possibility that certain individuals are not articulate or perceptive (Cohen, 2007, p: 189). The researcher required to ensure that the interview information was confidential and that the participants were anonymous. According to Saunders et al. (2000) ethical consideration will emerge as researchers plan their research, seek access to individuals and organizations, data collection, data analysis and reporting. Thus the ethical consideration will be evaluated accordingly in this study at each point of the studies. Specifically, the researcher was conscious of the issues of confidentiality, privacy, prevention of harm, and informed consent when using the interview method.

It should be noted that each of the interviews conducted by the researcher will begin with brief explanations about the research's goals; and the interviewees will be assured of the confidentiality of the data they shared during the interview session. Besides, the researcher forwarded to the interviewees the consent form. In addition to obtaining the interviewees informed consent, the researcher was obliged to explain her research to the interviewees clearly and correctly; the researcher also disclosed the dictation machine to be used during the interview. This is to explicitly exercise the researcher’s responsibility to guide, protect and oversee the interest of the people being studied (Neuman, 2014, p: 146).

In addition, the researcher maintained close contact with the appropriate staff to guarantee that all ethical issues are addressed. Interview notes were the data sources for this research. The interview sessions were carried out at the interviewees’ office or the offices where the SC were being appointed (responsible or contracted for). Few interviews were tape recorded and transcribed. Most interview sessions were not tape-recorded. Interview notes and tapes were transcribed and coded, providing textual material for analysis.

3.7Analysis of the Interview Data

This study explores the general and broad overview of problems and challenges facing Islamic Banking and finance industry, then, it will investigate the problems and challenges in ensuring the *Shari’ah* compliance in its operation and accounting and auditing practices and the problems and challenges related to regulation and management (i.e. Monitoring and control that exists).

It is important to examine such areas due to the emerging development of Islamic Banks and Windows and the core objectives of the banking businesses to provide a banking system that is based on *Shari’ah*. The problems and challenges will be analyzed through the view, perspectives, perception, and experience of the senior managers the bank’s management, *Shari’ah* officer, finance officers, and academician.

The interviews with representatives from several important financial institutions had many years of experience in Islamic Banks. These interviews would provide a good piece of work where academic views would be brought together (i.e. Literature review) and practitioners (semi-structured interview with the Head of *Shari'ah* Department or *Shari'ah* officer and CEO). This needs the researcher to create a critical and in-depth evaluation of the views of the interviewees about the overall understanding collected from the literature study to informing the problems and challenges facing Islamic Banking and Finance in Algeria through their industry expertise and experience.

The researcher intends to make a sense of (or interpret) the significance of the issues and difficulties facing Islamic Banking and finance in Algeria that the interviewees have had. In addition, the experience of the respondents that are involved with the operation and development of IBs allows an understanding of the problems and challenges faced by IBF in Algeria. It is perceived that through this method, it is possible to generate knowledge about and evidence for the research (Mason, 2002, p: 17). Also, individuals are seen as sources of information in the sense that they are the source of knowledge, evidence, experience, and anything else that applies to the studies. Further, in answering the research questions, the researcher expects depth, nuance, complexity and roundness in the data acquisition (Mason, 2002, p: 65).

The researcher began to gather text information by segmenting significant phrases or paragraphs into categories, which were then labeled to describe the environment of individuals using particular terms, as well as categories or topics for assessment. The themes were inductively generated from the raw material (Boyatzis, 1998, cited by Noraiza, 2014). Finally, the researcher advanced the description and themes in the form of a narrative passage, interpreting and giving meaning to the data. (Creswell, 2003; 2009, cited by Noraiza, 2014).

In reference to Figure 3.6.3.1, all the steps involved in the data analysis were being done manually. When reading all the data, the researcher highlighted sections that are considered significant in categories and labeled using particular terms. At the same time, the researcher scribbled suitable terms for the sections that were highlighted. Also, in extending and promoting the highlighted sections, the researcher scribbled ideas and made remarks. Then, as code, the terms were abbreviated.

Furthermore, bias in reporting the results from qualitative interview can be eliminated and controlled by standardising the stimulus, where any variations seen in the responses will be a true measure, rather than an object of personal methods (Mason, 2002).

The interview session needs to be done with an understanding of the complexities of social interactions and not merely just performing the interview (Mason, 1996).

The findings from the in-depth interviews were presented in Chapter four, Five, Six and Seven in the form of narrative passages, which included interpretations, quotes and discussions. Where necessary, the qualification of the interviewees, and position were also mentioned in order to emphasis the facts given by participants on the topics under discussion.

3.8 Summary

The study's research methodology was described in this section. This research aims to investigate and comprehend the problems and challenges faced in Algeria by Islamic Banking and finance. It focuses on four problems, they are: legal and regulatory framework, *Shari'ah* compliance, management and accounting. In this research, a semi-structured interview was deemed suitable for achieving the goals. The semi-structured interviews were performed with different interviewees presently engaged in Islamic Banks and Windows activities in Algeria. This section also described how to collect information and analyze information in order to answer the questions presented in this research.

Theoretical Part Conclusion

Conclusion of the Part

The first chapter provides a review of the philosophy and theoretical framework of Islamic Banking and Finance. The chapter begins with a short overview of Islamic Banking and Finance institutions, followed by a discussion on the developments of Islamic and Conventional Banks in Algeria. This is then followed by a discussion about Islam and Islamic Banking highlighting *Shari'ah* values and objectives, and the theoretical framework on which Islamic Banking and Finance functions has been based.

The second chapter presents a review of the literature on the problems and challenges facing Islamic Banking and finance in relation with the Legal and Regulatory Framework, Management, *Shari'ah* Compliance, Accounting, and Auditing. The chapter starts with a review of the literature on the operations and products in Islamic Banking system, than discusses the risk management in Islamic Banks. Furthermore; it reviews literature on the problems, challenges and risks in Islamic Banks and Windows. In addition, it focuses on the Islamic Banking and its Legal and Regulatory framework. Finally, the literature on Accounting and Auditing as a system of accountability in Islamic Banks is reviewed.

The third chapter addresses the objective of this study, describes the selection of Islamic Banks and Windows in Algeria (which are the topic of studies), as well as the methodology that was developed within the ontological and epistemological context of the researcher. The layout of this research includes the use of information gathered mainly from primary sources through semi-structured interviews. In this research, semi-structured interviews were conducted to gain a more accurate understanding of the problems and challenges confronting Islamic Banks and Window in Algeria.

Practical Part:
Practical Aspects of Problems and Challenges Facing Islamic Banking and Finance in Algeria

Practical Part

Introduction of the Part

In this research, a series of semi-structured interviews were conducted by practitioners and academicians to investigate the problems and challenges facing Islamic Banking and Finance industry in Algeria. Interviews were expected to contribute to the need to inform, from the perspective of the interviewees, the problems and challenges facing the Islamic Banking and finance industry in the context of Algeria. Semi-structured interviews enable the interviewer to explore from the interviewee's view about the issues and difficulties facing Islamic Banks in Algeria through their experience and involvement in the industry.

The study examines and analysis the findings of the compliance with *Shari'ah*, regulatory framework, accounting and auditing practices, and management in Islamic Banks and Windows environment (i.e. Islamic Financial Institutions). It also seeks to collect an understanding of the problems and difficulties facing Islamic Banks and Windows in Algeria to finalize the chapter's literature review.

The fourth chapter introduces the results of the *Shari'ah* compliance problems obtained from the semi-structured interviews. It starts by outlining some *Shari'ah* issues such establishing and harmonization SSB, *Shari'ah* interpretation and implementation, then examines *Shari'ah* compliance consideration and commercially feasible in Algeria's Islamic Banking and Finance including *Shari'ah* non-compliance and other issues . Next, it deals with the paradigm between Islamic Banking's theoretical structure and its application. The chapter continues with the emphasis on resolving certain cases of *Shari'ah* non-compliance. Finally, the chapter ends with a summary of the findings and discussion.

The fifth chapter continues to discuss problems and challenges facing Islamic Banks and Windows in Algeria. It highlights and analyzes results on legal and regulatory frameworks issues and challenges. It begins with a brief Overview of Legal and Institutional Structure in Islamic Banks, than it focusses on observations concerning the existing of regulatory and legal framework environment under which Islamic Banks and Windows operate in Algeria today. Next, it highlights the need to have independent or specific legal and regulatory structures to Support the *Shari'ah* Operation; it also discusses the debate about the Need of Standardizing and Harmonizing the Accounting Standards. The chapter concludes by summarizing the findings and discussions.

The sixth chapter focuses on the results of the semi-structured interview and analyzes them in regards to the Islamic Bank's accounting and auditing scheme. This chapter is divided into three sections besides the introduction; the first section outlines the lack of impact of accounting practices and reporting on the disclosure of reliable and credible information. It begins by highlighting the role of accounting and financial practices and reporting in the communication of reliable and credible information. It then describes the current accounting situation and practices in the Islamic Banks and Windows of Algeria. The section continues to underline the lack of *Shari'ah* expertise among SSBs and scholars and concludes with the issue of having separate SA standards for Islamic Banking; the second section analyzes and discusses the findings of the *Shari'ah* audit. It discusses the lack of *Shari'ah* audit experts and the lack of external *Shari'ah* auditors; the final section summarizes the findings and the discussion of the chapter.

The seventh chapter outlines the findings and discussions on management issues in the Islamic Banking system in Algeria. It begins to discuss the findings in Human Capital (HC), highlighting certain issues related to human capital; the role of the players in ensuring the direction of IB; The lack of expertise of IBs and Windows; the lack of awareness among staff; the negative perception of the public. Next, it analyses the result from the implementation of *Shari'ah* approval procedures including pre and post-compliance processes; then, discussing the knowledge gap between scholars of *Shari'ah* and technical people concerning product approval. Finally, the section examines the results and analyses identified in management area.

Chapter Four: Interview Findings and Discussions - *Shari'ah* Compliance

4.1 Introduction

This chapter introduces the results of the *Shari'ah* compliance problems obtained from the semi-structured interviews. It starts by outlining some *Shari'ah* issues such establishment and harmonization SSB, *Shari'ah* interpretation and implementation, then examines *Shari'ah* compliance consideration and commercially viable in Algeria's Islamic Banking and Finance including *Shari’ah* non-compliance and other issues . Next, it deals with the paradigm between Islamic Banking's theoretical structure and its application. The chapter continues with the emphasis on resolving certain cases of *Shari'ah* non-compliance. Finally, the chapter ends with a summary of the findings and discussion.

4.2 *Shari'ah* Issues

The interviewees were asked to describe briefly certain *Shari'ah* issues of their concern in Islamic Banks and Windows in Algeria. They commented as follow:

"…centralization of the *Shari'ah* Supervisory Committee (only one at the national level)…" Head of Participatory Finance in Private Window

"The biggest problem is the compliance aspect." Senior Manager in Sate Window

"…interpretations need to be standardized or harmonized…" Head of Participatory Finance in State Window

Therefore, this section seeks to develop knowledge of certain *Shari'ah* issues in Islamic Banks and Windows in Algeria, which might lead to *Shari'ah* compliance. The issues we will be discussing are the centralization of *Shari'ah* Supervisory and *Shari'ah* interpretation.

4.2.1 Establishment and Harmonization of *Shari'ah* Supervisory Board

The *Shari'ah* Board (also the *Shari'ah* Supervisory Board, the Advisory Board, or the Religious Board) ensures Islamic financial products as being *Shari'ah*-compliant (i.e. in accordance with Islamic law). Because compliance with *Shari'ah* law is the underlying reason for the existence of Islamic Finance, Islamic Banks (and conventional banking institutions that offer Islamic banking products and services) should establish a *Shari'ah* Supervisory Board (SSB) to advise them on whether their products comply, and to ensure that their operations and activities comply with *Shari'ah* principles (Jamaldeen, 2012, p: 265). According to the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI): A *Shari'ah* Supervisory Board (SSB) is an independent body of specialized jurists in *Fiqh al-Mu'amalat* (Islamic commercial jurisprudence) ... The *Shari'ah* Supervisory Board is entrusted with the duty of directing, reviewing and supervising the activities of the Islamic Financial Institution ... The *Fatawas* (legal opinions) and ruling of the Board shall be binding. (AAOIFI 2005. Manama, Bahrain: Accounting and Auditing Organization for Islamic Financial Institutions). (Khan, 2013)

While sharing a common goal, *Shari'ah* boards in different jurisdictions around the Muslim world vary in problems of appointment practices, membership structure, and legal status of the decision, inner oversight, among other things. In this issue, all the interviewees agreed of the necessity and the importance of the establishment of SSB. IB CEO and others commented:

"SSB guarantees that Islamic Banking is *Shari'ah* Compliant"

"SAC and SSB will surely have a positive impact in the future on the products and services offered.**"** Senior Manager in State Window

"...in case of divergence, we have recourse to the advisory council…" Head of Participatory Finance in in Private Foreign Window

A number of *Shari'ah* advisory firms have now emerged to offer *Shari'ah* advisory services to the institutions offering Islamic financial services. The World Database for Islamic Banking and Finance (WDIBF) has been developed to provide information about all the websites related to this type of banking. In addition to the individual *Shari'ah* boards that every Islamic Financial Institution has, there are organizations that have issued guidelines and standards for *Shari'ah* compliance: Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), *Fiqh* Academy of the Organization of Islamic Cooperation (FAOIC), and Islamic Financial Services Board (IFSB). However, since Islamic financial institutions have their own SSB, they are not obliged to follow these guidelines and standards (Khan, 2013).

A number of *Shari'ah* advisory firms have emerged to offer *Shari'ah* advisory services to institutions offering Islamic financial services. Concerning the different SSBs offering services in Algeria the interviewees explained how they get SSB services. The responses varied in 3 different groups as shown in table 4.2.1.1 below.

Table 4.2.1.1 Type of *Shari'ah* Advisory Board services

Type of Islamic banking institution	**State Windows**	**Private Windows**	**Islamic Banks**
Type of *Shari'ah* Advisory Board services	• Advisory services from external academicians; • Online information; • Assistance from IBs SSB.	• Own *Shari'ah* boards; • External academician consultant.	• Own *Shari'ah* boards.

Source**:** Elaborated by the researcher

From above table, we can notice that the first group which includes 2 foreign IBs and 1 foreign Private Islamic Window have their own *Shari'ah* boards; the IBs adhere to the standards and guidelines of AAOIFI; but the Window follow different firm.

"We are subsidiary of foreign Islamic Bank, so our SSB abide the standards and guidelines of AAOIFI" *Shari'ah* Supervisor of IB

"We don't have a local SSB in our branch, it is based abroad. However, there is a full cooperation between our management and SSB abroad. We do have more freedom in making decisions." Head of Participatory Finance in Private Window

Second group that consists on one foreign Private Islamic Window does not have its own SSB. However, they get advisory services from external academicians, online information and sometimes SSB of IBs advices.

"We do not have SSB. However, we have an external academician consultant to get *Shari'ah* advisory services ….." Head of Participatory Finance of Private Window

"I navigate on the net to get information about Islamic products and *Shari'ah* advisory services." Senior Manager in Private Islamic Window

Third group includes 6 state windows which they are not operating yet (waiting for BA agreement). So they do not have SSBs or getting any *Shari'ah* advisory services at the moment, but the government is planning to launch its own *Shari'ah* board.

"As mentioned above, the Islamic Window in our bank is not yet functional. The project has not started yet due to lack of authorization from the Central Bank." Head of Participatory Finance of State Window

"We are a state-owned bank, so, there is no SSB because we are not operating yet, and we are still waiting for government agreement." Head of Participatory Finance of State Window

"….SSB has not yet installed.**"** Senior Manager in State Window

"We are still in the project phase, for the moment we do not have SSB or advisory from anyone." Head of Participatory Finance of State Window

"…Not yet established. However, the government is planning to launch the *Shari'ah* board.**"** Senior Manager in State Window

Researchers have also questioned of the independence and conflicts of interest with *Shari'ah* supervisory boards (SSBs) whose employment and compensation are determined by the same institutions (via its board of directors acting on behalf of the shareholders) whose bottom line the SSB Fatawa can make an enormous difference. At least one study has found that this arrangement "compromise(s) the independence of the SSB" (Warde, 2000 p: 236), while another found Islamic Financial Institutions "do not have practices which ensure transparency in the role and functions of the SSBs". (Grais and Pellegrini, 2006, p: 12). To this, respondents were asked to give their view about having different SSBs in Algeria. The two IBs in Algeria do not have any concern about it; however, the private and state Islamic Windows have some concerns.

"We do not see any issues with having different SSBs." *Shari'ah* Supervisor of IB

"..Having different SSBs may create problem related to the divergence of the practices of the banks and the contradiction of the legal opinions and *Fatawas*, but the "slowness" in the handling of the problems posed by banks remains a possibility not to be neglected." Head of Participatory Finance of State Window

"Yes, of course, in case of divergence, we have recourse to the advisory council.**"** Senior Manager in State Window

Then they were asked that the existence of SAC and SSB in an institution enhances the management, operation and compliance of *Shari'ah* with the products and services offered.

"As mentioned above, the Islamic Window in our bank is not yet functional. The project has not started yet due to lack of authorization from the Central Bank. But the SSB has played its role in raising the awareness of our bank senior executives to the importance of the Islamic window of resources (liabilities) or employment (assets)." Senior Manager in State Window

"SAC and SSB will surely have a positive impact in the future on the products and services offered.**"** Head of Participatory Finance of State Window

"The difference can only be observed after the start of production." Senior Manager in State Window

In most cases, it seems that the relationship of an IB's SSB with the bank is of an advisory type as the ultimate responsibility for *Shari'ah* compliance appears to lie with the bank's board of directors (Song and Oosthuizen, 2014).

Regarding the relationship at Islamic Banks and Windows Services between SSB and the Accounting and Finance Department (including the *Shari'ah* Audit), Islamic Banks interviewees had a constructive and rigorous relationship, while Islamic Windows, on the other hand, and defined it as restricted and insignificant:

"There is a comprehensive relationship between SSB and Accounting and Finance Department." IB Head of Financial Department

"The relationship between SSB and the bank's accounting department remains superficial. However, the SSB confirmed that the incomes at the agency level although is unique (Conventional and Islamic), but, in the background, there must be separate accounting entries." Head of Participatory Finance of State Window

"There is no relationship between the accounting department and the *Shari'ah* Committee. The *Shari'ah* Committee reviews the reports provided by *Shari'ah* auditor and ask to see the accountant except when needed.**"** Head of Participatory Finance of Private Window

According to academic Mohammad Abdullah Nadwi, the AAOIFI attempts to give harmony to SSB (Nadwi, Mohammad Abdullah, 2012. Analysing the Role of *Shari'ah* Supervisory Boards in Islamic Financial Institutions. p. 11). Since the advent of modern Islamic banking, the work of the *Shari'ah* boards has become more standardized. (Askari, Iqbal and Mirakhor, 2010). As of 2013, for example, the regulators in Bahrain, Indonesia, Jordan, Kuwait, Lebanon, Malaysia and Pakistan have developed guidelines for SSBs in their respective jurisdictions. Some countries, like Indonesia, Kuwait, Malaysia, Pakistan, Sudan, and the UAE have centralized SSBs (Askari et al., 2010).

Following the above-mentioned issue of SSB standardization, most of the interviewees had no objection and were in favour of the unification and centralization of SSBs in Algeria.

"We are part of global Islamic Bank so we adhere to AAOIFI standards. However, we welcome the idea of harmonizing and unifying *Shari'ah* board in Algeria." *Shari'ah* Supervisor of IB

"However, lack of harmonization between jurisdictions would further affect development and globalization of the industry." IB CEO

Thus, some Islamic private and government windows are with the idea of centralizing SSB.

"The establishment of the *Shari'ah* Advisory Council (SAC) shows a difference or improvement in the structure of the SSB in Algeria." Head of Financing Department in Islamic Private Window

"The centralization of the *Shari'ah* Supervisory Committee (one at the national level) eliminates the problem of the divergence of bank practices and the contradiction of legal opinions and *Fatawas*, but the "slowness" in dealing with the problems posed by the banks remains a possibility not to be overlooked." Head of Participatory Finance of State Window

One IB, however, opposes the concept of centralizing SSB as indicated by the IB Commercial Department Director:

"The Islamic High Council would be a handicap with more hierarchy and problems. The board of the *Shari'ah* would be enough."

"The government is planning to create national SSB" Head of Participatory Finance of State Window.

Compliance with *Shari'ah* is at the heart of all Islamic Banks and Windows activities. The *Shari'ah* governance framework in Islamic Banks is designed to achieve *Shari'ah* compliance. Two levels of *Shari'ah* governance designed at the level of the bank and industry would at least be able to help achieve harmonization in *Shari'ah*'s pronouncements and rulings.

The key decision to be made (in relation to SSBs at a bank level) is to establish a centralised SSB to oversee the governance framework of the *Shari'ah* in IBs. A centralized SSB has the advantage of harmonising *Shari'ah* rulings, decreasing *Shari'ah* and IB compliance costs. The regulator may put up a centralised SSB, or IBs may be encouraged to set up such a board together (which is applicable in secular countries where the substantive land law of the regulator prevents immediate participation in *Shari'ah* issues).

In addition, a centralised model, a national body such as a central bank or capital market regulator establishes a *Shari'ah* board that is independent from financial institutions. This body can provide both guidance and oversight, and serve as an arbitrator providing final rulings in the event of disputes among *Shari'ah* boards of Islamic Banks. The centralized model is increasingly being adopted across the industry, with Oman and Bahrain having established national *Shari'ah* boards in the past year. The United Arab Emirates and newcomer Kenya have also proposed setting up similar bodies. Malaysia, Indonesia and Pakistan have centralized *Shari'ah* boards, but the way in which they operate can vary. The new standard aims to help define those roles and responsibilities, addressing issues such as optimal board composition, fit and proper criteria of scholars, as well as enforceability of rulings. Islamic Finance sets sights on centralized *Shari'ah* boards (Bernardo Vizcaino, 2010).

4.2.2 Role and Efforts of the *Shari'ah* Board

The existing SC appointed by the Islamic Banks and Windows comprise of expertise from comprehensive areas of expertise. The blend of knowledge is expected to open wider avenues for *Shari'ah* pronouncement and rulings. Although they have a blend of knowledge, they may still lack dual knowledge of expertise. Thus, they are still dependent on technical expertise to understand technical matters in order to operationalize the products approved.

However, the establishment of SBs is aimed for improving the performance of Islamic Banks. Also, they are appointed to ensure that all Islamic banks fully comply with the principles of *Shari'ah*. It is a council to safeguard the *Shari'ah* and give confidence and assurance to the stakeholders that the products are *Shari'ah* compliant. The *Shari'ah* Supervisor of IB highlighted that:

"…The roles of SC are more on *Shari'ah* governance to ensure that the principles have been complied by all IBs. This is very important because Islamic Banks are governed by *Shari'ah*. So, their role is to ensure that all Islamic Banks fully comply with the principles of *Shari'ah*. However, in Algeria, we don't have a centralized *Shari'ah* Supervisory Board. Some may argue that their roles can impede the performance because sometimes IB cannot apply everything that they plan to do, as it contravenes *Shari'ah* principles. In addition, when there is a conflict between *Shari'ah* and money, *Shari'ah* will prevail. It serves as an authority to ensure and safeguard the *Shari'ah* principles in line with the interest of stakeholders who demand confidence and assurance that the entire products are *Shari'ah* compliant. *Shari'ah* compliance is assured at two levels of governance, at the respective individual bank, and at the parent bank."

"The role of the SSB will be to rule on all *Shari'ah* matters from the *Halal* or *Haram* point of view, so it will have a central role in the activities of Islamic Finance." Head of Participatory Finance of State Window

The existence of the SAC and the SSB in an establishment improves the management, operation and compliance of the products and services offered by the *Shari'ah*. The Head of Participatory Finance State Window gave a description of the improvement that is taking place.

"As noted above, our bank Islamic window is not yet functional. The project has not yet started due to the Central Bank's authorization. But the SSB has played its role in raising awareness among the bank's senior managers of the importance of the Islamic Window in terms of resources (passive products) or employment (asset products)."

"The SAC and the SSB will certainly have a positive effect in the future on the products and facilities offered." State Window Senior Manager

The presence of SBs in Islamic banking and finance would help in the domestic harmonization of *Shari'ah* doctrines. It is considered in the future that such a committee will promote the industry's growth and innovation.

4.2.3 Interpretation of *Shari'ah*

In this subsection, we are going to focus on the respondent's views on *Shari'ah* interpretations.

The *Shari'ah* interpretations are the legal rulings applied in today's Islamic banking and finance, arrived at by using one or the other of four different techniques, namely: interpretations of the revealed sources (*Ijtihad*), choice (*Ikhtiyar*), necessity (*Dharura*), and artifice (*Hila*) (Venardos, 2006). The selections of one technique over another are used to obtain more *Fiqh* rulings (Venardos, 2006). Different schools of thoughts would have different methods of interpreting the *Shari'ah* laws. Besides numerous techniques to derive the *Fiqh* rulings, the different interpretations may occur to accommodate *Shari'ah* principles to the existing legal system and custom of a particular country (Venardos, 2006).

Since there are no comprehensive lists of what is permitted in Islamic business transactions, discussions (*Ijtihad*) will be held between '*Ulama* (scholars) to determine the lawfulness of certain decisions in respect of a business transaction. The scholars' opinions will be binding on Muslims when running Islamic Banks in the framework of Islamic Banks. The academics will take into account multiple elements when reaching the agreed views (*Ijma'*). However, other scholars will take into account schools of thought (i.e. *Math'hab*), jurisdiction, public perception, culture, custom, market convention, land law, etc. Because these variables vary from one jurisdiction to another jurisdiction, the academics make distinct views or interpretations of *Shari'ah*.

We will encounter in the Islamic banking industry that local *Shari'ah* scholars will make different interpretations based on their location, resulting in different products being offered in some countries. The different interpretations lead to problems in the worldwide market offering of Islamic banking goods. Different interpretations in accounting led in varying ways of recording and classifying banking transactions, making it difficult to evaluate the annual report for Islamic Banks operating in distinct nations. The different interpretations of *Shari'ah* effect Algerian Islamic Banks and Windows if they decide to offer their products in the international market. IB's CEO and foreign Islamic Window's Head of Participatory Finance identified the importance of consolidating *Shari'ah* interpretation to address the global industry.

"As far as we are concerned, to date, the different *Shari'ah* interpretation doesn't impact us so much. We don't do many international transactions."

"Due to differences in interpretation, In Malaysia and Turkey are approving certain products that are rejected in Algeria. This raises the need to harmonize *Shari'ah* interpretation."

Thus, difficulties faced by Islamic Banks and Windows due to different interpretations have an effect on the international scale. In the other hand, we asked the interviewees whether the different *Shari'ah* interpretations of Islamic Banks in Algeria have an impact.

"As far as we are concerned, to date, the different *Shari'ah* interpretation doesn't impact us so much...Thus; I don't think the differences in *Shari'ah* opinion will affect us so much." IB CEO

"As Algeria is *Maliki Math'hab*, we are not having problems with *Shari'ah* interpretation at the moment. Furthermore, we expressed our willingness to the government to harmonize the interpretation of the *Shari'ah*" Head of Participatory Finance of Private Window

However, the inconsistency of *Shari'ah* interpretation given by the SSB related to principles governing products and services is due to the diversity of opinion as to whether particular practices or products are *Shari'ah* compliant (Ainley et al., 2007; Wilson, 2007). Variant *Shari'ah* advisory boards may differ over details such as the legal status of the rulings and internal supervision. The differences in the *Shari'ah* interpretation may involve numerous rulings on similar practices between SSB of different banks and SSB of different jurisdictions (Ainley et al., 2007; Mohd Ariffin, 2005). This results in some products and services to be approved as being *Shari'ah* compliant by some *Shari'ah* scholars but not by others (Ainley et al., 2007; Errico and Farahbaksh, 1998). Furthermore, the issue of different interpretation of *Shari'ah* advisory board is also highlighted by (Chapra and Khan, 2000; Chowdhury, 2015; Hassan 2012; Iqbal, 1997; Kahf, 2002; Khan, 2007; Khan et al. 2015; Rammal 2006).

In this context, interviewees commented on *Shari'ah* interpretations and decisions made by SSB, a Head of Participatory Finance of Private Window raised again the problem discussed earlier about the relationship between SSB and management.

"Initially, the opinions, decisions, and interpretations of SSB members are far from the banking reality. First, they had to explain the process of conventional products before they pronounce on compliance. This allows them to reconcile the classic product with its Islamic equivalent, and thus to issue a subjective opinion. The goal is to find an "alternative" Islamic product or service that can replace or supplement the classic product."

"Decisions made by the SSB are always based on explanations provided by the bank." Senior Manager in Private Window

"*Shari'ah* repository, *Shari'ah* Committee charter, *Shari'ah* audit performance, activity-specific procedures, and regulatory accounting framework to ensure good progress of Islamic Windows.**"** Head of Participatory Finance in Private Window

Also, latest studies such as Ahmad (2016) have highlighted calls for *Shari'ah* scholar qualification to be established as an accredited, central award body to promote standardized rulings and improve the level of expertise in the Islamic Financial System. The replies extracted from the interviewees indicate that there is an agreement among all of them that important progress needs to be made towards the development of an outstanding fundamental regulatory structure.

"Establishment of a *Shari'ah* scholar's council is crucial in Algeria." Head of Participatory Finance of State Window

The standardization of interpretations are expected to clarify the functions of Islamic banking and may assist in clearing the way for more coherent regulation, and better understanding and acceptance of Islamic banking as a serious competitor to conventional banking systems (Ainley et al., 2007, Abd Razak, 2018).

Muslim and Zaidi (2008), on the other side, noted that in regards to full and total harmonization of *Shari'ah* standards, the *Shari'ah* scholars are in the view that the harmonization would prevent the dynamism of *Shari'ah* law to ensure its suitability in applying the *Ijtihad* procedures. Furthermore, since each religious board may have its preferences or adhere to a different school of thought (Iqbal and Mirakhor, 1999), the harmonization of *Shari'ah* rulings may mean the precedence of one school of thought over the other, which cannot be universally acceptable. The interviewees gave their views about the need to standardize or harmonize interpretations of *Shari'ah* in Algeria. All of them agreed that the interpretation of *Shari'ah* should be harmonized as the respondents stated:

"…Of course, and to guarantee the credibility of Islamic banking products and services and their customer acceptance." Senior Manager in Private Window

"…Yes, interpretations need to be standardized or harmonized." Senior Manager in State Window

"…I think so, *Fatawas* must be agreed upon." Head of Participatory Finance of Private Window

"In Algeria, it is feasible; however, the issue of harmonizing Interpretation of *Shari'ah* is difficult." IB SSB

"The usefulness of standardizing and harmonizing *Shari'ah* interpretations is purely qualitative, intending to improve banking benefits." Senior Manager in State Window

"Standardization and harmonization of *Shari'ah* interpretations eliminate differences in banking practices, thereby reinforcing the credibility of the product concerning the customer." Head of Participatory Finance in State Window

"…Standardization usefulness: customer perception…" Head of Participatory Finance in Private Window

"Due to differences in interpretation, Middle Eastern countries are rejecting certain products that are approved in Algeria. This raises the need to harmonize *Shari'ah* interpretation." Head of Participatory Finance in Private Window

Algeria has not made any attempt to fill the gaps in *Shari'ah* interpretations with the conduct of Islamic Banking business among *Shari'ah* scholars in different parts of the world. The point of view of Algeria's government is that Algeria has no problem with this issue because it follows one school of thought (*Maliki*) and has its scholars to interpret *Shari'ah*. However, the Algerian government established the Higher Islamic Council at the end of 2017, which acknowledged that the envisaged Islamic banking model in Algeria based on the principles "no reward without risk" and "income bound to obligation," is *Shari'ah*-compliant. The council also pushed for the creation of a central *Shari'ah* board within the central bank to overview all issues related to Islamic Finance and *Shari'ah* compliance. This opened the way to draw the said Islamic banking framework due to be launched in November 2018 and bring the country a big step forward on its Islamic Finance roadmap. "The end of 2017 into early 2018 should see efforts to establish a national *Shari'ah* board, with the six state-run banks signaling their intentions to begin offering Islamic financial services over the same period." CEO BADR. However, until now none of the above plans has been put to practice.

"According to my convictions, there is still a lot of work to be done in this direction." Senior Manager in State Window

"No effort has been made in the issue." Head of Participatory Finance of Private Window

"There's nothing we can say about this issue." Head of Participatory Finance of State Window

Shari'ah interpretation is the interpretation of *Shari'ah* Laws. The interpretation is based on culture, customs and law of the land. Furthermore, it's based on the existence of different school of thoughts. In addition, different *Shari'ah* interpretation is due to different culture, customs and law of the land. As a result, numerous practices and application of contracts exists across continents and countries. .

4.3 Consideration of *Shari'ah* Compliance and Commercial Viability in Islamic Banking and Finance in Algeria

4.3.1 Interpretation and implementation of *Shari'ah* Compliance and Commercial Viability

Importance of *Shari'ah* Compliance: In the previous chapters, we stated that the establishment of Islamic Banks is governed by the principles of *Shari'ah*. The requirements of the *Shari'ah* laid the unique principles of Islamic Banks that distinguish them from their conventional counterparts. Furthermore, since *Shari'ah* is the primary cause of the institution, it is important to comply with its requirements as it will be able to maintain its competitiveness and viability. Hence, it is essential to ensure adherence to the *Shari'ah* in its activities, management, and products and services. In addition, *Shari'ah* will assist the banks in preserving their image and reputation. In its comment on the *Shari'ah* Compliance, the Head of commercial Department of Foreign Islamic Bank asserted:

"The IBs have an enormous responsibility and accountability to ensure the *Shari'ah*'s compliance. It is also the focus of stakeholders when discussing the image and reputation of the bank."

The Head of Department of the Participatory Window in a state-owned bank added:

"*Shari'ah* Compliance is a key element in the establishment of Islamic Banks and Windows' system"

The same opinion was shared by the Head of Private Participatory Finance Window,

"The importance of compliance with *Shari'ah* is the foundation of any healthy Islamic Financial System."

Thus, for Islamic Banks and Windows, *Shari'ah* compliance is the main risk that they have to account for in everything because if the bank is perceived to being not compliant with *Shari'ah* this is, in a way, very damaging to the bank and the bank's reputation. In addition, there will be a huge loss of business as well; therefore, it is one of the main and very important risks that the bank has to control and manage efficiently. In fact, in the interviews conducted, the interviewees stated the significance of *Shari'ah* in the IB as an integral and very vital part for the legality of the transactions and operations of IBs and Windows. According to the SC in IB, the *Shari'ah* Compliance:

"…is the vital requirement. The contracts in IB are based on *Shari'ah* and SC must approve it or else the contract is void. If the contract is not *Shari'ah* compliant, it is not legal."

The head of the IB Department confirmed the view that "*Shari'ah* Compliance is essential; none of the products can be marketed without the (SCC) *Shari'ah* Committee Certification agreement."

It is also essential for organizations to create an adequate *Shari'ah* governance framework to guarantee adherence to *Shari'ah*, which would represent the credibility of IBs and Windows. The Head of Department of a Private Window highlighted that:

"*Shari'ah* is a fundamental component in Islamic Banks and Windows. Besides, it is essential to ensure *Shari'ah* adherence. If *Shari'ah* is not maintained and received complete attention, it will defeat the objective. If the bank or the window breaches the values of *Shari'ah*, it will be regarded non- *Shari'ah* compliance."

CEO of IB expressed his view about the same issue as:

"With regard to our bank, we're proud to be a *Shari'ah*-compliant bank. When we talk about it, we're talking about faith banking. One thing you need to be clear about in Islamic banking; you can't find a way around anything that doesn't comply with *Shari'ah*. *Shari'ah* is the most significant marketing motif and we are bound by *Shari'ah*. We take pride in checking and upholding *Shari'ah* as our priority in whatever we do. *Shari'ah* plays the main role in this institution in terms of going forward."

The factors that may influence the compliance of the *Shari'ah*, SC member of IB said:

"In addition to excellent relations with the CEO and management, I understand that the SC has no issue with the Board in most banks. The top management will help implement what is specified by SC."

A *Shari'ah* board member of the same IB affirmed the above statement:

"…I am pleased that the CEO offers the SC complete autonomy and power in this organization to review, monitor, and examine the extent to which a certain activity complies with *Shari'ah*. Furthermore, we will provide remarks accordingly."

The SC statements indicate even though they may face problems with deliberation and debate in ensuring *Shari'ah* compliance with the products and services provided by IB, they have complete assistance from the CEO where they have excellent communication, and full power and autonomy to make decisions and fulfill their responsibilities and accountability. It may help the SC in deciding on the *Shari'ah* product compliance decision.

Moreover, IB CEO expressed his understanding of compliance with *Shari'ah*, and he and his team would not impact SC's decision-making process. This ensures that the SC's decision is based exclusively on *Shari'ah* rather than on top leadership.

"In terms of communicating with the SC, we explain to them, and they will apply the relevant fundamental *Shari'ah* requirement to the topic as they understand what is being transmitted."

However, different respondents pointed out that certain factors of influence are ideological, financial, legal…etc.

"…The ideological factor that is related to theological influences…Financial factor (material influences)…" Private Window Senior Manager

State Window Senior Manager added "…Adapting to certain demands that do not meet the *Shari'a*h criteria. Example; business insurance undertaking in the absence of *Takaful* funds when speaking about *Murabahah* and *Ijarah* financing guarantees…"

"A multitude of factors that influence compliance with the *Shari'ah*, such as the legal factor, the micro, and macro-economic environment, may be distinguished." State Window Senior Manager

According to Private Window Head of Participatory Finance, the "primary basis" of the *Shari'ah* compliance process through Islamic Windows is:

"…the ideology of "*Fuqaha*" and their orientations."

4.3.2. Commercial Viability: In addition to establishing compliance with *Shari'ah*, it is also important to ensure its commercial viability. Commercially viable institutions would have high returns and would be able to provide their shareholders and customers with good returns. This would result in high amounts of *Zakat* paid and can be beneficial to the society. A member of *Shari'ah* Board of IB stressed that, in addition to *Shari'ah* Compliance, the need to ensure that the IB is viable and can make a good return is equally important in establishing its credibility.

"Banks need to show a healthy image to their shareholders and stakeholders. Although, generally speaking, customers or the public will refer to the profit and other numbers that represent its performance. Nevertheless, in the worldly context, we are not looking for a profit, but we are looking for a profit in receiving blessings from *Allah*."

Moreover, if the authorized *Shari'ah* compliant item is not commercially viable in the market, Islamic Financial Institutions may experience a circumstance. The organizations must explore other alternative products in this circumstance, and the introduction of the fresh authorized item must be maintained. The organizations must, therefore, guarantee that the products provided are products that comply with *Shari'ah* and are viable for marketing. To meet these specifications, organizations keep products equivalent to standard banking products as they are more familiar to the public. IB CEO responded by saying:

"IB's challenge is to be commercially viable and consistent with *Shari'ah*."

Also, other SC in IBs backed this view.

"Meeting the demand for both conventionally viable and competitive, and achieving the ideals under the goals of the *Shari'ah* and the *Shari'ah* at the same time is challenging."

Moreover, the Head of Participatory Finance of Private Islamic Window said that based on his knowledge; there is an example where, although the product is commercially compatible with *Shari'ah*, but it is not accepted by BA due to their shortage in understanding Islamic products. This underlines that the Head of Participatory Finance is very clear about the establishment's goal and dedicated to ensuring that compliance with *Shari'ah* is maintained in Islamic Window. The same view shared by Financing Director in IB, he highlighted:

"We are finding difficulties in approving our products. BA keeps rejecting our products due to the lack of understanding Islamic products."

Also, the SC of the Islamic Private Window agrees that top management is aware of and concerned about the importance of *Shari'ah* compliance. The CEO of this Bank stated that:

"I am very clear when I explained to the SC that I do not want to influence them to make any decisions on our behalf and compromise with the *Shari'ah* issues. Although, conventionally, I want SC to decide in our favour, but sometimes we cannot decide anything commercially in our favour, because of *Shari'ah* values…"

Muslim and Zaidi (2008) discuss the above scenarios as the difficulty of synchronizing business ideas and compliance with *Shari'ah*. It is compounded by the existence of multiple interrelationships between the *Shari'ah* Supervisory Board of an Islamic institution and the management, external auditor and the Audit and Review Committee. Furthermore, the Head of Participatory Finance of the Private Window also agrees that there is enhanced awareness and worries about the significance of *Shari'ah* compliance by the top leadership of the IB.

"If you are in Islamic Window, you are similarly worried about the element of *Shari'ah*."

IB's CEO also points out that the SC may approve a product as a *Shari'ah* compliant product, but it may not be on the market as it may not be approved by the Central Bank because of its viability and commercial value. Most of the time, banks would focus on the product's commercial viability and not on the real economic benefits that the Islamic Financial System can gain. Besides, IB must follow all that is dictated by the Central Bank.

"However, there are many instances where the *Shari'ah* will prevail if there is a conflict between the *Shari'ah* and business concerns dictated by the Central Bank, but at the end of the day, the products or services may not go through because the Central Bank has not approved it."

The top management must therefore comply with the BA guidelines. In this issue, the SSB of IB mentions that:

"... The stakeholders and the government must be willing to take IB to the next level so that IB can move directly to the correct point. It has to be a concerted undertaking and we are going to face a lot of difficulties... We also need perseverance along the path. It may not be ideal, though, but it may be improvised and modified."

As an employee, SSB of IB is bound to fulfil the interest of the owners and shareholders. He is an agent for them and the employee needs to deliver in accordance with the owner's interest. In addition, IB should also be streamlined to ensure the achievement of the socioeconomic objectives of an Islamic society (Ahmad, 1991; Siddiqui, 2001). Islamic Banks must not deviate from their initial goals (i.e. *Maqasid as-Shari'ah*) apart from pursuing earnings, according to the Islamic Bank's SSB. It is therefore essential to ensure that shareholders and clients' requirements are met and that *Shari'ah*'s goal is achieved. A *Shari'ah* supervisor in IB also supported this view.

"… We do Islamic banking to adhere to the ruling that *Allah* has given in terms of trade not for pure profit. We need to be very evident about that. It will lead us to deviate from the initial goals if we are not very evident."

A CEO of Islamic Bank added:

"…Islamic Banks go beyond profit gain. It is also expected that the problems of society will be resolved with the profit gained."

It is obvious from the above that the players know the goals of *Shari'ah* governance in upholding the *Shari'ah* standards and ensuring that IBs are commercially feasible. The awareness of the market player on both objectives is very clear. However, players may face challenges and problems in ensuring that both goals are met, as there is the possibility of prioritizing commercially feasible products compared to *Shari'ah* and *Shari'ah* oriented products. Furthermore, IB operation should also focus on achieving the *Shari'ah* goal (i.e. *Maqasid as-Shari'ah*). Thereby, the top management in the sector has distinctly different methods in managing the organizations in distinct governance structures of Islamic Banks.

An academician form the International Center of Islamic Finance (INCEIF) in Malaysia commented on the issue of *Shari'ah* compliance and commercial viability that:

"Commercialization activities are more emphasized than meeting the objectives of its establishment. This is supported by Mirakhor (2015) where he opines that IB is playing safe in ensuring the viability of banking business by not taking too many risks. Also, he stated that by playing safe, IB did not portray that they achieved market depth that will ensure long term profitability and survival (Mirakhor, 2015). It creates another challenge in the IB industry to ensure that the IB is *Shari'ah* compliant and commercially viable. Being *Shari'ah* compliant is part of the initial objective of the establishment and being commercially viable is part of the nature of commercial institutions. *Shari'ah* compliant is ensuring that all aspects of its operation, management, products and services are in line with everything stipulated in *Shari'ah* principles. On the other hand, commercially viable institutions would entail high returns and would manage to give good returns to its shareholders and customers. In addition, high returns would result in high amounts of *Zakat* paid and can be beneficial to the society."

4.3.3 Issues Concerning *Shari'ah* Non-Compliance

Shari'ah non-compliance risk has been defined as "The risk that arises from the bank's failure to comply with the *Shari'ah* rules and principles determined by the relevant *Shari'ah* regulatory councils". (Islamic Financial Services Board, IFSB). *Shari'ah* non-compliance will lead to a number of consequences such as higher cost, financial losses, liquidity problems, bank runs, bank failure, industry smearing and financial instability (Ginena, 2014).

Currently, it is difficult to measure the *Shari'ah* compliance risk, as financing and investing activities are not standardised across IBs (Ariss and Sarieddine, 2007). According to a Senior Manager of State Window, *Shari'ah* non-compliance contributes to ambiguity so that the agreements or products are cancelled.

"The risks of non-compliance with the *Shari'ah* can be summarized in the following: A transaction (*Murabahah*, *Ijarah* or *Mudharabah*) may have elements of uncertainty or ambiguity if the contract is not properly informed… The nature of the assets that must be lawful and consistent with the principles of Participatory Finance (speaking of *Murabahah* and *Ijarah*)… The asset is non-existent at the time of sale by the seller or the bank (speaking of *Murabahah*)… The seller and the customer can sometimes be the same person, speaking of the *Murabahah* (*Bai' al-'ina*)… Signature of the *Murabahah* sales contract with the customer before the Bank acquires the asset"

"… There is the uncertainty of the viability of the *Shari'ah* based product (i.e. Profit and loss sharing product such as *Musharakah*). The uncertainty faced by the Islamic Banks leads the bank to act like CB." IB Head of Commercial Department

However, a Senior Managers State Windows stated (This window is waiting for the BA agreement to be launched, even though currently they are offering Islamic services in some way):

"Means for measuring *Shari'ah* compliance risk will be put in place once the window is activated."

"In order to control *Shari'ah* non-compliance risks, the management should monitor the implementation stage. The establishment of a *Shari'ah* manual may reduce the exposure of *Shari'ah* non-compliance risks".

The Issue of Ex-ante and Ex-post Compliance

In order to ensure the *Shari'ah* compliance of Islamic banking operations, the industry is equipped with arrangements, both internal and external to the institution; ex-ante compliance and ex-post compliance (Abdul-Rahman, 2008). Dusuki and Abdullah (2007) further elaborated on the ex-ante compliance as being the *Shari'ah* compliance of product and validity and permissibility of contracts from *Shari'ah* perspectives. Since ex-ante relates to the validity and permissibility of the products and services, Abdul-Rahman (2008) asserts that ex-ante compliance relates to the SSBs' supervision, monitoring and control tasks that take place before and during implementation of the bank's dealings. This would involve *Shari'ah* compliance at different stages that are (1) the designing of the contract (2) the process of the transactions, (3) the conclusion and execution of the contract, (4) the implementation of the terms of the contract and (5) the liquidation (Abdul-Rahman, 2008).

Interviewees were asked about the measures taken to ensure *Shari'ah*'s compliance with Islamic banking operations, a Senior Manager of State Islamic Window stated:

"The compliance function is managed by setting up the following buildings within the bank:

- A *Shari'ah* Compliance Committee (SCC) composed of '*Ulama*s specialists in the field of business affairs (*Fiqh al-Mua'malat*), independent and external to the bank;
- A "*Shari'ah* Governance Subcommittee" within the Audit Committee;
- A *Shari'ah* Department of Compliance with two services:
    - Compliance and Relationship Services with the SCC;
    - Audit, Research, and Supervisory Services.
- The creation of a Department of Permanent Control of Participatory Products.
- The issues and challenges that accompany the *Shari'ah* compliance process (i.e., ex-ante and ex-post)."

His colleague responded by saying: "We have not yet defined the compliance management policy." Senior Manager of State Window

"As already stated, the compliance policy has not yet been defined." Senior Manager of State Window

"Nothing is formalized, except consulting the consultant." Senior Manager of Private Window

4.4 Paradigms between Islamic Banking's Theoretical Structure and its Application

With respect to implementation, various interviewees indicated that there are differences in implementation compared to the *Shari'ah* Board's approval. Several interviewees highlighted the influence of the educational background and experience on the way human capital implements the approved *Shari'ah* procedures. The respondents shared the same view on this issue as follows:

"We lack human capital that operates in the Islamic Bank or Window and understands Islamic Financial Services' entire philosophy. Islamic Banks and Windows' staff normally worked in the conventional bank. Therefore, they are conventional bankers who move to an Islamic Bank to work."

In addition, the absence of recognition of the theoretical elements of the fundamental ideas can be obtained from the interviewees. The following are quotations from different IBs and Islamic Windows interviewees on their interest and knowledge of Islamic banking implementation:

"We learn about *Mudharabah*, *Musharakah*, we learn about the various *Ijarah* types and others. But it is done differently when it comes to implementation, so you need to mix between the two; between the theoretical elements and how they are applied." IB Credit Director

"Of course, there will always be problems implementing anything because you're trying to make something new work, and people will always be reluctant to change the way they do things because they feel it's more burdensome." Head of Finance and Accounting Department in Private Islamic Window

"…lack of reference *Shari'ah* and *Shari'ah* consultants with a double knowledge in *Fiqh Al-Muamalat* and banking techniques especially when launching new products." Head of Participatory Finance of Private Window

Different interview sessions highlighted the duality between the theoretical underlying values and practical issues. This issue is being constantly underlined, and it has been the SC's concern about human capital's inability to comprehend and appreciate the theoretical and practical elements that would lead to errors in execution that would breach *Shari'ah* compliance. Although the players may not make errors in the execution phase intentionally, any misconduct of the processes and procedures will lead to the risk of non-*Shari'ah* compliance and to the rise of *Shari'ah* problems that effect *Shari'ah* compliance achievement. Moreover, it will undermine Islamic Banks' legitimacy and efficiency.

SC's repetitive challenges are similar to the significance of this issue. The constant emphasis on personnel's difficulties in appreciating the distinction between Islamic Banks' theory and practice increases the significance of getting staff who comprehend technical and *Shari'ah* issues. Through understanding Islamic Banks' theory and implementation, it would ensure that the mindset, ethics and staff's importance are directed toward fulfilling the goals, tasks, and vision that are under *Shari'ah*'s objectives. Therefore, awareness of human capital is required to demonstrate that their procedures are in agreement with the *Shari'ah.*

The more current Islamic banking practices diverge from the paradigm version, the more IB loses their distinctive features and tends to resemble Conventional Banks (Zainol and Shaari, 2008).

4.5 Solution for *Shari'ah* Non-Compliance Cases

IBs discussed problems related to the channeling of revenue from non- *Shari'ah* adherence to government funds and charities. One of the Islamic Banks CEO described how they and other Banks and Windows would handle unlawful revenue as follows:

"I understand that in other banks, not necessarily in Algeria, but worldwide, they meet those cases where they do the annual report and look at some of that transaction, they discover that there is some non-compliance that they usually do not recognize the transaction resulting from non-compliant operations, so they have to give that income to charity. So, these are some of the cases we've experienced in non-compliance cases."

IB Credit Director gave an illustration of the money taken from impermissible operations, which are in line with the above declaration:

"At first, our bank did not apply delay penalties, but after customers had neglected to do so, we had to apply them to raise awareness. Then, the delay penalties money is given to charity."

The problems highlighted earlier were directly related to the implementation factor; whereby, the implementer had wrongly operationalized the contracts of the products and services which resulted in the problems regarding non-*Halal* earnings.

The implication of non-*Shari'ah* compliance can be categorized into two groups: non-financial impact and financial impact (Chik, 2011). The non-financial impacts are against the commands of *Allah*, devoid from *Allah*'s blessing or *Barakah* and are contravention of the provision of the Islamic Banking Act 1983 (Section 3 (5) (a) & Section 4).

In the case of Islamic banking, non-financial impacts can jeopardize their reputation as an IFI (Chik, 2011). On the other hand, the financial impacts are invalidation of contracts ('*Aqad*), non-*Halal* income and capital adequacy ratio (CAR) as per IFSB, subject to regulatory decision (Chik, 2011).

4.6 Summary

However, various problems and challenges occur in providing support in terms of infrastructure and guaranteeing the compliance in operations, products and services. The basic themes that relate to the *Shari'ah* compliance are the interpretations *Fatawas* and guidelines, ex-ante *Shari’ah* Compliance (proposal, deliberate, approve) and ex-post *Shari’ah* Compliance (implementation).

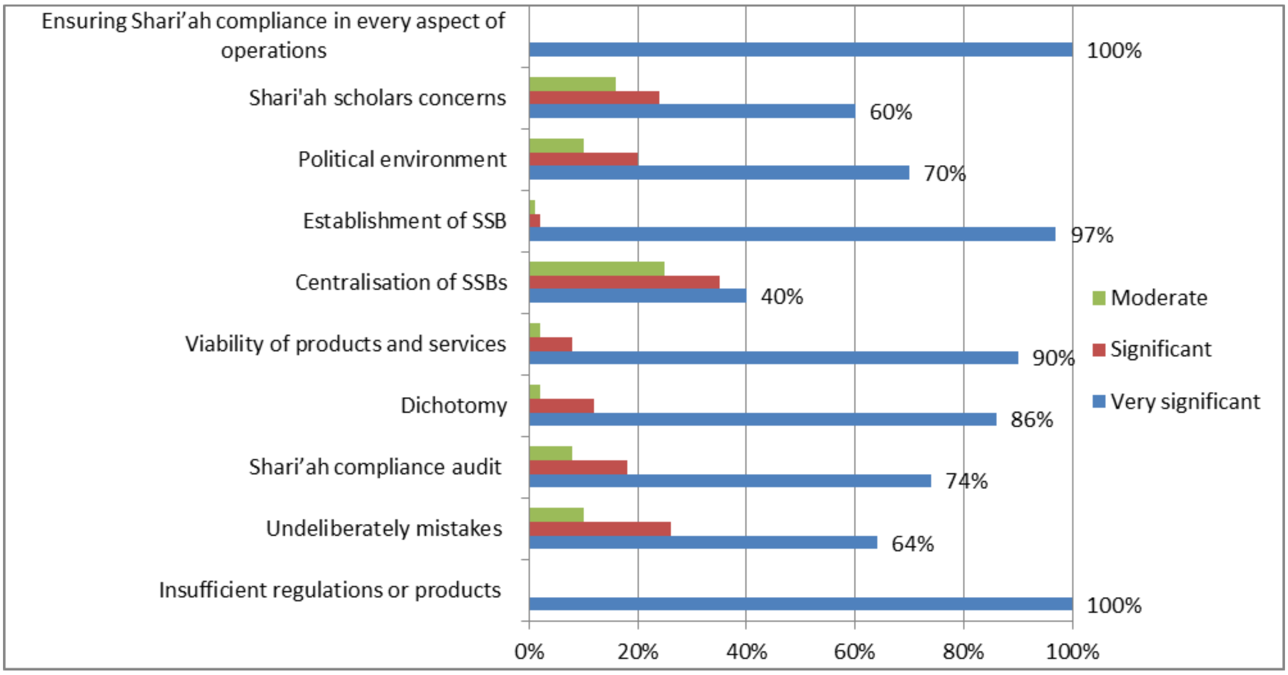
All the respondents emphasised the importance of ensuring *Shari’ah* compliance in every aspect of operations, products and services of Islamic Banks. However, different groups of interviewees portrayed numerous views and perspectives regarding compliance. In reference to *Shari’ah* scholars, they were more concerned with the differences between theory and practice, since the theory was based on religion and it is crucial to uphold *Shari’ah* principles. The *Shari’ah* principles must be maintained as they are the root of the system. Moreover, upholding *Shari’ah* principles will consequently lead to the achievement of *Shari’ah* objectives, which will then guarantee the welfare of society.

CEOs had shown their awareness on the need and importance of *Shari’ah* compliance in all aspects of operations. However, in terms of products and services, *Shari’ah* compliance was not the sole criteria in the offered products.

The key decision to be made (in relation to SSBs at a bank level) is to establish a centralized SSB to oversee the governance framework of the *Shari'ah* in IBs. A centralized SSB has the advantage of harmonizing *Shari'ah* rulings, decreasing *Shari'ah* and IB compliance costs. The regulator may put up a centralized SSB, or IBs may be encouraged to set up such a board together (which is applicable in secular countries where the substantive land law of the regulator prevents immediate participation in *Shari'ah* issues). In some jurisdictions (e.g., Sudan, Turkey, the United Arab Emirates) the centralized SSBs has been set up as an independent public institution, while in others (e.g., Afghanistan, Bahrain, Malaysia, Pakistan, and Palestine), the SSB has been set up at the central bank (Song and Oosthuizen, 2014). SSBs also tend to differ in their mandate and accountability to the IBs’ board of directors.

The main problems and challenges related to *Shari'ah* Compliance are shown in the figure 4.6.1 below.

Figure 4.6.1 Problems and challenges related to *Shari'ah* Compliance



Source: Elaborated by the researcher

Firstly, the inconsistency in interpretation of *Shari'ah* in the Algerian industry is not seen as a problem and it is harmonized and controlled by the existence of SC. Currently, Algerian IB only commercialize their product in the local market. In the event that they decide to market their product globally, they will do modification towards the products and services in accordance to the selected jurisdiction. The competition exists between local Islamic Banks, Private Islamic Windows and State-owned Islamic Windows. Also, nowadays various Islamic Banks are being introduced in foreign countries such as Europe, United States of America, Hong Kong, China, etc., that increase the competition in the industry. Thus, in the future, lack of harmonization will further affect development and globalization of the industry. Also, calls for the harmonization will assist in terms of financial reporting and users of financial statement to make a comparison of performance between IB in different jurisdictions.

Another important element was the viability of products and services. If a product that was well-developed and approved in terms of *Shari'ah* compliance was not viable in the market, the offered product would then be held. CEOs are responsible to shareholders and other stakeholders; thus, it is crucial for them to ensure *Shari'ah* compliance and business performance. On the other hand, *Shari'ah* scholars possessed a different aspiration. They were more focused on guaranteeing that the objectives of *Shari'ah* are achieved, and that the public would enjoy the benefits.

Findings regarding problems among the human capital to appreciate and understand the dichotomy between theoretical and practical aspects of innovating and implementing products and services, resulted in the misunderstanding of *Shari'ah* related matters. In addition, the existence of non-*Shari'ah* compliance cases heightened the need to have the *Shari'ah* compliance audit in the context of product implementation. Auditing will assist the institution to guarantee what is being deliberated by the *Shari'ah* Advisors, is being implemented correctly and accordingly. Thus, IB requires SA practices, in addition to financial audit practices.

Various evidences from the *Shari'ah* review process reported by the *Shari'ah* Committee and the *Shari'ah* officers show that there is evidence of *Shari'ah* non-compliance where the mistakes were not deliberately done. Various reasons have been discussed earlier such as educational background, experience and lack of knowledge about the operation of Islamic Banks. The problems of non-compliance with implementation of products and services need to be curbed to ensure that IB is able to maintain their credibility as an Islamic Financial Institution.

There are still factors that hinder the IB to offer such products, such as insufficient regulations, or products not favored by the customers due to its high risk and involvement in long-term financing.

However, it is being argued by academician in Islamic economics that, although such products may appeared to be *Shari'ah* compliant, it is lacking of macroeconomic impact that lead to fulfilment of the objective of *Shari'ah*.

Since, more debt-based product than equity based product, more efforts are needed in order to gradually introduce *Shari'ah* based products and services in order to open up possibilities and opportunities for the public to engage with banking and financial activities. In addition, the *Shari'ah* scholars further voiced out that on the need to have IB's products that are more *Shari'ah* compliant. The *Shari'ah* committee terms it as greener product. Thus, it is a call to have products that are based on the *Shari'ah* principles (i.e. value-based system).

Furthermore, it is not a problem to have *Shari'ah* compliant product, however, it should be greener in the sense that the products are not just simply mirrors of conventional banking products, but it must be based on a value-based system. The economic values of the products and services should aim to eradicate poverty and promote welfare of the public.

Chapter Five:
Interview Findings and Discussions - Legal and Institutional Framework of Islamic Banking and Finance Industry

Chapter Five: Interview Findings and Discussions - Legal and Institutional Framework of Islamic Banking and Finance Industry

5.1 Introduction

The previous chapter presented the findings and discussion of the semi-structured *Shari'ah* Compliance interview.

This chapter continues to discuss problems and challenges facing Islamic Banks and Windows in Algeria. It highlights and analyzes results on legal and regulatory frameworks issues and challenges. It begins with a brief Overview of Legal and Institutional Structure in Islamic Banks, than it focusses on observations concerning the existing of Regulatory and Legal Framework environment under which Islamic Banks and Windows operate in Algeria today. Next, it highlights the need to have independent or specific Legal and Regulatory structures to support the *Shari'ah* operations; it also discusses the debate about the Need of Standardizing and Harmonizing the Accounting Standards. The chapter concludes by summarizing the findings and discussions.

5.2 Overview of Legal and Institutional Structure in Islamic Banks

The growth and development of Islamic Banking, relies on having a comprehensive legal framework. The success of the implementation of Islamic Banking relies on the correct approach of its legal facilities. Islamic Financial Institutions have the duty to be *Shari'ah* compliant as well as meet other statutory laws either substantial or procedural. (Zulkifli and Hasan, 2006). Acknowledging that the infrastructure needed to strengthen the Islamic financial sector continues to expand, the Islamic Development Bank (IDB) has taken several initiatives, including the establishment of specialized institutions such as the AAOIFI, the IFSB, the Islamic Financial Market and the Islamic Rating Agency (IRA). These organizations, as well as Islamic Finance's fundamental characteristics, have reinforced the international financial architecture, particularly banking, and encouraged higher economic stability. For the most parts, these global Islamic institutions have operated separately. Nevertheless, the need to consolidate these institutions' operations was acknowledged to stimulate the development of the Islamic financial industry. All organizations, for example, should comply with AAOIFI norms and implement IFSB-specific international risk norms. For instance, the Islamic Rating Agency must depend on IFSB and AAOIFI norms for its task. The utility of Islamic economic architecture relies on the full consolidation of these institutions' activities to prevent overlapping tasks and distinct norms. (Ahmad Mohamed Ali, 2000, pp: 147-159)

5.2.1 The Guidelines Governing the *Shari'ah* Governance System

Since the establishment of the IB is based on the *Shari'ah* law, it is essential to guarantee that all aspects of its activities are complied with Islamic Bank activities. In addition to ensuring compliance with operational elements, IB should also guarantee that it meets stakeholders' needs in terms of business viability and returns. Thus, compliance with *Shari'ah* and commercial viability are two major governances in IB goals. Furthermore, IB leadership must maintain the values of *Shari'ah* in the banking organization and, at the same moment, face influences from their standard CB. IB also needs to abide by legal structures based on the standard banking system in its endeavor to comply with *Shari'ah*.

However, Islamic Banks and Windows are also required to abide by present legal and regulatory frameworks that apply to them. This might consist of national and international legal and regulatory frameworks for banking organizations and Islamic Banking organizations. Islamic Banks and Windows constitute a corporate governance system that governs its operations to ensure that the institutions are governed to maintain and take into account the interests of the stakeholders (the shareholders, IAH, institutional investors, borrowers, entrepreneurs, governments, and customers).

For the management to report to the BOD on the operations, management, and various internal experts, the management will prepare annual reports on the financial position and performance of the IBs. Besides, auditing is required in the banking system to monitor the staff, scheme, process, business, and project or product of the organizations. The audit will be conducted to determine the validity and reliability of the data. It will also provide an evaluation of the internal control of a system.

5.2.2 *Shari'ah* Manual as a Guideline for the Implementation

Although, the products and services of the IB are based on *Shari'ah* Law and the IB lack human capital that is well knowledgeable in both technical and *Shari'ah*, coupled with unique characteristics underlying its product and services, it is essential to ensure full compliance with the implementation of the contract to ensure that the product is in substance and form compliant with *Shari'ah*. To ensure that the requirement is met and *Shari'ah* compliance is upheld in every aspect of banking activities, the IB initiates a compliance manual for *Shari'ah* in every product and aspect. The *Shari'ah* compliance manual is expected to minimize any non-*Shari'ah* compliance risk when implementing the approved products. Foreign IB *Shari'ah* Supervisor and CEO highlighted that all banks are required to have manuals to assist the human capital in fulfilling their responsibilities.

"Islamic Banks are required to have *Shari'ah* compliance manuals for each product and support services, especially, for the leveraged model operating Islamic Banking subsidiary. We use our human resources, compliance, and legal and vendor leverage. We have the manual of *Shari'ah* compliance that guides products from end to end."

"Since we are a global IB subsidiary, our parent bank has its *Shari'ah* compliance manuals that we conform to."

In addition to manuals, banks provide or organize internal and external training for their staff. IB *Shari'ah* Supervisor stated: "Besides the *Shari'ah* compliance manuals, we organize and provide training for our staff and other organizations inside and outside the bank."

The relation between accountants, accounting professionals or accounting executives and the *Shari'ah* commission appears to be lost at this point. The bank created the *Shari'ah* handbook to complement the absence of expertise; a certain checklist of recruiting employees for an Islamic Banking subsidiary or electing a *Shari'ah* department officer to advise the accounting and auditing team. However, there are Islamic Banks and Windows in Algeria that already have the *Shari'ah* manual in place and Islamic Windows that do not have the *Shari'ah* manual in place but are in the process of developing it. The Head of Participatory Finance of Private Window stated the following:

"…We have our compliance manual to complement the manual we had from our current standard bank. The *Shari'ah* compliance manual describes everything from end to end, as well as support facilities so that our initiative to ensure that the bank complies with *Shari'ah* in all aspects …." Head of Private Participatory Finance.

However, the manual is not fully available in all Private and State Islamic Windows. It is still under construction for some banks. All State Islamic Windows pointed out that the government did not provide them with *Shari'ah* manuals and that the banks still lack them.

"We don't have *Shari'ah* compliance manuals. We are waiting for the government that will take the initiative to come out with the *Shari'ah* compliance manuals. Currently, the Window is not operating yet." Senior Manager in State Window

Besides, the IBs and Islamic Windows underlined the need for the *Shari'ah* Manual to develop a *Shari'ah* framework that could be a challenge for the industry as banks vary in the scope of the *Shari'ah* Manual. In terms of the accessibility of the *Shari'ah* manual, there are mixed findings from the respondents whereby the IB may have it, develop it or not at all:

"In fact, Islamic Finance has grown in the last 30 years. Of course, Islamic Finance has been on the market, there are many challenges that Islamic Finance has faced. First of all, you see, in establishing the banks' adequate *Shari'ah* framework, each bank must have its *Shari'ah* manual." Academician

A Malaysian academic commented on the issue: "One of the *Shari'ah* Committee's duties and responsibilities is to promote the *Shari'ah* manual. It was outlined in the Guidelines of the Governance of *Shari'ah* Committee for Islamic Financial Institutions as: The Islamic Financial Institution shall have a *Shari'ah* Compliance Manual.

The Manual must specify the manner in which a submission or request for advice be made to the *Shari'ah* Committee, the conduct of the *Shari'ah* Committee's meeting and the manner of compliance with any *Shari'ah* decision. The Manual shall be endorsed by the *Shari'ah* Committee.

The present situation requires harmonization of all operational levels, such as internal oversight, methods, terminology, contract, form, etc. Furthermore, harmonization in reports, balance sheets, and other financial statements is also important. In addition, harmonization of manual and definitions of different transactions as well as methods of accounting would assist in comparing and enhancing current performance and development and growth (Kahf, 2005).

5.3 Current Legal and Regulatory Framework Environment in Algeria.

Although Algeria is a Muslim country, the constitution's second article establishes that Islam is the religion of the state. And yet, Islamic Banking has grown rapidly in Algeria in latest years; the banking sector's legal and regulatory aspect is based on the Conventional Banking system.

Islamic Banks and Windows operate within the applicable laws and regulations of other financial institutions. Islamic Banking in Algeria is therefore runs under the conventional law. The Banking Law "Money and Credit Act of 1990" defines the institutional framework for banks and sets out reporting requirements. The Act does not define or acknowledge the existence of Islamic Banks and Windows and does not define its operations. This absence of legislative regulation has made Islamic Banking vulnerable to inappropriate regulation, as it has to depend on Bank of Algeria (BA) and day-to-day government guidelines. Although, BA issued the first and only regulation in December 2018 to define the rules applicable to "Participatory" products leading to perception or interest payment "Regulation No. 18-02 26 Safar 1440 corresponding to November 4, 2018, with conditions for the exercise of Bank operations under Participatory Finance by banks and financial institutions". However, it is not applicable until today.

5.3.1. IBs and Windows Actual Legal and Regulatory Situation in Algeria

The regulation and the supervision framework of the banking industry is important to increase the information available to investors (transparency), to ensure the soundness and stability of the financial system, and to improve monetary and *Shari'ah* supervision of IBs (Gambling et al., 1993).

Participants were asked to speak specifically about the current legal and regulatory framework in Algeria in which Islamic Banks and Windows operate. All the interviewees agreed that there was no Legislative or Regulatory Framework for Islamic Finance. However, the government recently issued a provision on Participatory Regulation (IBs and Windows) but has not yet applied it. The IB Credit Director commented on the matter:

"Concerning the current situation in legislative framework, the Central Bank treats Islamic Banks and Windows exactly as it does with the CB without taking into account their specific characteristics."

"The Bank of Algeria Regulation No 18/02 of 041/11/2018 is currently the only and first step towards the revival of the Islamic Financial Industry in Algeria. This is the first regulatory text to have officially established the general circumstances of exercise for Islamic Finance and banking operations by banks and financial institutions, and to have determined the prods. However, this regulation remains inadequate and requires other enforcement texts to go further." Head of Participatory Finance State Window explained the current situation.

"Explanatory text on participatory expectations for the year 2021." State Windows Senior Manager asserted.

"…it's completely ambiguous." Private Window Head of Participatory Finance

Similar statements supported the above statements were made by the other interviewees.

"…Absence of the legal and regulatory framework governing Islamic Finance…Absence of an Islamic (interbank) money market allowing Islamic Banks or Windows to acquire the necessary funds for Islamic activity… Absence of Islamic insurance funds (*Takaful* fund)." IB Head of Commercial Department

"Islamic Banks are facing a legal vacuum, indeed, there are no regulatory texts governing the activity of the Islamic Window; the concept of Islamic Finance is new at the level of our country banks and will have the role of popularizing Islamic products through the organization of open doors ... etc." State Window Senior Manager.

“The current problems and challenges are the absence of a legal framework that regulates the activity of Islamic Finance, the absence of an adequate tax regime, and the creation of an appropriate financial fabric so that Islamic Finance can prosper in a serene way.” State Window Head of Participatory Finance

“Conventional and IBs and Windows operate under the same conventional regulation and law.” Private Window Head of Financial Department

“Islamic Banks and Windows have the right to take deposits and offer loans but not commercial transactions.” The Head of Private PF Window added.

“Conventional and IBs and Windows operate under the same conventional regulation and law.” CEO IB supported the same statements as above.

“CEOs, *Shari’ah* officers and scholars expressed their concerns in regards to the absence of legal and regulatory frameworks in supporting the development and innovations of *Shari’ah*-based products.” CEO IB

“Lack of repository of *Shari'ah* and Central Committee.” Private Window Head of Participatory Finance

“We are not licensed as Islamic Banks or Windows, but as Conventional Banks.” IB *Shari’ah* Supervisor

“Government calls us participatory Banks and Windows.” State Window Head of Participatory Finance

“…Alternative products rather than Islamic products.” Private Window Head of Risk Department

5.3.2 How IBs and Windows Offer Services under the Current Legal Environment

The industry experiences a lack of legal and institutional framework to facilitate appropriate contracts, as well as mechanisms to enforce them; it also experiences a lack of appropriate products containing a broad range and a variety of maturity structures of financial intermediation (Iqbal and Mirakhor, 1999). Despite the absence of the Legal and Regulatory Framework in Algeria, the Islamic Banks and Windows are offering Islamic products.

In this mater, the interviewees explained how they are offering their Islamic services under the absence of Law. They stated that:

“Participatory Finance in our foreign Bank does not yet have a form of Islamic Window. It is panoply of Islamic products alongside conventional products.” Private Window Head of Participatory Finance

“We strive to find methods and alternatives to deliver Islamic services under standard law and with the tolerance of government and the Central Bank.” IB *Shari’ah* Supervisor.

“…For example, we ask the client to sign a debt recognition to justify the transaction against the accounting expertise or the auditor as well as other deviations leading to non-compliance with the *Shari'ah.*” Private Window Head of Participatory Finance

However, a state-owned Islamic Window stated “…The Islamic Window is in the process to be launched but not operational yet. In the time being, we are offering “Islamic products” alongside of the conventional products from the same desk.” State and other respondents also shared this view.

“Trade Code does not allow Islamic Banks and Windows to conduct transactions such as sale and purchase. It is done in an unlawful way.” IB Head of Commercial Department

“Islamic Banks and Windows operate under the conventional law. However, we are using methods and our experience in Conventional Banks to offer Islamic products” Private Window Head of Participatory Finance

“The positive side is that the legal environment in Algeria tolerates Islamic practices even if the Algerian regulations are not adequate.” Private Window Head of Risk Department

From above statements, we can conclude that the Islamic Banks and Windows in Algeria are not allowed to offer Islamic services under the current law. However, with the tolerance of the government and the shortage of liquidity permitted to the IBs and Windows to provide their services and products by using their experiences in Conventional Banks, *Dharura*, *Hiyal*, illegal procedures…etc. However, IBs and Windows have been criticized over the way they offer their services and products. Some local scholars ruled the products and contracts as unlawful, others academicians think that IBs are driven by profit, which lead them to deviate from the objectives of IBF.

Despite the demand for Islamic financial products, more so, by the Algerian Muslim population, there is still a lack of availability of organizations offering *Shari'ah*-compliant products and facilities. The main cause of this is the shortcomings in the Algerian Islamic Banking legal and regulatory system. It is therefore essential to analyze the existing legal and policy structure to identify regions requiring reform. In this context, the interviewees suggested:

"The government has to follow an explanatory text to the new regulation…" Private Window Head of Participatory Finance

Al-Ayashi Fadad, Professor of Economics and member of the Islamic Bank Group, proposes to the competent authorities "to grant licenses to Islamic Banks to carry out their activities in accordance with the provisions of the *Shariah*."

"…Environmental pressure to recognize Islamic Finance." Private Window Head of Risk Department

"In 2018, the IMF clearly recognized the term "Islamic products", but the government rejects that title." Private Window Head of Financial Department

"The provision of statutory texts is an essential element." State Window Head of Participatory Finance

"The new regulation must be applied in the nearest time…" Private Window Head of Participatory Finance

5.3.3 Challenges and Risks under the Current Environment

The Islamic Banks in Algeria are operating under a conventional environment banking system, which is considered as not having a suitable environment to implement the Islamic principles fully. Therefore, currently the operation of Islamic Banks is highly influenced by the operation of the Conventional Banks. They are facing more problems and risks under the current juridical environment. As an example, *BBA*, based on *Murabahah* values, is the most marketable and common item in the sector. It is a debt-based product, which is in nature similar to loans in Conventional Banks; however, there are differences in documentation to ensure the *Shari'ah* compliance of the product. On the other hand, *Musharakah* and *Mudharabah* are products that are based on PLS where it has certain principles underlying it.

These products involve sharing of profit and loss. Also, these products involve sharing effort and risk. The Interviewees commented on this issue:

"The risks of non-compliance with the *Shari'ah* …A transaction (*Murabahah, Ijarah* or *Mudharabah*) may involve elements of uncertainty or ambiguity if the contract is not properly informed… The seller and the customer can sometimes be the same person, speaking of the *Murabahah* (*Bai' al-'Inah*)…Signature of the *Murabahah* sales contract with the customer before the Bank acquires the assets." State Window Head of Participatory Finance

"Among the relevant problems resulting from the practices planned for Islamic Windows: The credibility of the bank." State Window Senior Manager

"…Issue of compliance in the existing Islamic Windows …" Private Window Head of Participatory Finance

"…Difficulties to convince customers wishing to adhere to Islamic products… speaking of "Islamic Windows". A simple client is not easily convinced when he addresses a traditional banking agency with an "Islamic counter" (separation of accounts, cash, destination funds, human resource ...)." State Window Senior Manager

However, a State Islamic Windows Senior Managers responded differently because the Windows are not operating at the moment:

"Means for measuring *Shari'ah* compliance risk will be put in location once the Window is activated."

"Problems cannot be really detected until Islamic Windows come into production."

Another challenge for Islamic Banks is having a controversial *Shari'ah* contract. Although the regulators come out with guidelines for alternative contracts to replace *BBA*, *Bai' al-'Inah* and *Tawarruq*, it is difficult to come out with an alternative contract. Today, despite the unfamiliarity of clients in these products, the sector infrastructure has not yet supported the operationalization of PLS-based products. Islamic Banks in Algeria must comply with regulatory frameworks at national and global levels. Moreover, it must compromise with current legal systems and laws based on the conventional economic system that does not fully promote Islamic contract implementation. However, for IB to implement the PLS products, the CEO of foreign Islamic Bank opine that there are no legal backup from national and international laws. A *Shari'ah* Officers in foreign IBs stated that there are international regulations that hinder the development of the products.

"We must comply with international standards (i.e. BASEL) which require higher capital reserve that slows down the development of products that are based on PLS, and on the other hand, with the requirements and standards of the regulatory authority (Central Bank)."

"…The obstacle of the international legal framework…"

Although, Algeria is considered to have no infrastructure to support the operation of Islamic Banks, it also faces legal and regulatory challenges that could impede or slow down the development of products and services. Besides, it generates obstacles for IB to operationalize certain products that are distinct from standard banks and unique to Islamic Banks. The IB Senior Manager identified the following:

"The legal issues hinder the Islamic Bank's operation and application to be in line with *Shari'ah* and civil law, lead Islamic Banks to face various hindrances to operate in a *Shari'ah* compliance manner and, at the same time, bind to the law and regulation."

"… Due to the high regulatory nature of the industry, the Islamic Banks have to follow and implement BA's rules and regulations. All of BA's rules and regulations are not Islamic. In practice, it is still not really Islamic to support IBs' operations Islamically." Private Window Head of Participatory Finance

They added in regarding the alternative contracts:

"…We are moving towards providing non-conventional market Islamic products. For example, *Musharakah*-based products or contracts are not available in conventional products because conventional under BA products do not allow banks to offer products where the bank itself can own the equity. Also, as far as *Mudharabah* products are concerned, contracts applying *Mudharabah*, for instance, profit-sharing equity account, PSIA, whether it is general PSIA or specific PSIA, under the same concept that we can be a matchmaker between buyer (*Mudharib*) and service supplier or the business itself…"

"For a *Musharakah* contract, we find ourselves in the process of deviating from all its circumstances one by one at the time of its realization. For example, we ask the client to sign debt recognition to justify the transaction against the accounting expertise or the auditor as well as other deviations leading to non-compliance with the *Shari'ah*"

5.3.4 Inexistence of Regulations for Each and Specific IB's Product

Theoretically, the *Shari'ah* Committee believes that the legal and regulatory framework should fully support Islamic Banking systems' fundamental principles. For instance, there should be an act to guide product development for each Islamic Banking concept. In the meantime, different regulations still need to be amended to make them applicable to IB procedures. Furthermore, the appropriate provisions must also be improvised in order to fit the industry's present growth. It will also help develop a wider variety of products and services available to the customers. The CEO of IB is in view that:

"Regulatory texts should be amended or changed to suit the framework of Islamic Finance. Trade Code goes beyond commitments, including the *Sukuk*. I made a proposal for participation securities but… In the fiscal code, we need changes to purchase and sale transactions."

"We need Explanatory Text for the new regulation. It is not available…" IB Head of Commercial Department.

Mr.MOUHOUB, founder of Al-Baraka Bank and Private Participatory Window, the Head of Participatory Window actually, proposed for refinancing to the Central Bank in 1992:

"... The aim is to deposit surpluses at the BA level without remuneration and to use them, if necessary, i.e., to borrow their deposits without interest to avoid the *Riba* principle." The proposal was rejected for a non-conviction of Islamic Finance.

In addition, Islamic Bank CEO and Islamic Bank SC concentrate on some operational problems such as taxes and property code:

"We are still governed by Conventional Banking laws that the Islamic Bank may not adapt. As far as the legal system in Algeria is concerned, we need a more appropriate approach to solving operational issues such as taxes and property code. Islamic Banks may need to approach this differently."

In addition, *Shari'ah* officers IB agreed that "the legal and regulation needs an on-going (i.e. continuous) improvement."

Other amendment needed concerning double taxing as IB Head of Commercial Department and *Shari'ah* Supervisor comments:

"Tax office does not take into account the specificity of Islamic operations. We get taxed twice for one transaction" IB Head of Commercial Department /SSB

"Taxation and Trade register inappropriate for IB." IB Head of Reporting Department

5.4 Initiatives to Enhance the Establishment

The IF sector and government now need to consider a shift of mindset followed by enhancing the legal, financial and supervisory facilities supported by an adequate governance structure to enable banks to trade in equity-based operations. Consistent with IF provisions, one concrete way forward is to focus efforts to develop right framework and applications for PLS-*Shari'ah* compliance (Shamshad, 2008). The players in Algeria should, therefore, take measures to create and improve Algeria's Islamic Banking. To respond to the juridical environmental problems, in 2017-2018, the government launched a reform to improve IBs by adopting the first regulation and allowing 6 Islamic Windows in the state-owned banks. However, the plan to improve the IBs sector was postponed owing to the slow policies and decision, and the current political crisis in Algeria. As the interviewees commented on the initiatives:

"The Bank of Algeria Regulation No 18/02 of 041/11/2018 is currently the first and only step towards the revival of the Islamic Financial Industry in Algeria. This is the first regulatory text to have officially established the general circumstances of exercise for Islamic Finance Banking operations by banks and financial institutions, and to have determined the prods. However, this regulation remains inadequate and requires other enforcement texts to go further." Senior Manager State Window explained the current situation.

"Absence of a real political will on the part of the authorities for the adoption of Islamic Finance (a "reluctance" is strongly noted)." State Window Head of Participatory Finance

"The directives of the Bank of Algeria did not take into account all the aspects governing Islamic Finance, particularly with regard to AAIOFI standards." Senior Manager State Window

"In the case of Algeria, the Bank of Algeria's projects are very timid and the standards of international regulatory bodies are not yet taken into account…" State Window Head of Participatory Finance

"The initiatives of our Conventional Bank are concretized by its project of conformity to the new regulation about Participatory Windows then proceed to its development." Private Window Head of Participatory Finance

"…Pressure of the local and international environment to recognize Islamic Finance in Algeria" Senior Manager Private Window

5.4.1 The Need for a Legal and Regulatory Framework to Support the *Shari'ah* Operations

Subsequently, the current environment in which Islamic Banking and Finance functions is regarded not to have an adequate environment for the full implementation of Islamic values. Therefore, the IBs and Windows may need a separate set of a regulatory framework, as the interviewees expressed the need for a different framework:

"Accounting in Islamic Finance is different from that of conventional accounting, hence the obligation to separate the two balance sheets, in case of setting up an Islamic Window.**"** State Window Head of Participatory Finance

"Obviously, the "specificity" of Islamic products requires: a separate regulatory framework… or, at least, the enrichment and adaptation of the current regulatory framework." State Window Senior Manager

"…Yes, it is necessary to distinguish between the characteristics of the two systems (Islamic and Conventional); especially the separation of these two systems." State Window Senior Manager

"The regulatory framework is very important because it defines the limits and the fields of application of this finance." State Window Head of Participatory Finance

"For standards, it is best to start with existing standards such as the AAIOFI and the IFSB and to set other standards in the future as needed" Private Head of Financial and Accounting Department

"…Of course, the Islamic industry needs a specific regulatory framework, particularly with regard to laws governing all banking activities in all their forms." Private Window Head of Participatory Finance

"Islamic Windows and the banking sector, as well as the Islamic Finance Industry, need a separate set of the regulatory framework." Private Window Head of Treasury Department

"Currency and Credit Law: should have new legislation in line with Islamic Finance through parliament." Private Window Head of Risk Department

5.4.2 The Need of Standardizing and Harmonizing of the Accounting Standards

Accounting is a well-established field in Conventional Banks and conventional business entities, but the knowledge sector is not well developed in terms of accounting for Islamic Banking activities and Islamic business organizations. Though the AAOIFI was set up to account for Islamic products and corporate governance, however, its standards are voluntary. Islamic Banking in Algeria is bound to comply with IFRS in the preparation of its financial statements. Since the majority of the products offered are debt-based products, the industry did not have many challenges in accounting for such transactions. However, once the IB ventures into risk-sharing products, legislators need guidance. Here the IFRS needs to harmonize the norms to suit the corporation operations of the IB. This matter is addressed by SC in IB in the following:

"In accounting practices they said that they follow AAOIFI, well because they have to follow IFRS by statute. At this stage, I don't think it is a problem; because most of the products in Algeria are *Murabahah* or *BBA* that is basically, in substance, a loan. So I suppose they could use IFRS for loan accounting. This will prevent them from going over to more risk sharing products, and BA is encouraging this, but if they introduce risk-sharing products then we have a problem; we cannot treat it as a loan. So in terms of accounting standards, we have to look for it. IFSB has to solve this issue."

This is endorsed by another SC in different IB, that accounting procedures are bound to comply with IFRS in Algeria.

"The approach taken by many institutions is bound up with IFRS, so we are also working with AAOIFI to examine this issue if there is any contradiction between the *Shari'ah* principle and IFRS. Currently, all of the banks are using IFRS."

Islamic economic transactions are not fully supported by IFRS. It will therefore not encourage a specific transaction's objectives and will not transmit the transaction's real financial values. The accounting academic believes that the route to adopt the accounting standards, based on AAOIFI, is still uncertain for the sector to move forward. The use of Islamic accounting standards is required to streamline Islamic Banks' operations to achieve their goals. Furthermore, harmonization between conventional accounting standards and Islamic Banking products was necessary to match the nature of IB economic operations for the sector to implement IFRS. Moreover, as far as financial reporting is concerned, IB reporting still lacks consistency when it comes to providing data to users of financial reports and stakeholders.

In the IB, there are still differences of treatment that would breach the concept of fairness of the reporting. The action to harmonize the IFRS standard is being supported by academician from The Islamic Finance and Economic School of Istanbul in Turkey:

“Islamic Banks should apply Islamic accounting, which might be different from IFRS. It is a challenge now. I do not think IFRS will be the solution. If Islamic Finance and the Muslims want to achieve the social economic objective of Islamic Banking and Finance, then you cannot adopt IFRS, unless IFRS has a parallel set of standards just for Islamic Finance, which they do not want to have; they want to converge. In my opinion, I do not think convergence is possible. However, harmonization is possible. However, they (i.e. IFRS) are enforcing the issue. But we will see how it develops, it is better, but then again, AAOIFI has done a lot of work. However, the standards are a bit obsolete, they are under-funded, so I think we need a white line to save the AAOIFI and bring it up to speed and rigor, to the level of at least decent standards setting bodies, that’s are capable of rising to the challenge, while keeping it owns values system and fighting off convergence. Also, we can harmonize the standards where the *Shari’ah* says otherwise, so it is not in harmony with IFRS.”

The respondents articulated their opinions in harmonizing the IFRS standard as follows:

“Standardization of accounting standards and other standards following IFSB and AIIOFI is a far-reaching goal. ..., Islamic Banks (and Windows) are faced with one major problem: They must, on the one hand, comply with the international standards of IFSB and AAIOFI and, on the other hand, comply with the requirements and standards of the regulatory authority (Central Bank) IFRS.” IB Head of Financing Department

"…Yes, Conventional Banks adoption of Islamic standards AAOFI and others for their Islamic Window are paramount." Senior Manager State Window

"It is an obligation for banks to apply international standards so that it is the latest in accordance with the principles of Islamic Finance." State Window Head of Participatory Finance

"Absolutely, comply with IAS / IFRS but the framework should be defined by the state." Private Window Head of Participatory Finance

Furthermore, CEO in foreign IB state that the drawback is that current standards being used by the industry are not really accommodating to the products specific to Islamic Banks:

"Some of the reasons that failed to accommodate the development of more IB products are unfamiliar with clients, non-accommodating legislation, risk structure, BASEL and accounting standards. These factors are more suitable for conventional products."

Moreover, while the sector recommends AAOIFI norms, the sector is extremely regulated, and the bank is bound to pursue Central Banks' guidelines. In order to examine the suitability of present standards and practices, various attempts need to be made. They also need to investigate the need to harmonize procedures, debt and equity classification, and measure and valuation. Accounting standards as a guideline for the bank to produce a reporting medium enable users to assess and monitor whether IB is capable of managing or implementing social-economic objectives, and to measure performance under the *Shari'ah* principles.

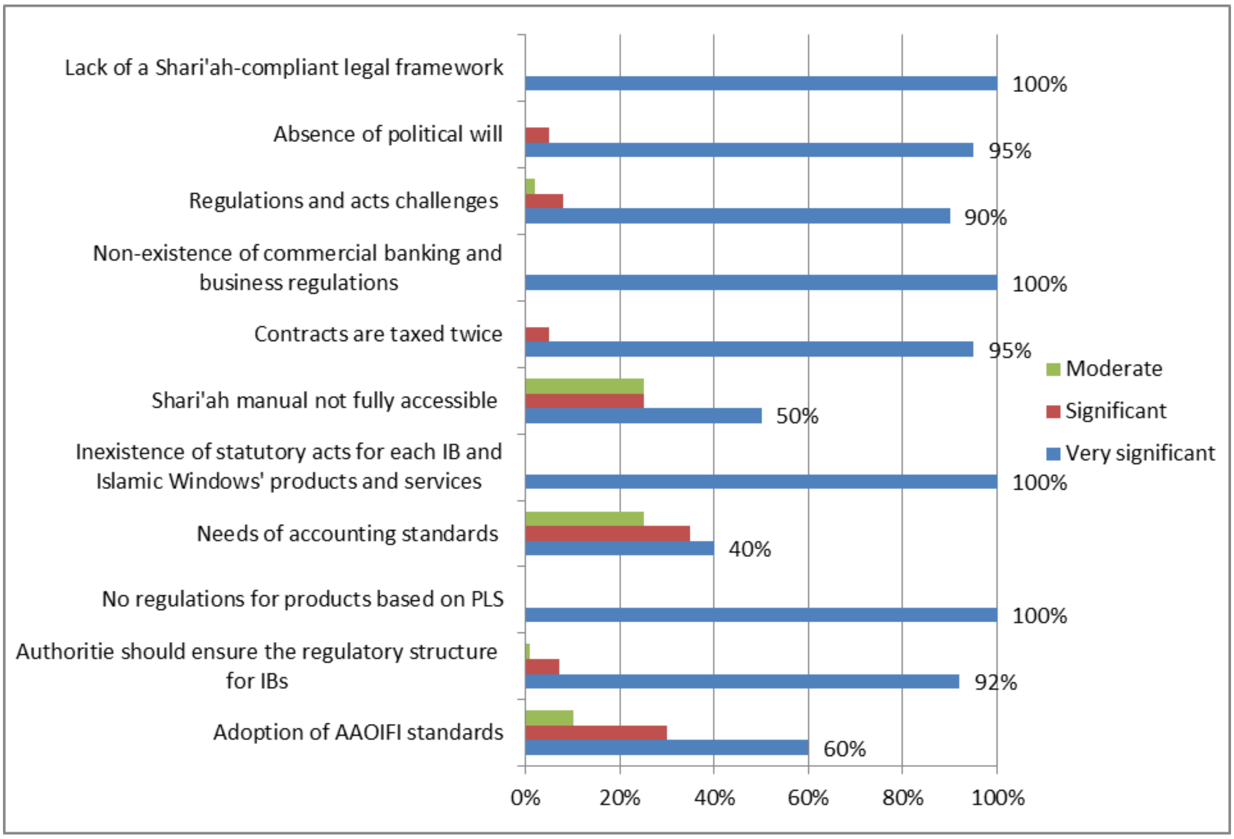
5.5 Summary

The section investigated the regulatory framework of the banking industry in Algeria. The primary results of this section relate to problems and challenges within the Legal and Institutional Framework and can be summarized as follows.

Over the last two decades, the Islamic Banking industry has been attempting to stretch its reach to at least the level of standard banking. However, the lack of a *Shari'ah*-compliant legal framework, needed to make interest-free banking acceptable and create sound financial institutions, is the major hindrance behind its low penetration in the financial market. The legislative structure is functioning against the complete growth of Islamic Banking in the country.

The main problems and challenges related to Legal and Institutional Framework are summarized in the figure 5.5.1 below.

Figure 5.5.1 Problems and challenges related to Legal and Institutional Framework



Source: Elaborated by the researcher

Chapter Five: Interview Findings and Discussions - Legal and Institutional Framework of Islamic Banking and Finance Industry

The Banking Act, Central Bank Act and other regulations pose the greatest challenge to the development of Islamic Banking in Algeria. The Banking Act defines the Institutional framework for banks and sets reporting requirements. The Act does not define or acknowledge the existence of Islamic Banking and does not define its operations. Although certain exemptions were made in areas such as restrictions on trading and ownership of assets and reporting interest income in the case of Islamic Banks, the Act is seen by the industry players as being deficient in the scope of coverage of Islamic Banking. (Sheikh, 2009).

Commercial and financial contracts and transactions have their framework for the implementation of Islamic law. However, commercial banking and business regulations that are suitable for the application of Islamic Banking and economic agreements do not exist. Islamic Banking contracts are regarded as buying and selling properties and are therefore taxed twice. Commercial banking and corporate regulations comprise narrowly described provisions prohibiting the range of Islamic Banking operations within standard boundaries.

The *Shari'ah* manual is not fully accessible in all Private and State Islamic Windows. It is still being developed for some banks. All State Islamic Windows pointed out that they were not provided with *Shari'ah* manuals by the government and that the banks still lack them. The interviewees highlighted on the reliability of the *Shari'ah* committee report issued yearly. Also, it was found that, not every Islamic Window has the *Shari'ah* manual as a guideline for the staff in carrying out their duties and responsibilities.

In terms of legal and regulatory framework for the operation and products and services of IB, it is found that more regulatory framework is needed to support the *Shari'ah*-based operations and inexistence of statutory acts for each IB and Islamic Windows' products and services to encourage more product development and innovation.

Regarding financial reporting, IBs in Algeria comply with IFRS. Various researchers are opposed to the idea of complying with IFRS because it is not fully accountable for Islamic Banking business activities. However, since the current products and services in IB resemble the CB's products and services, the compliance with IFRS is acceptable. However, the industry needs to have an accounting standard that fully support their products and services, especially products based on PLS.

More regulations are required to support the innovation and development of products based on PLS. In addition, the need for well-defined property rights for efficient PLS function and fairer treatment in taxation, are considered to be a major obstacle in the use of PLS and secondary markets for trading in Islamic financial instruments; *Mudharabah* and *Musharakah* are particularly non-existent (Dar and Presley, 2000).

The attempt to construct Islamic Banks and Windows' legal and regulatory structure and prudential supervision is essential, as Islamic Banks have distinctive features compared to their conventional counterparts. The development of regulatory and supervisory framework that would address the issues specific to Islamic institutions would further enhance the integration of Islamic markets and international financial markets (Iqbal, 1997). The regulation and the supervision framework of the banking industry is important to increase the information available to investors (transparency), to ensure the soundness and stability of the financial system, and to improve monetary and *Shari'ah* supervision of IBs (Lopez Mejia et al., 2014). The growth of the Islamic Banking system through the history can be concluded that, there is a growing amount of developments in the Islamic Banking system linked to the implementation and establishment of regulatory and supervisory structure.

For IB's safe development, the main requirement is a sound legal framework. General banking rules (or specific IB laws) have to define the nature of these banks and their connection (if applicable) with the Central Bank and other Conventional Banks in order to provide the legal foundation for IB oversight. Jurisdictions have embraced distinct strategies in creating the legal framework that enables IBs to function. These strategies are adopted because IBs function across nations in very distinct legal settings that represent distinct legal traditions and differing opinions on the *Shari'ah* as a source of law.

The authorities should ensure the regulatory structure for IBs and thus allow them to be on a level playing field with CBs. Ensuring also that the legislative structure is properly aligned with the standard setter rules is critical to resolving the major hazards associated with IB operations. The standard framework in most nations where IBs are present is the Basel Committee on Banking Supervision's (BCBS) fundamental legislative framework.

In order for the industry to allow Islamic institutions to operate according to Islamic rules and to encourage financial market for Islamic financial transactions, the industry needs law in terms of the Islamic Banking law and laws concerned with financial intermediation.

Furthermore, a uniform regulatory and legal framework supportive of an Islamic financial system is required and has not yet been developed (Iqbal, 1997).

Nevertheless, to implement *Shari'ah* law, several jurisdictions supplement it with the standards of the Islamic Financial Services Board (IFSB) and the Islamic Financial Institutions Accounting and Auditing Organization (AAOIFI). Around 65% of countries that allow IBs have adapted their standard finance laws for IB activities. Several elements of the regulatory structure need to acknowledge the distinctive characteristics of IB.

Finally, the main aim of IFIs is to adhere to the principle of *Shari'ah*, IFIs operate in Western-dominated competitive and dynamic industry. IFIs need regulatory supervision much like Western institutions (Islam, 2003). The key to successfully regulating IFIs was the establishment of AAOIFI. AAOIFI developed 60 standards covering accounting, auditing, governance and ethics that IFIs need to apply. AAOIFI works are a lot based on the current reporting system. The approach began with objectives established in contemporary accounting thought, and then testing them against Islamic *Shari'ah*. In short, accepting those consistent with *Shari'ah* and rejecting those that are not (Lewis, 2001). This approach avoids redundancy in the current reporting system and is seen as harmonizing the accounting standards so that consistency with globally accepted accounting standards is attained. The Deloitte Islamic Finance Knowledge Center (IFKC) finds that 79% of the industry leaders surveyed support a convergence initiative of the AAIOFI standards with IFRS, while 7% did not support the convergence. An alternative approach is to establish objectives based on the spirit of Islam and its teachings and then consider these established objectives in relation to contemporary thought (Lewis, 2001).

Some Islamic accounting scholars support IFIs to comply the accounting standards promulgated by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) to reflect the unique transactions of IFIs (Archer and Karim, 2007; Vinnicombe, 2010). Employing AAOIFI accounting standards would not only improve the comparable, relevant, reliable, transparency and efficiency of the countries' financial institutions but would also expedite the processes of globalization (Karim, 2001). The adoption of AAOIFI standards is useful as there are areas of differences in reporting IFIs and likewise, the IFIs need to be sustained in this global financial market dominated by Conventional Banking transactions. Although AAOIFI managed to develop a set of accounting standards for IFIs, this body lacks the power to enforce regulations. AAOIFI accounting standards have not been fully accepted by regulatory regimes and a range of political, economic, and social circumstances due to the lack of appreciation of the benefits of these standards (Karim, 2001; Vinnicombe, 2010).The choice of whether to adopt AAOIFI accounting standards depends on national regulators. There are a few factors influencing the decisions to adopt AAOIFI standards. AAOIFI was established in the early 1990s, the era before the move to IFRS. With the whole world moving towards a single set of accounting standards, many regulators are reluctant to have a separate set of accounting standards. Since IFRS is becoming the lingua franca of financial reporting, it is costly for IFIs to prepare two sets of financial statements. Additionally, comparing financial statements will be affected by having two sets of accounting standards. Some scholars argue that there is not much difference between AAOIFI accounting standards and IFRSs. The financial accounting standards issued by AAOIFI are basically compatible with IFRS except in only one or two cases (Archer and Karim, 2007). Since AAOIFI standards have mainly been based on IFRS, this approach has been criticized as embracing the spirit of dominant capital and free market ideology (Kamla, 2009). This approach has endured due to the challenges faced by IFIs that operate in a competitive and risky industry. The growth of Islamic Finance has seen many products offered that are copied from the Conventional Banking industry (Khan, 2010). It is argued that rather than fulfilling religious duties, the real aim of IFI has been seen by some as creating secular goals and not religious ones (Haniffa and Hudaib, 2010). This has led the national regulators including the Malaysian Accounting Standards Board (MASB) to have the view that IFRS adheres to the principle of *Shari'ah* and is applicable to IFIs.

The effort to build the legal and regulatory framework and prudential supervision of Islamic Banks is crucial, as there are unique characteristics of Islamic Banks as compared to their conventional counterparts. The development of regulatory and supervisory framework that would address the issues specific to Islamic institutions would further enhance the integration of Islamic markets and international financial markets (Iqbal, 1997).

Thus, a further challenge faced by the industry is to develop a uniform regulatory environment and legal framework; which are still yet to be developed (Mohd Ariffin, 2005; Karim, 2001; Sundararajan and Errico, 2002).

Chapter Six:
Interview Findings and Discussions - Accounting System and Auditing Practices

Chapter Six: Interview Findings and Discussions - Accounting System, and Auditing Practices

6.1 Introduction

Although the development in Islamic Banking is enormous, nations around the globe are using this financial model. The Islamic Banking scheme is one of the emerging fields of the global financial market, with an immense prospect of very rapid growth in all parts of the world. However, accounting standards and compliance with current accounting reporting requirements referred as IFRS are virtually unnecessary, given the distinct nature of Islamic products. This turn has raised several issues and challenges for accounting and auditing in the Islamic Financial Institutions.

This chapter focuses on the results of the semi-structured interview and analyzes them in regards to the Islamic Bank's accounting and auditing scheme. This chapter is divided into three sections besides the introduction; the first section outlines the lack of impact of accounting practices and reporting on the disclosure of reliable and credible information. It begins by highlighting the role of accounting and financial practices and reporting in the communication of reliable and credible information. It then describes the current accounting situation and practices in the Islamic Banks and Windows of Algeria. The section continues to underline the lack of *Shari'ah* expertise among SSBs and scholars and concludes with the issue of having separate SA standards for Islamic Banking; the second section analyzes and discusses the findings of the *Shari'ah* audit. It discusses the lack of *Shari'ah* audit experts and the lack of external *Shari'ah* auditors; the final section summarizes the findings and the discussion of the chapter.

6.2 Accounting Practices and Reporting

Analysis of accounting practices in IBs can be categorized as accounting and finance, approval of product development and innovation, implementation of approved products, financial accounting and reporting, accounting system, financial regulatory procedures, and *Shari'ah* auditing.

6.2.1 The Role of Accounting and Finance

Despite concentrating on the IB growth and development, the perfect aspirations behind its institution should be taken into consideration. In this context, therefore, the role of accounting and auditing and financial reporting is vital in communicating with users of financial statements on the banking activities of Islamic Banks. In the case of Islamic Banks, in addition to providing information that will help users make arm-length transactions, it also serve as an important mechanism for monitoring, control, and a means of communicating whether the establishment of Islamic Banks is in line with *Shari'ah* and achieving *Shari'ah* objectives. This would grant stakeholders certainty of the extent of *Shari'ah* compliance and would give credibility and legitimacy of the Islamic Banks to the stakeholders as a whole.

The table below describes the process of ensuring *Shari'ah* compliance with financial transactions featuring product development and innovation approval, approved implementation, financial accounting, and reporting and auditing.

Table 6.2.1.1 Transactions – From Concept to Reporting – *Shari'ah* Compliant Financial Transactions

***Shari'ah* Compliance**	**Financial Institutions**	**Accounting Standards**	**Auditing Standards**
Approval of Product Development and Innovation	Implementation of Approved Product	Financial Accounting and Reporting	Auditing
Prudential Requirement			
Shari'ah-Based Prudential Requirement			

Source: (Noraiza, 2014)

The first stage: approval of product development and innovation involves the deliberation by the *Shari'ah* Committee on the contract-based concepts. It also involves discussions between the *Shari'ah* Committee and the staff or management of the bank (i.e. Product development department, legal department, and *Shari'ah* department) on product and service proposals approval, operationalization, and other related matters. During this stage, the SC would maintain that *Shari'ah* complies with the underlying concepts of products and services. Next, it involves the financial institutions implementing the approved product. The contract should represent the basic concepts approved by the councils of the *Shari'ah*. It should also describe the contractual obligations formulated and achieved.

The second stage includes the financial accounting process to determine whether the methods of accounting for the contracts nullify the validity of compliance with *Shari'ah*.

The last stage: auditing implementation is brought up due to the risks of contract parties manifested in contracts. In this respect, the prudential regulation on a conventional and Islamic basis would direct how the risks and rewards in the financial system would be represented.

6.2.2 Financial Accounting and Reporting

Accounting includes the recording, classification, and summary of financial transactions, which are the fundamental essence of the product, and define the way the contract accounted for. Furthermore, proper transaction recording will also determine the validity of the transaction's *Shari'ah* compliance. It is therefore vital for the IB to account for transactions in accordance with its fundamental nature so that the user of the accounting report can have a clearer picture of the operations of the IB. It is therefore important to report Islamic Finance accurately, as mentioned by the Head of the Islamic Private Window:

"It is important to ensure that the Islamic financial transaction is recorded correctly, as it will help the preparer of the accounting record or treatment of the Islamic transaction to think Islamicaly."

"The importance of the accounting report is to guarantee that all movements of substance within the bank are traceable and that they do not mix (Islamic / Conventional) State Window Head of Financial and Accounting Department

"The purpose of financial statements is to determine the resources and uses of each activity of the bank." Private Window Head of Treasury Department

Besides, questions about the financial treatment and financial reporting of Islamic financial transactions are still based on the local application of IFRS accounting and auditing standards and are not fully supported by IFRS. Therefore, it will not support the goals of a particular operation and will not represent the true economic values of the transaction. Because of the distinct fundamental concepts, some of the standards may not be appropriate for implementation to Islamic Banking and Finance products. These problems in the financial reporting are highlighted by the interviewees:

"Financial reports and statements for the Central Bank are similar to those for Conventional Banks." Head of Participatory Finance of Private Window

"Central Bank: regulatory and legislative framework that poses problems when declaring and reporting." IB and Islamic Window

"Accounting is done in duplicate, internal is done in the specific language of the *Shari'ah*, but the reports intended for the BA must be rewritten in such a way that they have a conventional aspect." IB Finance Director

"In case of purchase: all taxes are paid (TAF, VAT, IBS...) but are declared as a margin on turnover." Participatory Finance Head of Private Window

"Penalties for late payment are income: the taxes of which are paid are declared unlawfully in the accounting scheme of the reports and financial statements intended for the Central Bank." Private Window Head of Participatory Finance

"Contracts are identical to conventional contracts except for details and payment deadlines and reimbursement of credits." IB Reporting Director

"…Difficulties related to the design of the accounting records (schemes) specific to the Islamic products to be launched by the bank, these accounting records must comply with the requirements of the Central Bank and, on the other hand, with the AAIOFI standards." IB *Shari'ah* Supervisor

"Terms and language of Islamic Finance: reports and financial statements to the Central Bank must be accompanied by definitions in the Islamic terms used." IB Finance Director

"Accounting: specific canvas. Internally, the information system is suitable for Islamic Finance." Private Window Head of Financial Department

"The balancing method is in an attempt to have appropriate classification. So you can't split the world into equity and debt if we need a fresh classification. Operationalization is hard if debt characteristics and equity characteristics are separated. It faces issues like two distinct entities' issue." Private Window Head of Participatory Finance

6.2.3 Current Accounting Situation and Practices of Islamic Banks and Windows in Algeria

Accounting is a well-established field in Conventional Banks and conventional business entities, but it is not well developed in terms of accounting for Islamic Banking activities and Islamic business organizations. Though the AAOIFI was set up to account for Islamic products and corporate governance, however, its standards are voluntary. Islamic Banking in Algeria is bound to comply with IFRS in the preparation of its financial statements. Since the majority of the products offered are debt-based products, the industry did not have many challenges in accounting for such transactions. The SSB of IB explains the current situation:

"There is no Islamic accounting in Algeria"

"…Accounting plan is used in conjunction with BA, including SCF / Sector Accounting…" IB Head of Reporting Department

This is endorsed by another SC in different IB, that accounting procedures are bound to comply with IFRS in Algeria. State and Private Windows commented on the current situation:

"The current accounting practices of our bank are those of the IFRS."

"Current accounting practices are bound by IFRS standards."

"…Inappropriate accounting scheme for Islamic Banks" Private Window Head of Participatory Finance

Although all interviewees stated that the accounting system in Algeria is bound by IFRS, Islamic Banks and Windows must also comply with IFRS. On this issue, the interviewees were asked to explain their accounting practices in these circumstances, in particular, the two foreign IBs that follow the AAOIFI banking standards. IBs SSB commented on that:

“In internal accounting practices we follow AAOIFI. In the other hand, the external accounting reports, we have to follow IFRS. At this stage, I don’t think it is a problem; because most of the products in Algeria are *Murabahah* or BBA that is basically, in substance, is a loan...”

“The approach taken by many institutions is bound up with IFRS, so we are also working with AAOIFI to examine this issue if there is any contradiction between the *Shari'ah* principle and IFRS. Currently, all the banks are using IFRS in Algeria in accounting system.”

However, the Islamic Windows have different approach to the accounting practices.

“…Yes. Accounting operations are completely separate from that of conventional operations. This is done at the accounting software parameter. Accounting operations separate Islamic current accounts from conventional ones.” Finance and Accounting Department Head of Private Window

“Same accounting and financial statements except for those intended for the SB: specific format of internal accounts, steps of transactions, calculation of purchased assets ...” Participatory Finance Head of Private Window

“As far as our bank is concerned, financial reports are made available through an information system specifically dedicated to the Islamic Window. Therefore, the quality of information is not a problem.” Participatory Finance Head of State Window

“…Accounting separation (split) between the two entities (classic Bank and Islamic Window).” Participatory Finance Head of Private Window

From the above, it can be noted that all Islamic Banks and Windows send their financial reports to the BA according to conventional language; however, 1) Islamic foreign Banks use internally AAOIFI’s accounting standards; but, external reporting is sent according to the IFRS standards; 2) Some of the Islamic Windows use conventional accounting software; however, one of them uses a specific parameter in conventional software for Islamic accounting operations, others use separate *Shari'ah* compliant software in parallel to the conventional; 3)The state-owned Islamic Windows are in the stage of launching their operations, they are prospecting to use separate *Shari'ah* compliant software.

6.2.4 Lack of expertise in accounting and finance among *Shari'ah* Scholars

This relates to SB's participation in IB accounting and financing components. Various feedbacks on accounting and finance are obtained from the interviewees through the interviews. The accounting document is chosen after the *Shari'ah* advisor reviews the agreement, according to SSBs in both foreign IBs with an accounting background. The accounting entry concerned is defined before the approval is made, and the agreement will be submitted to SSB for further evaluation.

"The *Shari'ah* Board will review the contract after the contract has been formulated. Then, it has to go through the IT infrastructure and accounting treatment. Once the product is finalized, it will be re-submitted to the *Shari'ah* committee to review of all aspects of the product in order to approve it." IB CEO

"Before we approve the product, we really need to deliberate by looking into all aspects: legal, accounting, internal policy of the institution, and everything. The approved product will be the product that we have duly considered on all aspects." IB SSB

With an accounting background, the SSBs explained their participation in deciding the accounting treatment. Though, SSB's participation in the decision on accounting procedure does not occur in all Islamic Banks and Windows, because not all SSBs have an accounting background and finance knowledge. In addition, while SC has no accounting history, the emphasis has been placed on taking accounting issues into account in ensuring compliance with the *Shari'ah*. The Director and Head of Credit and Finance of foreign Islamic Window also noted the gap in accounting knowledge faced by SSB.

"There is a gap in accounting and finance skills."

"Usually, the members of the *Shari'ah* Supervisory Committee do not dominate the operations of traditional banks, which pose a serious problem."

In addition to the knowledge gap in accounting, the interviewees also mentioned the relationship between the SSBs, and the accounting, finance, and audit departments.

"The relationship between the Bank's SSB and its accounting department remains superficial." State Window Senior Manager

"The role of the SSB will be to decide on all *Shari'ah* issues from the *Halal* or *Haram* point of view, so it will have a central role in the activities of Islamic Finance." State Window Head of Participatory Finance

"There is no relationship between the accounting service and the *Shari'ah* committee. The *Shari'ah* Committee reviews the reports provided by the *Shari'ah* auditor and asks to see the accountant except in case of need." Private Window Participatory Finance Head

Most of the *Shari'ah* commission and *Shari'ah* supervisors stressed that they did not highlight or mention accounting or auditing problems during the discussion and deliberation of the *Shari'ah* agreements, but if they had a background in accounting and finance, they would be more involved in the discussions about the accounting and auditing issues.

It was observed during this phase that Islamic Banks and Windows in Algeria lack *Shari'ah* expertise that is well versed in technical knowledge and absence of technical expertise that is well versed in the understanding of *Shari'ah*. This is clarified by the absence of technical employees with an understanding of *Shari'ah*. Thus, the *Shari'ah* commission will rely on technical department explanations to comprehend technical issues in Islamic Banks. Also, there are SSBs in both foreign IBs who admit their lack of knowledge regarding accounting and finance.

"…I need to know about accounting, that's why we have limitations in technical knowledge... We depend on the accountant to clarify to us how it works and how the accounting component for certain products or transactions is being handled… We always emphasize transparency and disclosure. Apart from that, it will be hard for us to assess"

Additionally, participants pointed out, that owing to the absence of technical understanding (i.e. accounting) between the SC, they depended on accounting skills to explain the fundamental structure of the operations. There is also an absence of technical knowledge of the members of the *Shari'ah* board. Precisely, in terms of accounting and finance, we have found that there is a lack of accounting experts who sit on the board and can understand the principles of *Shari'ah* underpinning the products and explain how to account for the products and services. On the other hand, there is a shortage of accounting and auditing professionals who have *Shari'ah* expertise. Furthermore, there is also a lack of particular legislation or accounting standards that support distinctive underlying IB concepts.

These further support the dynamic problems of *Shari'ah* scholars' understanding of the roles, functions, and functioning of the IB.

6.2.5 The need and its impact to have separate Islamic accounting standards

As Islamic Banking in Algeria is being established under the conventional Banking system, all of the legal and regulatory frameworks are still based on the conventional system. As for accounting practices, the Islamic Banks are bound to comply with IFRS. Interviewees had their opinions on the need to have suitable standards to support underlying operations of Islamic Banks. Therefore, it is essential for the Islamic Banks and Windows to have separate Islamic accounting standards. All the interviews supported the idea as stated bellow:

"…Yes, there must be a different accounting system that meets the specificity of Islamic Finance."

"…Yes, it is vital for the Islamic Windows and other Islamic standards banks to adopt standards of AIIOFI."

"Banks are obliged to apply international Islamic standards so that IBs and Windows comply with the principles of Islamic Finance."

"Accounting in Islamic Finance is different from conventional accounting, hence the obligation to separate the two balance sheets in the event of the establishment of an Islamic Window."

"For standards, it is best to start with existing standards such as AAIOFI and IFSB, and to set other standards in the future as needed."

"Since our bank has not yet started in this niche, it should be noted that the IFSB and AOOIFI are institutions with different tasks, and if the bank wants to embark on Islamic Finance, the ideal is to take into account the standards of the two organizations."

The participants indicated in regard to the effect and impacts of having different accounting norms:

"For example, accounting report allows: to separate the resources and the jobs of the two entities (classic bank and Islamic Window); chart the objectives of the two entities in order to make strategic decisions; contribute to the separation of accounting data and the required transparency”. Participatory Finance Head of State Window

“The effects will be seen after the Islamic Window is established.” State Window Senior Manager

IFRS does not completely support Islamic financial operations. Therefore, it will not promote the objectives of a particular transaction and will not convey the true economic values of the transaction. An academician in the interview about adopting AAIOFI standards believes that: “The route to adopt the accounting standards, based on AAOIFI, is still uncertain for the sector to move forward. The use of Islamic accounting standards is required to streamline Islamic Banks' operations to achieve their goals. Furthermore, harmonization between conventional accounting standards and Islamic Banking products was necessary to match the nature of IB economic operations for the sector to implement IFRS. Moreover, as far as financial reporting is concerned, IB reporting still lacks consistency when it comes to providing data to users of financial reports and stakeholders.”

6.3 *Shari’ah* Auditing

Due to the differences between the Islamic and the Conventional Financial Institutions, several issues and audit challenges have arisen in the Islamic Financial Institutions. Few issues and challenges have been highlighted, such as the adequate standards for *Shari'ah* auditing practices, the independence of *Shari'ah* auditing practitioners, the qualifications of *Shari'ah* auditing practitioners, and the lack of accountability of *Shari'ah* auditors. (Yaacob, 2012; Kasim and Sanusi, 2013)

The *Shari’ah* board may face difficulties in ensuring the compliance of the products (Ahmad and Khan, 2001). An obligation to obtain approval about the Islamicity of its products and also a certificate about all its operations being in conformity with *Shari’ah*, relates to the effective performance that involves the bank management, which is found to be difficult for the *Shari’ah* board to monitor. Thus, the difficulties raise the need (1) for the Central Bank to undertake the *Shari’ah* Audit (SA) during the process of its banking inspection so that the conformity of *Shari’ah* is examined along with that of the national banking laws and accounting practices or (2) establishment of the independent SA firm in the private sector to undertake SA along with their account audits (Chapra and Khan, 2000).

Chapter Six: Interview Findings and Discussions - Accounting System, and Auditing Practices

Even though in the recent revised *Shari'ah* Governance Framework there is a fresh requirement for the bank to provide more SSB at bank-level consisting of SB from different backgrounds, Islamic Banks are presently facing problems in looking for SSB that can fulfill this requirement. Therefore, it is challenging to find suitable personnel, in terms of SB that are suitable to be appointed as SSB. Challenges in the development or implementation of the *Shari'ah* governance framework are the expertise of SA and *Shari'ah*. As pointed out earlier, *Mu'amalah* involves complicated banking products, where there is sometimes a dichotomy between what is approved and how it is implemented. The sector still has an insufficient amount of expertise to understand the theoretical and practical elements of the products and services. It is currently the responsibility of *Shari'ah* department staff and audit staff to perform both duties.

Observations on human capital issues of the understanding of the nature of the dichotomy between theoretical and practical elements of innovation and implementation of products and services led in the misunderstanding of *Shari'ah* issues. Furthermore, the presence of non-*Shari'ah* compliance situations increased the need for the *Shari'ah* compliance audit when implementing the product. Auditing will help the organization in ensuring that what the *Shari'ah* Advisors are deliberating is properly and appropriately enforced. Thus, besides financial auditing procedures, IB needs SA practices. In addition to above, the interviewees highlighted the role and objectives of the *Shari'ah* audit as follows:

“The main purpose of the audit supervision is to detect the slightest deficiency in our proposed banking operations and various products.” Private Window Senior Manager

“The objective of the *Shari'ah* Audit is to ensure compliance: process, parameterization, and accounting.” Private Window Head of Participatory Finance

“It has already been mentioned that the main objective is to ensure ongoing consistency, effectiveness, efficiency and improvement of the governance framework, including through the issuance of recommendations.” State Window Head of Participatory Finance

Different reasons for non-compliance with *Shari'ah* have been discussed earlier, such as educational background, experience, and lack of knowledge of the functioning of Islamic Banks. To guarantee that IB can retain its legitimacy as an Islamic Financial Institution, the issues of non-compliance with product and service execution need to be reviewed.

In the meantime, the CEO of IB and Head of Participatory Window stressed the need for *Shari'ah* audit to reduce the risk of non-*Shari'ah* compliance cases.

"I think it's a good step for the sector to move towards the *Shari'ah* audit, and they should rightly help us to identify all levels of *Shari'ah* non-compliance in Islamic Bank operationalization. We also heard some declarations about non-*Shari'ah* compliance instances from some other banks, academicians, and people." IB CEO

"The audit of *Shari'ah* is not well carried out. This is the issue, and Islamic Windows do not disclose the *Shari'ah* committee. So, the *Shari'ah* audit and the *Shari'ah* department need to be strengthened. The *Shari'ah* department must then operate with the audit, either on an internal or external basis." Participatory Finance Head of Private Window

In addition, *Shari'ah* Supervisor of IB and Senior Manager of Participatory Window observed the significance of the *Shari'ah* audit as seen by bank leadership.

"… In terms of performing *Shari'ah* audit, banks which are subsidiaries of foreign Islamic Banks will depend on their management. So, it will help in terms of avoiding the potential risk in case there is non-*Shari'ah* compliance." IB *Shari'ah* Supervisor

"There is no audit in the *Shari'ah* context of product execution, whether Islamic Banks and Windows follow the guidelines or principles of *Shari'ah*. The *Shari'ah* audit needs to be carried out to avoid any dichotomy between theory and practice and the application of Islamic Banking. We do not want a situation in which theory is left on paper, and implementation is equivalent to Conventional Banks." Senior manager of Participatory Window

Other issue raised by the interviewees is the current *Shari'ah* auditing environment. The Participatory Finance Head of a State Window explained how the auditing service situation in his bank at the moment is:

"Currently our bank constitutes of: A "*Shari'ah* governance sub-committee" is set up within the bank's "Audit Committee," which complements the role of the Audit Committee by ensuring consistency and continuous improvement of the *Shari'ah* governance framework as a whole… Its role: To ensure the ongoing consistency, effectiveness, efficiency, and improvement of the governance framework, including through the issuing of recommendations. Its composition: This sub-committee is composed of a member of the Audit Committee, a member of the *Shari'ah* Compliance Committee and the Chief of the

Shari'ah Compliance Department. Its incorporation: This subcommittee is hierarchically attached to the bank Board of Directors."

However, the other state-owned Participatory (Islamic) Windows stated that at the moment audit service has not been established (the Windows are not operating yet).

"This *Shari'ah* auditing committee has not yet been established."

"The *Shari'ah* audit committee is currently underway."

On the other hand, the both foreign Islamic Banks have a SA as highlighted by Head of SSB and SSB:

"As subsidiary of foreign Islamic Banks, we have an internal SA, which is based in the parent Bank."

"Internally, we have our SA committee, you know, in our bank we depend on management abroad."

In contrast, some of the foreign Participatory Windows do not have a *Shari'ah* Audit Committee. They refer to the conventional audit committee of their banks.

"We have no SA in our Window; we refer in auditing to our Conventional Bank."

"SA does not exist in our bank; we have the same auditing committee of the mother bank."

Table 6.3.0.1 *Shari'ah* Audit Committee

Islamic Bank	State Windows	Private Windows
Do have own *Shari'ah* Audit Committee.	*Shari'ah* auditing Committee has not yet been established.	Do not have a *Shari'ah* Audit Committee.

Source: Elaborated by the researcher

6.3.1 Lack of the expertise of *Shari'ah* audit

There is also a lack of SA expertise in the industry that the SA can perform or exercise, hindering the SA's implementation. The industry is absent in terms of knowledge and experience from experts in *Shari'ah*, Islamic Banking, and auditing. There is a consensus among interviewees that the industry lacks auditors with both *Shari'ah* and auditing expertise and knowledge.

“The lack of qualified or experienced auditors in both *Shari'ah* and conventional auditing could negatively affect the growth of *Shari'ah* auditing and the Islamic Financial Industry as a whole.” IB Head of Reporting Department

“… In *Shari’ah* auditing there is a lack of expertise.” Participatory Finance Head of Private Window

“The industry lacks audit and operational background with *Shari'ah* auditors.” State Window Senior Manager

The findings show that there are very few audit practitioners qualified in both *Shari'ah* auditing and conventional auditing. A study by (Kasim and Sanusi, 2013) found that those practitioners who possess accounting qualification mostly do not have the *Shari'ah* qualification at the same time. Therefore, the sector lacks the knowledge to carry out *Shari'ah* auditing in SA with functional and technical knowledge, set up of an audit framework plan, absence of SA manuals, ability of employees to make critical decisions on *Shari'ah* matters, *Shari'ah* compliance reviews, and *Shari'ah* compliance audits. This subsequently may fail in determining the vision and mission of Islam that preserved within the IFIs. Therefore, a crucial need of the IFIs of having competent auditors that is *Shari'ah* qualified with the accounting and auditing background needs to be addressed promptly.

6.3.2 Absence of External *Shari’ah* Auditor

IFI stakeholders believe that auditors have integrity through the perceived independence of the *Shari'ah* auditors themselves, both in appearance and in act. The integrity of the *Shari'ah* auditors could be further enhanced if they are independent enough to give opinions on the position of the IFIs in being *Shari'ah* compliant (Kasim et al., 2009). In this issue, the existence of an external *Shari'ah* auditor was touched by various interviewees. According to Participatory Finance Head at foreign Window and SSB at IB, an independent external *Shari'ah* Auditor is needed to check the IB activities.

“Although it does not have a direct influence on top management, the function of SSB is seen as similar to that of the company auditors as it is to conduct audits to ensure compliance with *Shari'ah*. This raises the problem of having an external auditor for *Shari'ah*.”

"As far as the execution process is concerned, there must eventually be an autonomous external auditor to check it, to fulfill the interests of shareholders and stakeholders. Their concerns are economic transparency in the operation of the bank and the *Shari'ah* element."

The presence of an internal *Shari'ah* auditor will also benefit the sector and the organization in assessing the extent to which IB fulfills its operational objective. Furthermore, according to Finance Manager at IB, organizations need external *Shari'ah* auditors to check their financial transparency and aspect of *Shari'ah*.

"The presence of an external auditor supervising Islamic Banking or financial institution procedures would help the sector monitor what the Islamic Banks have provided, and is in accordance with the *Shari'ah* Committee's rules and resolutions by examining the audit parameters."

However, according to an Academician, the regulator is still considering whether or not to require the external *Shari'ah* auditor:

"Another thing that may still be missing is external SA. In addition to its internal *Shari'ah* secretariat and audit committee, the regulator has considered whether external SA should be made compulsory for Islamic Banks."

Another Academician added:

"The IFIs is bound to the principles of *Shari'ah*, which among other things proscribe interest element in business transactions. This indicates the need for integrated *Shari'ah* auditing standards that covers all aspects of *Shari'ah*."

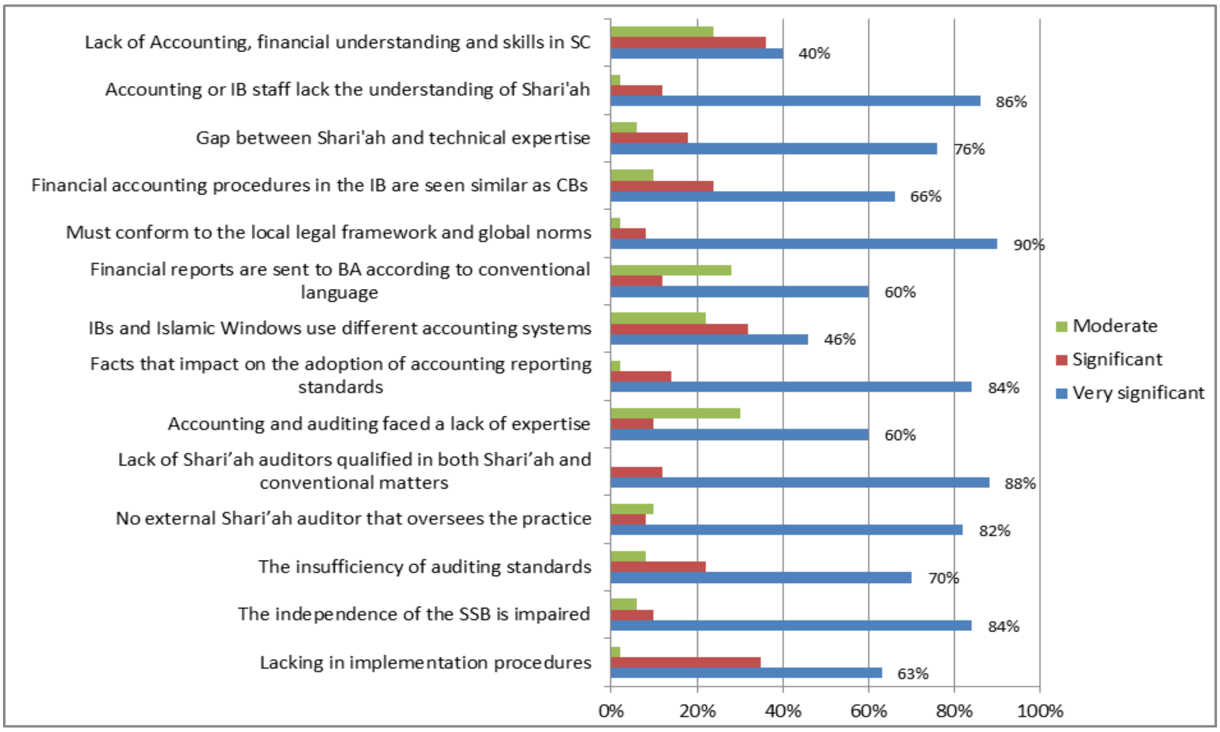
Although there is a need for an external *Shari'ah* auditor in IB, the regulator is still checking whether it should be compulsory. However, the insufficiency of auditing standards that cater for *Shari'ah* principles may lead to misinterpretation of *Shari'ah* rulings and could offer a legitimate platform for any case against the regulation of IFIs to be made.

6.4 Summary

Accounting procedures in Islamic Banks differ a little from those in Conventional Banks. Overall, a discussion with the interviewees provided the feeling that accounting is only the assistance unit (i.e., supporting function) of Islamic Banking. The *Shari'ah* Committee has started to raise awareness of the significance of accounting and financial reporting. It is an important tool to communicate the financial performance and *Shari'ah* compliance of IB. The financial performance is presented in accordance with the statutory requirement and BA's guidelines and *Shari'ah* compliance is being assured through SC's report. This will assist the stakeholders and shareholders in making decisions.

The main problems and challenges related to Accounting and Auditing are summarized in the figure 6.4.1 below.

Figure 6.4.1 Problems and challenges related to Accounting and Auditing



Source: Elaborated by the researcher

Although the statutory requirements for financial reporting are initially designed for Conventional Banks, BA's and IFRS guidelines were created to support the need of reporting in IB. Algeria as a MENA member cannot insulate itself from the developments taking place worldwide. In 2007, the Algerian accounting regulator released The Act 07-11 of November

25, 2007 to replace the rule of the national accounting plan adopted since 1975. The new act is aimed to align the Algerian Accounting Plan (hereinafter, NAP75) with the International Financial Reporting Standards (IFRS) (The Algerian National People’s Assembly, 2007).

Currently, the problems present are pertaining to accounting treatments, which are still tolerable due to the similar nature of products and services with Conventional Banks, however, more standards and guidelines are needed to support *Shari’ah* based products such as *Musharakah* and *Murabahah*. Most the interviewees acknowledge that there is inadequate knowledge of accounting and finance. Accounting and financial understanding and skills are lacking in SCs. Only a few SCs and *Shari'ah* staff know accounting and finance. SCs with knowledge and expertise in accounting and finance will usually operate as middlemen to decrease the distance between SCs and technical professionals. Besides, SCs with accounting and financial backgrounds will be directly involved in accounting and financial issues. SCs with accounting and finance backgrounds illustrate their participation in the discussion of accounting and classification of transactions of operations with accounting experts. However, these SCs, without any background in accounting and finance, have demonstrated their knowledge gap and their dependence on technical employees.

For the SCs to approve certain products suggested by the companies, they are going through a series of meetings consisting of in-depth debates and conversations with practitioners. Practitioners need to be transparent in describing how they do business and how they describe things. This will assist SC to know the fundamental essence of the product and how it is applied in the bank.

On the other hand, accounting or IB staff lack the understanding of *Shari'ah*. They still experience problems in the system if any issues are arising from any misunderstandings that give rise to the need to narrow the gap between the two sides. In the whole system, a strong level of trust is anticipated from the technical professionals to explain to the SCs. Reliable information is extremely requested, as it will help SCs to create reliable and credible *Shari'ah* decisions.

Briefly, The *Shari’ah* committees start to express their awareness on the importance of accounting and financial reporting. Most of them admit that they are lack of knowledge and regarding accounting and finance. They emphasized the gap between *Shari’ah* expertise and technical expertise. Also, SC found that they lack technical knowledge such as accounting and finance. Furthermore, they are aware that more knowledge needs to be acquired by them in order to have a better understanding on the operationalization of the products and services in terms of accounting and finance.

SC and *Shari'ah* officers showed an increased awareness on how they perceived accounting and accountability practices in IB. The process of ensuring the *Shari'ah* compliance of Islamic transactions will influence how people understand the nature and underlying concepts of the products. Also, they portray the importance of such practices in communicating reliable information to the public.

Financial accounting procedures in the IB are seen as complying with statutory reporting, and auditing requirements as performed by Conventional Banks. The external auditor shall comply with the requirements of the leadership, shareholders, stakeholders, and auditing tasks conducted by the external auditor. In fact, as a heavily controlled organization, banking organizations must conform to the local legal framework and global norms.

Besides inadequate accounting standards that will assist the IB to account for Islamic Banking activities, the industry is lacking in accounting systems that assist the preparer of the account to communicate the accounting data. Currently, all Islamic Banks and Windows send their financial reports to the BA according to conventional language; however, Islamic foreign Banks use internally AAOIFI's accounting standards; but, external reporting is sent according to the conventional accounting system; Some of the Islamic Windows use conventional accounting software; however, one of them uses a specific parameter in conventional software for Islamic accounting operations, others use separate *Shari'ah* compliant software in parallel to the conventional; The state-owned Islamic Windows are in the stage of launching their operations, they are prospecting to use separate *Shari'ah* compliant software, however, they are using the conventional accounting system at the moment.

Many prior studies (Cooke and Wallace, 1990; El Khatib and Nizami, 2015) argued that the legal system, political system, tax, reporting system, the legal system and globalization have a significant impact on the adoption of accounting reporting standards.

Furthermore, the problems related to accounting and auditing was discussed. Firstly, both accounting and auditing faced a lack of expertise; *Shari'ah* auditors are expected to serve the needs of the Islamic society whose focus and priorities are different from other contemporary views (N. Kasim and M. Sanusi, 2013). As such, *Shari'ah* auditors are not only accountable to maintain the transparency of financial reports but also ensure that funds in the IFIs are appropriately utilized. However, *Shari'ah* auditors are expected to be qualified in both *Shari'ah* and conventional auditing and accounting matters. They must have adequate knowledge in all finance and accounting related areas including auditing in order to effectively play the role as *Shari'ah* auditors for IFIs. Empirical finding shows that there are very few audit practitioners that are qualified in *Shari'ah* auditing as well as the conventional auditing. A study by (N. Kasim and M. Sanusi, 2013) found that those practitioners who possess accounting qualification mostly do not have the *Shari'ah* qualification at the same time. The lack of auditing practitioners that is qualified or experienced in both *Shari'ah* and conventional auditing could negatively affect the growth of *Shari'ah* auditing and Islamic Financial Industry as a whole. This subsequently may fail in determining the vision and mission of Islam that preserved within the IFIs. Therefore, this crucial need of the IFIs of having competent auditors that is *Shari'ah* qualified with the accounting and auditing background needs to be addressed promptly.

Finally, also, there is no external *Shari'ah* auditor that oversees the practice. Though, there is a need for an external *Shari'ah* auditor in IB, the regulator is still checking whether it should be compulsory. However, the insufficiency of auditing standards that cater for *Shari'ah* principles may lead to misinterpretation of *Shari'ah* rulings and could offer a legitimate platform for any case against the regulation of IFIs to be made; According to Haniffah (2010), the independence of the SSB is impaired as they are involved in supervising the products and operations of IFIs while at the same time conducting *Shari'ah* review or *Shari'ah* audit. With this in mind, there is no clear line of separation of duties that is fundamental in the practice of good governance. As such, the IFIs will have to reassess the needs for clear separation of duties to avoid the misperception of stakeholders of the SSB or *Shari'ah* auditor independence; In addition, the *Shari'ah* auditing is also lacking in terms of its implementation procedures. In addition, the existence of non-*Shari'ah* compliance cases heightened the need to have the *Shari'ah* compliance audit in the context of product implementation. Auditing will assist the institution to guarantee what is being deliberated by the *Shari'ah* Advisors, is being implemented correctly and accordingly. Thus, IB requires SA practices, in addition to financial audit practices.

Chapter Seven: Interview Findings and Discussions - Management

Chapter Seven: Interview Findings and Discussions - Management

7.1 Introduction

The previous chapter focuses on the results of the semi-structured interview and analyses them in regards to the Islamic Banks and Windows' accounting and auditing scheme.

This chapter outlines the findings and discussions on management issues in the Islamic Banking system in Algeria. It begins to discuss the findings in Human Capital (HC), highlighting certain issues related to human capital; the role of the players in ensuring the direction of IB; The lack of expertise of IBs and Windows; the lack of awareness among staff; the negative perception of the public. Next, it analyses the result from the implementation of *Shari'ah* approval procedures including pre and post-compliance processes; then, discussing the knowledge gap between scholars of *Shari'ah* and technical people concerning product approval. Finally, the section examines the results and analyses identified in management area.

7.2. Human Capital

7.2.1 The Role of the Players and the IB's Path to the *Shari'ah* Objectives

At present, Islamic banks and Windows' growth is anticipated to accomplish *Maqasid as-Shari'ah*. The interviewees expressed worries about the path Islamic Banks and Windows are going to take to allow them to fulfil the original goal of establishing Islamic financial institutions. They are also dissatisfied with government assistance for the route taken in order to attain the Islamic Banking and finance goals. Even though, the interviewees understood that Islamic Banks and Windows in Algeria are restricted by the infrastructure that is dependent on the conventional economic system, the original goals must be maintained to reach the advantages of developing Islamic financial institutions for stakeholders and the public.

Therefore, the Islamic Banks and Windows should concentrate on achieving the *Maqasid as-Shari'ah*, which is the pillar of its institution, in addition to focusing on returns. Besides, the role of players and organizations were clarified by the SSB's Head of IB and a *Shari'ah* supervisor as:

"I think that Islamic Banking participants need to create greater efforts to guarantee that the IB is a fully *Shari'ah*-compliant organization in terms of governance, legal and Islamic risk management. If not, it'd be the same as Conventional Banking."

"The players have to understand the differences between Islamic and conventional Banking."

Players should perform their part in ensuring that IB moves towards attaining *Maqasid as-Shari'ah*, in the same context, an academician indicated that the sector appears to have marketed IB while, at the same moment, the foundations and values of IB should be very evident in determining its path towards achieving its *Shari'ah* goals.

"I would conclude at the macro level that we do not have a map of Islamic Banking... Islamic banks constitute a subset of Islamic economics. It seems, though, that we've commercialized Islamic Banking. By freedoms, we should highlight the basis for clarifying the Islamic Banking map."

In addition, another academician in the interview also supported that the establishment of Islamic banks was intended to achieve the *Maqasid as-Shari'ah* (i.e. objective of *Shari'ah*):

"…Islamic Banking and finance's entire purpose is to achieve the goal of Islamic economics, which Chapra has described as a socioeconomic goal. The goals include satisfaction and fair profits."

An IB CEO pointed out his worries on this issue. He said that we should be very clear about IB's foundations and values in determining its path towards achieving its *Shari'ah* goals. However, IB teams need to define where they are going after three decades. For IB, the way forward is either to become real Islamic Banking or merely to mirror CB.

"If we don't adjust the route we do Islamic Banking in Algeria and around the globe, we'll be a mirror of a Conventional bank and will operate in a standard environment. It's going to take a lot of redesigning, a change of mind-set, a paradigm shift, and an assessment of staff. It will be a lengthy evolution, the kind of revolutionary thing…Being an Islamic Bank under a conventional environment… It is a decisive issue."

In addition, a Head of Participatory Finance from Foreign Islamic Window stated the same concern.

"…In terms of direction, we are still uncertain in establishing our own identity on our journey. Islamic Banks will have to develop their path in life in the future. This describes why Islamic Banks go beyond profit-making."

The interviewees at present stated the player's responsibilities to affect future advancement and development in Islamic Banking in Algeria. Their awareness is essential because it will fuel subordinate behaviour in IBs. Islamic Banks, though, are also restricted in the decision-making mechanism by different authorities

7.2.2 Lack of Awareness among Personnel in Islamic Banking Practices' Theoretical and Practical Aspects

Several interviewees identified the willingness of the sector to adopt the conceptual or theoretical model of Islamic Banking business for the sector to progress towards real Islamic Banks and Windows. The interviewees voiced their greater awareness of the need to enhance Islamic Banking operations to attain *Shari'ah* goals. Islamic Banks and Windows were set up from a religious motivation (i.e. *Shari'ah* law); they are anticipated to accomplish their *Shari'ah* (i.e. *Maqasid as-Shari'ah*) objectives.

The interviewees expressed their worries about the path Islamic Banks and Windows are going to take to allow them to meet the primary goal of establishing Islamic financial institutions. They are also worried about support from the government in Algeria to promote the path that Islamic Banking will take to attain their goals. While the interviewees recognized that Islamic Banks and Windows are restricted by standard economic system-based infrastructure, the original goals must be maintained to attain the benefits of developing Islamic financial institutions for stakeholders and the public.

“The development of the Islamic Windows project requires political will...” Senior Manager of State Window

The sector needs a CEO or top leadership of Islamic Banks and Windows who appreciate and comprehend the theory and practice of Islamic Banking and finance operations, as well as the distinctions between what is theoretically practiced and what is practiced in Islamic Banks and Windows. *Shari'ah* background and technical experience held by top management would lead to the comprehension of the CEO and the capacity to understand the practical and theoretical elements of the Islamic Banks and Windows' products, facilities, and activity. A leader needs to know the goals of setting up Islamic Banks and Windows, and be prepared to streamline the IB's mission, vision, and goals that support both business viability and socio-economic advantages. Failure to acknowledge the establishment's aspiration could hamper growth and prevent lower-level employees from fulfilling their duties following Islamic banking values. The commitment to *Shari'ah* will also affect the top leadership to make the correct mind-set judgments.

Because of various decision-making authorities and the expertise and abilities of top management, several interviewees especially from the foreign and State-owned Windows voiced their fear at the absence of top management governance, leaving the bank with the incorrect mind-set.

“I think the Participatory Head must have a powerful *Shari'ah* context and knowledge in Islamic Banking and finance.”

“The Window leader should possess Knowledge in *Shari'ah* and had good experience in IBs.”

A senior manager from State-owned Participatory Window anticipates that Islamic Banking's potential leaders would have more exposure to *Shari'ah* to create more knowledge of Islamic Banking's principles and procedures.

"I expect individuals who have a strong knowledge of *Shari'ah* leading Islamic Windows and Banks. Thus, both the concept and the implementation will be straightforward for them to comprehend."

The interviewees emphasized the importance of people who lead the financial institution to know the objectives, mission, vision, concept, application, and adequacy of human capital to innovate. They also highlighted the significance of complete support from top leadership, and the need for top management to direct the IB towards its socio-economic goals. They also pointed out that some Banks and specifically Windows lack the will of the top management, which is essential to the capacity to spread the real spirit of Islamic Banks' institution and operation.

"Support from top leadership is challenging and vital …." Senior Manager of IB

"Upper-level management's dedication and impact on lower-level management will facilitate the process of influencing lower-level management." Head of foreign Participatory Window

"We need the top management's political will. In some Islamic Windows, parent Banks don't promote the concept. This leads to some Windows' trouble in getting assistance from their top management." Senior Manager of foreign Participatory Window

In addition to having CEOs or senior management of Islamic Banks and Windows in the business who appreciate and comprehend the theoretical and practical problems of Islamic Banking and finance operations, and make differences in Islamic Banks and Windows between the theoretical and practical elements; The interviewees identified the same concern for middle and front line management. It is also anticipated that they will know and appreciate the theoretical and practical elements of Islamic Banking operations.

"Being familiar with banking activities is not the same as a standard operation as an Islamic Banking operation. …." Senior Manager State Window

"…The employees can sometimes not apply their standard bank understanding to the Islamic bank. They can't do what we want and expect." Head of Commercial Department IB

“Lack of skills and qualifications of the Back Office (sales staff placed at the level of the operating agencies responsible for marketing these products) in Islamic Banking.” Senior Manager State Window

“…Comprehension problems with front desk employees (ex-conventional bankers); in particular, Islamic products and the difference between the concept of Islamic finance and that of conventional finance.” Senior Manager State Window

“Shortness in qualified staff, in particular the persons in charge of the sales force placed at the level of the operating agencies (managers and commercial assistants).” Senior Manager State Window

Furthermore, a Head of Department of a foreign Window describes that the human capital for developing and innovating products resides in the Window, while the parent Banks leverage other professionals. A CEO IB also revealed that they only have a support team in the IB to promote the bank's Islamic Banking operations.

“The main Bank has all the expertise, but the experience in Islamic Banking products, *Shari'ah*, and Islamic Banking risk are all with the Participatory Window. In addition to these components, we make use of the main bank.”

“We are a subsidiary of foreign Islamic Banking Group, which means we don't recreate another independent bank. We exploit the infrastructure of the parent bank within the banking community. We also have our own worldwide Islamic industry, Islamic treasury, Islamic company, human capital, and growth of company…”

Even though the respondents stressed the need for top leadership with the correct mind-set in the development of IBs and noted the absence of knowledge in human capital at the bank stage. There is a lack of experts in the sector who are both skilled in technical and *Shari'ah* knowledge, that will speed up certain procedures and understand the distinct IB needs. For all types of tasks, the balance of requirements is crucial. But on the other side, fresh graduates are very new in the industry, and this is where they begin their profession. However, having senior staff in the bank with prior expertise in Islamic Banks provides oversight to the new graduates. The interviewees, therefore, noticed that the values in line with the *Shari'ah* instruction are not transpired.

7.2.3 The Absence of Industry Expertise in Islamic Banks and Windows.

In this subsection, we are further debates linked to the absence of industry expertise in Islamic Banks and Windows. To comprehend the theoretical and practical elements of Islamic Banking and finance, the employees need to obtain dual understanding. There is a need for understanding, as this will generate Islamic Banking staff that will be willing to apply their knowledge to achieve a juncture between theory and practice. In Algeria, *Shari'ah*'s implementation in products and services is still regulated by the country's conventional law and several global laws. In addition, interviewees also stressed the significance of dual understanding and multi-skills which increases staff understanding of the overall operations of Islamic Banks.

"Concern…lack of reference *Shari'ah* and *Shari'ah* consultants with a double knowledge in *Fiqh Al-Mu'amalat* and banking techniques especially when launching new products." Head of Participatory Finance of Foreign Window

Furthermore, according to interviewees, if the staff had value-added skills such as comprehension expertise and dual language, it would be a benefit for businesses

"As IB staff, you have to comprehend and know the information that underlies it. In the Islamic Banking sector, we lack staff with efficient interpersonal skills…" Head of Financing Department IB

"Currently the staff and executives practicing in traditional Banks planning the establishment of Islamic Windows do not have the necessary knowledge on the subject (*Fiqh Al Mu'amalat*), neither comprehend English language they must be trained in this direction." Head of Participatory Finance of State Window.

"…In addition to the technical and practical expertise and skills of IB staff, those with English and Arabic skills would be extremely haunted." Head of Commercial of IB

"The human capital exercising in Conventional Banks setting up Islamic Windows are not experts in the field, the bank has set up a program to form a significant part of its workforce". Senior Manager of Participatory Finance of State Window

The level expertise in IB influences the way they show appreciation of *Shari'ah* in the operation, products and services and implementation. Because Algeria has been colonized by the French colonist for more than 132 years, it is regarded a French-speaking country. Moreover, today's world business and most literature, particularly Islamic, English, and Arabic, are the dominant languages. It is, therefore, vital for the Islamic industry in Algeria (knowing that English is very weak in Algeria) to have staff with expertise and skills in both languages.

Thus it is suggested that dual knowledge would result in an understanding and appreciation of the unique operation and environment of the IB industry and would allow the diversification of human capital that would allow us to find a point of junction between theoretical and practical, which, in turn, would allow better products to be developed and innovated.

Furthermore, the lack of *Shari'ah* awareness among practitioners and the lack of technical expertise among *Shari'ah* academics require an in-depth understanding to enable everyone to understand the *Shari'ah Maqasid* and Islamic Banking concept. Adequate knowledge and understanding permit to better understand the topics and procedures that have taken place and to prevent *Shari'ah* problems after approval of the product.

Besides, the bank's technical expertise is required to obtain fundamental *Shari'ah* understanding. For instance, human capital could design a viable product and *Shari'ah* compliant in product development and innovation Also, when checked by the *Shari'ah* Advisors, the raw product may experience fewer issues, which will speed up its launch. On the other hand, it would take less time to approve a certain item for the SA that possesses the technicalities of IB activities on product and system. As they know the technical aspect of the procedure, they will also generate more accurate and credible decisions. This is supported by SC IB:

"The most significant element to be encouraged by the IB is to have a combination of SC backgrounds. In my experience, if an individual who has *Shari'ah* expertise without any technical knowledge is unable to understand what is being submitted to him and can quickly approve the product without any true understanding of the product's operationalization… Not only does it look at the framework, but it also includes verifying the agreement and all associated problems. Because of the involvement, I believe there is a need to improve a *Shari'ah* advisor's ability to have dual knowledge." CEO of IB

Also, for those who have obtained *Shari'ah* understanding, familiarity with technical expertise is very fundamental. The *Shari'ah* area they acquire is also a major problem as it is the measure of the depth of understanding that human capital has in promoting the *Fiqh Mu'alamat*. They may also have other fields of *Shari'ah* knowledge, which assist them to understand *Fiqh Mu'amalat* indirectly or assist them to make a decision on the Islamic transactions and *Mu'amalat*.

"We have individuals who are qualified in *Shari'ah*, who have good knowledge of *Shari'ah*, *Fiqh*, *Fiqh Mu'amalat* or *Usul Fiqh* but we don't have a lot of individuals who know the details of *Mu'amalat* and people who comprehend complex banking products." CEO of IB

In addition, interviewees highlighted the significance of double-majoring or multi-knowledge, and multi-skills.

"For instance, graduates with a double degree would be extremely requested by someone who has *Shari'ah* and at the same moment has legal training that will be extremely refined afterward." SB of IB

"I believe you have to define the IBF or Islamic financial services diversification of human capital as it is very distinctive. You need to have a mix of understanding in that sense." Head of Participatory Finance of Foreign Window

In addition, the contest is also applied to standard Banks' Islamic Windows. This is because of the nature of the Windows operating on a leveraged model in which parent Banks leverage departments. There will be a department in the Windows that will train the bank employees of the parent involved in the product sales. Moreover, staff is initially from Conventional Banks or is in fact Conventional Banks (i.e. parent banks). Islamic Banking products and services lack adequate knowledge, specifications, and comprehension. They also lack the ability and skills to explain clients Islamic Banking goods.

"This suggests that when given the chance the staff of Islamic Windows prefer to sell Conventional Banking products because they are more confident and knowledgeable about conventional products." Head of Participatory Finance of Foreign Window
"We are having difficulties to convince customers wishing to adhere to Islamic products-speaking of Islamic «Windows"." Senior Manager in Foreign Islamic Window

"A simple client is not easily convinced when he addresses a traditional banking agency with an Islamic "counter" (separation of accounts, cash, destination funds, human resource ...)". Private Window Senior Manager

The interviewees also highlighted the IBS and widows level's efforts to ensure that human capital is prepared to develop IBS in conjunction with its conventional counterparts in every aspect of the operation. In addition, the interviews concentrated on training, campaigning and marketing to guarantee that standard markets affect or influence the end-to-end process of product development, and sales person support at parent companies and Islamic financial service pricing.

“The use of research, promotion, and training is essential, given the novelty of the experience. Conventional Banks planning the opening of Islamic Windows are faced with a need: "they must find equivalent solutions and adapted Islamic Banking services and products" likely to replace or supplement existing conventional products”. State Window Senior Manager

“…All these elements are essential to the evolution of Islamic finance activity.**”** Head of Participatory Finance of State Window

“Business development unit will guarantee an end-to-end process for the development of Islamic products. In addition, the unit will support the sales individual at the bank in terms of training, campaigning and marketing.” IB Head of Commercial Department

“Since Islamic Banking and finance operates in the same environment and market forces with Conventional Banks, we experienced that Islamic financial service pricing is affected or influenced by the conventional market due to its competition….”Head of Participatory Finance of Private Window

From the above we can summarize, IB's debate about human capital concludes that there is still a lack of human capital in education and information about *Shari'ah* knowledge or technical expertise and abilities. There is also a shortage of experience in IB among the human capital. In terms of experience, the employees can either obtain experience from standard banks or join the IB without any knowledge from new graduates. On the one hand, human capitals possessing CB experience may be influenced by their work experience in IB. On the other hand, new graduates entering the IB will be influenced and trained by their co-workers who have had previous experience in the IB.

Therefore, according to the interviewees IBs and Windows in Algeria need; 1) for Conventional Banking experience because this will help in terms of knowledge and experience that can be useful in product development and operation of Islamic Banking; 2) for qualified Islamic Banking staff is a significant factor in the Islamic Banking industry; 3) Islamic Banking staffs need to have Conventional Banking experience in order to add value to their services. Conventional Banking experience will be an added advantage to the staff in Islamic Banking product development and operation.

The overall findings indicated there was less qualified Islamic Banking staff in Algeria due to minimal and inadequate training in an Islamic Banking environment, which is consistent with the findings of (Karbhari et al, 2004). Thus, the lacking in the qualities or requirements needed from the staff is an evidence for the need for education and training to create awareness and to increase the awareness level of staff.

7.2.4 A Negative Conception of the Public

Because of an absence of comprehension and knowledge of Islamic Banking, human capital may find it difficult to explain its products and facilities to clients and the public. Lack of adequate and thorough information can lead to confusion and misunderstandings between customers and the public about Islamic Banks' products and services. This will thus become another challenge facing the sector, which is an adverse view of the public. This issue could begin with an absence of education, information, and awareness among bankers about Islamic Banking and finance, leading to miscommunication with the customer and the public. There is a shortage of range of experiences in Islamic Banks that can justify and educate IB products and services to customers. It starts with front-line employees in the bank who do not adequately describe Islamic Banking products to the client and do not respond to the customer's request and complaint. The interviewees further describe that problems related to the shortage of personnel expertise may lead to an absence of customer comprehension in appreciating Islamic Banking companies and operations.

"…lack of training that generates errors. In some cases, customer loads are unable to answer customer questions." Head of Participatory Finance of Private Window

"…For example, when bankers and customers have concluded a contract between them and the manner in which they explain the product to the end-user may not reflect an Islamic product, they may simply explain the product to their customers as a loan and say that there is no difference in the rate you have paid from the conventional. The pricing may be comparable, of course, in terms of the price, but the agreement, the entire fundamental values, is distinct. These are things they may not have complete knowledge of and therefore they cannot educate their clients or end-users on these elements." Director of Commercial department of IB.

Furthermore, to the above issue another challenge may occur from the approach of clients and the public who continue to compare the IB and CB without really knowing IB's fundamental values. The clients know the Conventional Banks very well and tend to compare both services. As a result, customers will misunderstand and confuse the general activities and products of Islamic Banking activities due to the lack of explanation from the front line.

The senior manager in a foreign Islamic Window highlighted as follow:

“Islamic Banking customers are very much used to conventional products that lead to a tendency to choose a product that eliminates the uncertainty and inclination of customers to choose a debt-based product.”

The SSB of IB added:

“Some people view that the Islamic Banks and especially the Windows products and services are the same as the conventional ones they use deceit (*Hyal*) to expose it as compliance with the *Shari'ah*. This negatively affects the minds of conservatives.”

As staff is unable to recognize the distinction between Islamic Banks and the products of standard Banks, they may provide incorrect information that will lead to misunderstanding of clients, potential clients, and the public. Customers and the public may interpret the information they have obtained differently or incorrectly, leading to allegations that there are no differences between Islamic and conventional products.

The following points were illustrated by several interviewees:

“…The transactions of the contract involve various documents to ensure compliance with *Shari'ah*, Therefore, . This leads to the negative perception.”

“The seller and the customer can sometimes be the same and unique person, speaking of the *Murabahah (Bai' Al-‘Inah*), which increases the speculations that IBs use deceit (*Hyal*)…”

“The sales contract with the client is signed before the acquisition of the assets by the Bank (*Murabahah* Signature). This transaction was found to be unlawful by some scholars in Algeria, increasing doubts about IB's operations and products.”

"If we are not clear on our map, we tend to follow the practices of Conventional Banks. Therefore, at the end of the day, the public will claim that there are no differences between Islamic and conventional."

"The same product is sold in the same Conventional Bank (with a Participatory Window in it) in different desks with different names (i.e., Islamic and conventional labels). Sometimes some issues are hard to understand, how can they be clarified to customers?"

IB's Director of Commercial Department gave an example of the staff's lack of explanation to inform the customer; is the explanation of documentation processes in IB involving documents that outweigh CB's:

"The cost of contract stamping is also increased in addition to various contracts and documentation involved. Different procedures are also involved in concluding a contract to ensure that the contract is fulfilled and that it is compliant with *Shari'ah*. There is always a justification, however, why it requires different documentation and why it should maintain the sequence. Irrespective, it will lead to negative perceptions of the overall operation if the public is not well informed."

As stated above, negative perception may result from the attitude of clients and the public who continue to compare the IB and CB without really knowing the IB's fundamental values. The customers know the standard Banks very well and tend to compare both services. As a result, given the absence of front-line explanation and the lack of customer knowledge and understanding, clients will be confused and uncertain about the general operations and products of the Islamic Banking organization. As a consequence, customers will pick a product comparable to CB as they are more conscious of the item of CB. This will generate a product that is more debt-based, with less risk and less uncertainty marketed to the customer.

The public's negative perception of IB is attributed to the lack of customers and players' education, understanding, and awareness. If clients lack the understanding of Islamic Banks, the participants are anticipated to perform their part in assisting or correctly explaining to clients or potential clients. However, as there is also a lack of human capital in the sector in education, understanding, and awareness of the expertise and spirit of IB, it results in confusion, misunderstandings, and misperceptions of clients and prospective clients.

CEOs attracted attention to how clients' requirements were produced. In this situation, the familiarity with CB products affected the requirements of clients of IBs. As the top leadership, their problem is to know what clients are requesting as it will help them deliver products and services that are feasible on the market. As a consequence, different products have the same features as standard products. However, it may seem feasible the *Shari'ah* scholars pointed out that this supplied the same macroeconomic effect as standard products in the long term. Measuring the religious commitment through the *Shari'ah* compliance of the overall operations, products and services should be extended to the macroeconomic impact of business banking activities. The lack of a macroeconomic impact would hinder the fulfilment of the objectives of *Shari'ah*. However, the macroeconomic implications of Islamic Banking are still being formulated on the assumption that it should largely be based on profit sharing (Siddiqi, 2006). Furthermore, among others, the application of an Islamic financial intermediation is expected to create risk-bearing capital and new entrepreneurs to generate innovative sources of growth in the economy; meeting the capital needs of entrepreneur expertise, enabling the circulation of wealth, reducing income inequality and ensuring economic stability (Khan, 1994). However, having different products with similar features to conventional products will result in an Islamic Banking institution with the same exposure as a Conventional Banking institution; Whereby, any impact on the property side would create the bank's instant crisis which could derail the bank's balance.

Shari'ah scholars also stressed the absence of customer education, understanding, and awareness that influences the decision to select products and facilities from IBs. Besides, CEOs and academics of *Shari'ah* expressed worries about the absence of human resources education, understanding and awareness when interacting with clients; this may affect the perception of clients or prospective clients when selecting products and services from IBs. CEOs were generally more worried about IBs ' ability to commercialise their products; factors that may boost demand for IB products and services were therefore focused. *Shari'ah* academics, on the other side, were more worried about the factors that affected customer choices in selecting products and services from IBs.

7.3 *Shari'ah* Compliance Procedures

7.3.1 Pre-Compliance Procedures

There are two categories of *Shari'ah* compliance procedures: pre-compliance and post-compliance. Also known as pre-launch procedures or ex-ante compliance are the pre-compliance procedures. The procedures are performed before the product is placed on the market to confirm its compliance with *Shari'ah*. The product is being conceptualized at this point. Product conceptualization includes different parties in Islamic Banks. In the interview the participants pointed out that; it generally involves the product development department, legal department, and any other associated department to forward their product proposition to the *Shari'ah* department for them to submit product proposals to the *Shari'ah* board. The product development team is involved in proposing a proposal for new products by obtaining the product structure and establishing the product's compatibility with *Shari'ah*. The proposal will be forwarded to the legal department to review the legality of the product. The proposal will then be presented to the *Shari'ah* Department for review of *Shari'ah* compliance and submitted to the *Shari'ah* Committee (SC) of the Bank. During the approval phase of product development and innovation, the committees concerned will confirm the initial proposal for product development through making the product *Shari'ah* compliant or innovation of *Shari'ah* based products. Before endorsing and validating the agreement, the *Shari'ah* committee will address and deliberate the fundamental ideas and methods to guarantee that the agreements comply with *Shari'ah*. They will also deliberate on *Shari'ah* -related problems and discuss and resolve any *Shari'ah* problems that may occur. The deliberation will be carried out thoroughly until SC is satisfied with the product's *Shari'ah* compliance. Discussion and deliberation may take more than one session on certain products. Once the product is approved, the concept used will be approved, the contract will be recognized, the documents concerned will be verified, and the procedures engaged in a transaction will be established; it’s prepared to place the product on-the-shelf. If the item is not approved, however, it will be amended and re-submitted to the SC. Moreover, the issue will become essential since most people do not have a dual understanding. However, in this case, the middle man between the *Shari'ah* individuals and the technical individuals would be those who have dual understanding.

The SC, therefore, needs the collaboration of bank management and *Shari'ah* officers in the *Shari'ah* department in this situation to allow them to comprehend Islamic bank practice.

For SC to approve certain products suggested by the banks, they will go through a sequence of conferences consisting of in-depth debates and conversations with professionals. Practitioners need to be clear about how they do business and how they describe things. This will assist the SC to know the product's fundamental nature and how it is applied in the banks. However, if any issues arise from any error that created the need to reduce the gap between the two sides, they will still experience problems. Management of the bank is anticipated to demonstrate their collaboration, approach, and leadership knowledge centred on *Shari'ah* as the grounds of the procedure, capacity to implement instructions or choices. On the other hand, the department of *Shari'ah* should perform its part in avoiding miscommunication between the leadership of the bank and the *Shari'ah* commission in order to achieve greater item innovation, growth, and execution.

There is a great need for collaboration between the sides concerned and SC to ensure that SC is able to fulfil its responsibilities. Cooperation with various sides will assist SC to perform accountability to approve the product and sign the document and assure the public those Islamic Banks ' activities are consistent with the *Shari'ah*. It also enables Islamic Banks to fulfil their responsibilities. Also, they need to equip themselves with different kinds of information to ensure that the SC is willing to fulfil their responsibilities and accountability. The *Shari'ah* committee's participation with technical issues differs depending on their knowledge. The SC with accounting and finance backgrounds, for instance, would be directly involved in accounting and monetary issues. Those SCs with no accounting and finance background, however, confessed their knowledge gap and dependence on technical employees. Besides, the SCs became more aware of the significance of accounting to communicate Islamic Banks' real financial value to stakeholders as a whole.

7.3.2 The Knowledge Gap in Pre-compliance Processes between *Shari'ah* Scholars and Technical Expertise

In previous and current chapters, we have already discussed some issues related to SC (SB); role, relationship, dual expertise ... etc. In this subsection we continue to highlight the involvement of SC in the management.

The *Shari'ah* committees/scholars without the technical background will depend on the technical people's explanation to clarify the product's proposition so that the *Shari'ah* committee/scholars can comprehend the technicalities and the product's implementation.

The head of SC and an SC in IBs refer to the reliance on the explanation provided by the technical human capital.

“SC relies on the bankers' explanation of the product's proposition so that they can comprehend the technicalities and the product's execution …”

“I should have excellent leadership interaction. Management must, therefore, emphasize this point to all the institution's departments and stakeholders to guarantee that everything complies with *Shari'ah*. We are not masters of all, we have certain limitations….”

In addition, both interviewees emphasize the significance of transparency during the *Shari'ah* committee/scholars' explanation. Transparency in clarifying and notifying will guarantee the accuracy level of the SC's decisions. The head of SC in IB stressed the issue of transparency.

“I always emphasize the issue of transparency to my colleague to deliver on our responsibility as a *Shari'ah* committee. We're afraid, without transparency, the decision we make it will be affected because we are very dependent on the technical people's explanation.”

In addition to ensuring that the data they obtain is right, according to SC in IB, the *Shari'ah* individuals may experience problems in understanding the technical people's explanation owing to an absence of technical issues:

“We, *Shari'ah* individuals, have different approaches and languages than technical individuals. Most of the time when we meet with them we have a problem of misunderstanding. So we're doing our utmost to understand one another. There is also sometimes a situation where human capital occurs that both understandings will require a middle person to decrease the gap between *Shari'ah* and technical individuals. That's essential, or else the SC ends up approving something unique about what we know.”

He added: “However, if we rely solely on the technical people's explanation to comprehend the technical views, it would mean that the explanation's reliability depends on the staff's confidence. Having staff with the correct values, such as honesty, is essential.”

In addition, the SC of IB also emphasizes that:

"*Shari'ah*, or technical human capital, may misunderstand what is being discussed and delivered. This, therefore, raises the importance of good communication."

Moreover, when the explanation provided by the assistant agent is not evident, there are also cases where issues occur. Therefore, the head of Department has to explain. This demonstrates that the head office can do the explanations more effectively. The human capital and SC, therefore, need more visibility and knowledge to allow them to clarify the topic. The Participatory Finance Head of Private Window highlighted the problems faced by the industry in terms of the staff's inability to understand or explain:

"How lower-level managers explain certain subjects may lead to dissatisfaction among higher-level managers with the explanation or justification provided by *Shari'ah*'s advisers, due to the inability of lower-level managers to explain to *Shari'ah*'s advisers correctly."

The above discussion demonstrates the diverse issues between *Shari'ah* scholars and the innovator and executor based on the different expertise and background in the exercise of responsibility and accountability. This section highlights the aspects of understanding *Shari'ah* issues and the technical issues of the technical people and the scholars of *Shari'ah*, respectively. These issues will lead to a misunderstanding and miscommunication by both parties to ensure that the operation of certain contracts is consistent with *Shari'ah*.

So we can conclude that there is a lack of technical expertise for the *Shari'ah* individuals and that there is a lack of technical individuals in *Shari'ah* knowledge. Thus, in the area in which they are deficient, they depend on each other to provide them with the information explained to them. *Shari'ah* individuals will clarify *Shari'ah* issues and try to understand technical issues of technical competence, and technicians will clarify technical issues and try to understand *Shari'ah* issues. This shows that individuals from *Shari'ah* and technicians are extremely dependent on each other.

The sector requires knowledge in *Shari'ah* committees / scholars and the *Shari'ah* department needs to be strengthened to decrease turnaround times in order to achieve approval, to speed up the approval process, to support the audit process, to address inner *Shari'ah* problems, to supervise the products and services, the documents concerned, advertising, marketing and ethics, and to decrease SC's total reliance. Furthermore, to speed up the decision-making process, IBs must have a personnel pool that can inspire their knowledge.

Furthermore, an SC foreign Participatory Window stated:

"We need more *Shari'ah* scholars in the bank with key positions, it's useful for day-to-day decision making because they have direct access to the front liner."

However, it was found from the interview that the *Shari'ah* department in the Islamic Windows banks still lacks strength.

"Strong *Shari'ah* department will decrease waiting time for some approval procedures…" According to the Head of foreign Participatory Window:

"By enhancing the *Shari'ah* department, the approval process is considered to be accelerated as the staff is with the bank full-time. Moreover, the procedures of auditing will fall into line." Private Window Senior Manager

"I would, therefore, suggest that Islamic Windows should have *Shari'ah* as a fundamental department to examine *Shari'ah* components in the products and other components that should conform to the *Shari'ah*. The staff in the department of *Shari'ah* will be accountable for the products, the name of the product, records, advertising, and marketing and ethics of the staff." Private Window Head of Participatory Finance

"We need a very strong *Shari'ah* secretariat, which can advise, I mean, in-house *Shari'ah*, as well as the external committee." Foreign Private

Furthermore, the lack of expertise on the *Shari'ah* management issue was addressed by the head of the IB SSB:

"People-related issues, the level of skills available in the sector concerning Islamic Banking, particularly about *Shari'ah* leadership."

The knowledge gap between the *Shari'ah* scholars and the industry's technical expertise will lead to *Shari'ah* committee/scholar's requirement for skills in understanding Islamic Banks' roles, functions, and activities. It will also decrease the waiting time required to acquire permission, speed up the approval process, help the audit process, fix inner *Shari'ah* problems, oversee products and services, records concerned, advertising, marketing, and ethics, and decrease SC's complete dependency. The IBs need a pool of employees to be able to synergize their knowledge to speed up the decision-making process. It is therefore essential to have *Shari'ah* committee/scholars capable of understanding the technical viewpoint of the products and services provided by IB, understanding transactions under *Shari'ah* and understanding the *Shari'ah* laws in regards to the offered product.

Establishing departments of *Shari'ah* in Islamic Windows or IBS will strengthen the governance of *Shari'ah* in IBs. The interviewees stated that the *Shari'ah* department would assist communication between IBs and SC. It is also viewed that in IB, for instance, when suggesting new product development or innovation, the department can help and speed up multiple procedures. The department may also be the intermediary between technical staff and *Shari'ah* staff. The department still lacks *Shari'ah* management knowledge, though. The department must be reinforced in order to enhance the present management of *Shari'ah* in IBs.

The Department of Internal *Shari'ah* Control is the most important component of *Shari'ah* implementation outside the supervisory board of *Shari'ah* and is the mirror through which the supervisory board of *Shari'ah* illustrates the financial institution or product. It must also possess appropriate relationships with the *Shari'ah* supervisory board and management, and must have access to any information it requires in order to ensure proper *Shari'ah* compliance (Muslim and Zaidi, 2008).This department must have an official connection within the organization, and among many other circumstances, such as integrity and resource accessibility, must meet the requirements of understanding and independence.

7.3.3 Post-Compliance Procedures

Post-compliance (known as post-launch or ex-post compliance) processes occur after the product has been approved and is ready to be placed on the market. Once the products have been approved and on the shelf, it is the responsibility of the front-line staff to carry out their responsibilities to guarantee that the application (i.e. the process to conclude the contract) is in accordance with *Shari'ah*.

While the pre-compliance process is vital to ensuring that the product's *Shari'ah* compliance is in order, it is also essential to make that line management is responsible; The product shall be implemented following *Shari'ah* (i.e. under the approval of the SC; as it shall operationalize all the processes authorized by the *Shari'ah* Board. The accountability resides in the implementer's hand, such as front-line employees, during ex-post compliance. Furthermore, the *Shari'ah* committee is concerned with implementing authorized and endorsed products and services. Ensuring that all processes and commitments are developed and executed is essential for the bank. Thus, line management will implement and execute the approved product as well as perform the sales and purchase agreement.

Next, in the process of selling or supplying the product and services to the client, they must ensure that the agreement is executed in accordance with the correct sequence established by the *Shari'ah* committee to ensure compliance with *Shari'ah*. The line management is also the intermediary between bank management and customers. They are accountable for providing data on Islamic Banking products to present customers and prospective customers. They are anticipated to be able to provide the customer with the right product and service information. In addition to a proper explanation, line management is anticipated to clarify the distinctions that arise in Islamic Banks between products in Conventional Banks and products. In order to obtain a better knowledge of the products, relevant data must be revealed to clients.

A proper application will guarantee that *Shari'ah* complies with the products and services. On the other hand, the inability to demonstrate that execution is in line with *Shari'ah* will lead to a risk of non-compliance with *Shari'ah*. Several cases of non-compliance with *Shari'ah* were recognized during execution. The Head of SSB of IB, SSB of IB, and Head of Foreign Islamic Window illustrated examples of the non-compliance.

"…Once we approve the product, it will be implemented by the bank employees. Sometimes we find few things haven't been in accordance with *Shari'ah*. As an example, we approved a product that went through all the procedures and seemed to be compliant, but, after offering it to the customers, we realized that one thing was not according to the *Shari'ah*, and then we had to reconsider a different solution that conforms to the *Sahri'ah*."

"Sometimes things happened unintentionally against what was agreed and decided at the level of the *Shari'ah* Committee. These are the things that need to be reinforced and improvised."

"During the implementation phase, we discovered that there were a few cases of non-compliance with *Shari'ah*."

Interviewees identified cases of non-compliance with *Shari'ah* that arose in Islamic Banks in different interviews. They stated that lack of expertise in both *Shari'ah* and technical knowledge risk *Shari'ah* non-compliance cases in Islamic Banks. *Shari'ah* cases of non-compliance will affect the reputation and image of Islamic Banking.

"If we have not paid enough attention to *Shari'ah* skills and technical knowledge, this will result in a risk of non-compliance with *Shari'ah*. It is a risk where the bank breaches *Shari'ah* principles and causes non-compliance with *Shari'ah*, which will ruin the image of Islamic Banks and the image of Islam, as Islamic Banking cannot represent Islam itself." SSB IB

Furthermore, the existence of a manual as a guideline for the personnel in Islamic Banking operations still exposes the bank to *Shari'ah* non-compliance. The Head of foreign Window expressed:

"It is difficult to ensure the implementation of Islamic Banking's products and services by the front-line staff, despite training being given and the manual provided."

As we mentioned in chapter five, the manual is not fully available in all foreign and State Islamic Windows. It is still under construction for some banks. All State Islamic Windows pointed out that the government did not provide them with *Shari'ah* manuals and that the banks still lack them. This is another challenge some Islamic Windows that make them more exposed to the risk of non-compliance.

Another case of non-compliance in implementation may be due to the lack of understanding among human capitals, which may result in mistakes that are not deliberately made.

"While the item may originally be accepted as *Shari'ah* compatible in terms of execution by the *Shari'ah* advisor, errors may be made to lack the of comprehension on the side of the responsible staff. They think they properly implemented it, whereas, in the end, it turns out to affect terms of accordance with *Shari'ah*. As the example, we discussed previously in this interview." Head SSB IB

The above comments indicate the absence of support personnel expertise. Besides, throughout the questionnaires, several SCs realized that front-line employees would take an easy way out by informing the client that Conventional and Islamic Banking products had nothing very distinct. Examples of statements used by front-line employees when interacting with customers; more documents or contracts involved in the Islamic Banking product that may lead to higher cost of stamping; the Islamic Banks and Windows replaced the term 'interest' with 'profit'; the Islamic Banks and Windows use the same type of product and change its underlying concept with the same economic benefits; for debt-based products, the repayment price in IBs and Windows may be greater, resulting in IBs and Windows clients having to pay more than standard banking clients. Besides, in the event of a BBA-based housing loan or car loan, clients sometimes complain that the Islamic Banking consumer continues to pay more for the same as a standard client. The front-line staff is not adequately attending to the complaint or charges. Moreover, when a car loan agreement is delayed, front-line employees do not clarify to the client that the asset should exist for them to complete the agreement; consequently, the delay in completing the agreement is due to the vehicle distributor's delay in ensuring that the vehicle exists. In addition, the front-line staff should explain to the customer the underlying concept of the products and should supply an explanation on the calculation or additional information. These issues were outlined as follows:

“The contract document must be adequately and correctly formulated, particularly *'Inah*. All the procedures specified must be carried out in a specific way. We are especially concerned with how it is implemented by the marketing individual. In practice, we need to educate them. Staff from the *Shari'ah* department will go and inspect transactions. If the agreement is violated, we must report it.” SSB IB

“There are still many fields to be enhanced because they do not comprehend the item in terms of *Shari'ah* adherence and why the item is distinct from standard banking products when describing the IB's products and services to clients and prospective clients.” Head of Foreign Window

Implementation of line management (i.e., lower management) assured that product and service operationalization was consistent with approved processes. During their review exercises, however, different *Shari'ah* non-compliance instances were recognized by SCs. The justifications for *Shari'ah*'s failure to comply, among others, were lack of understanding of *Shari'ah* issues and the absence of a manual on the operationalization of products and services to guide procedures. This showed, therefore, that the lower management did not practice non-compliant methods intentionally. It disclosed a lack of appreciation on the front-line side of the *Shari'ah* issue. Besides, it depicted a lack of accountability in ensuring compliance was in place. At the implementation stage, the *Shari'ah* non-compliance must be addressed at product issuance to ensure that the entire process had been decided by SC. The absence of accountability has resulted in numerous instances of non-compliance with *Shari'ah*, which will restrain Islamic Banking from meeting its original goals. In this situation, the Islamic Banks and Windows were deemed not fully compliant with *Shari'ah*.

7.4 Summary

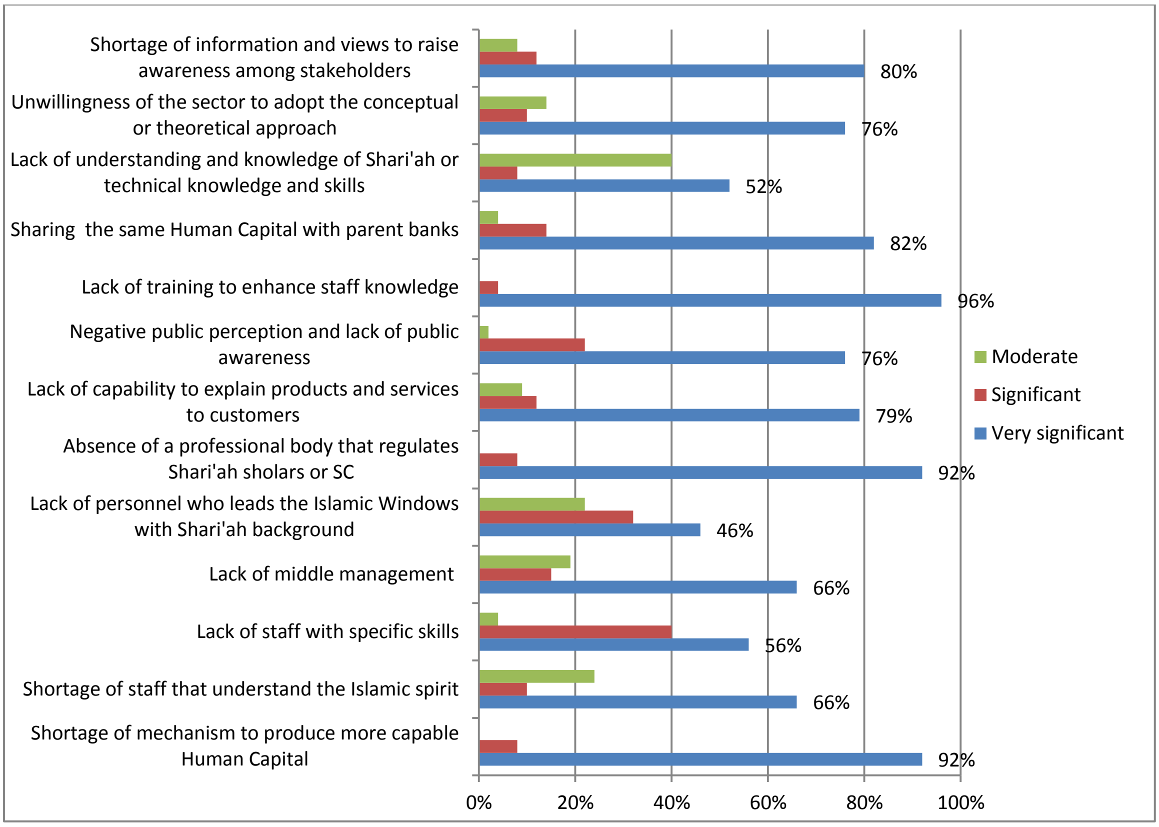
According to the interviewees, in order for the IB to achieve its objective, the industry needs the willingness of players and customers, or potential customers, to enrol in the implementation of the IB operation under its theoretical framework. Given that IB's banking business is valued on the basis of the value of its underlying asset, which represents the true economic value of the asset, it is important for the customer to be prepared to live in moderation and accordance with his financial capacity, because IB is not based on leverage, but depends on the true value of the asset.

Besides, to achieve the true IB, the question raised is: are different groups of people, organizations and governance structures in industry and regulators having the same ambition, insight, understanding, awareness, and tuning to achieve the true Islamic Banks that support the goal of achieving the *Maqasid as- Shari'ah*? The socioeconomic objectives of Islamic economics need to be upheld (Kamali, 1991; Metwally, 1997; Siddiqui, 2001; Metwally, 2002; Kahf, 2006; Siddiqi, 2006; Dusuki and Abozaid, 2007; Kasim et al., 2009; Siddiqui and Iqbal, 2010; El-Karanshawy, 2015; Shaikh, 2017; Rano, 2017). IB needs to achieve healthy development through upholding the initial idealism in meeting these socioeconomic objectives. In addition, Chapra (1979) supported the above statement where he opined that profit is recognised in Islam. However, since profit can be categorised as just and unjust, certain moral restraints should be put in place to foster individual self-interest within a social context in order to not violate the Islamic goals of social and economic justice and equitable distribution of income and wealth (Chapra, 1979).

There is also a need to shape the information and views to raise awareness among stakeholders. The objectives of setting up Islamic Banks to assist identify the direction of Islamic Banking. It would also assist the bank in streamline its activities and decisions. Thus, the Islamic bank should also concentrate on achieving the *Maqasid as-Shari'ah,* which is the pillars of its institution, in addition to concentrating on returns.

The main problems and challenges related to Management are summarized in the figure 7.4.1 below.

Figure 7.4.1 Problems and challenges related to Management



Source: Elaborated by the researcher

According to the interviewees, an organization that offers platforms and players themselves should be sufficiently innovative in terms of *Shari'ah*, and well versed in banking activities that do not follow Conventional Bank activities. Factors that may hinder Islamic Banks from moving towards real Islamic Banking are the general willingness of the public and players, cooperation between Muslim countries, cooperation and collaboration between all stakeholders, economics, political, religious and social will, and absence of a map. Therefore, players must play their roles to ensure that their establishment's true goals are reached.

Overall, different interviewees highlight the willingness of the sector to adopt the conceptual or theoretical approach of the Islamic Banking business for the industry to move towards real Islamic Banks.

Another effort that needs to be adopted is cooperation between Muslim countries to conduct business activities and further strengthen, grow, and promote the Islamic Banking and finance sector. The sector is still deprived of collaboration between other Muslim countries at the time. To guarantee that Islamic Banks move towards proper Islamic objectives; the industry needs a religious, economic, political, and social will. Besides, the industry needs the collective readiness of all stakeholder groups. This involves constructive support from the top management of the bank, the values of the players, and the Bank's willingness to move forward. It may also expect more relevant products to ensure that the economic system achieves the objective of *Shari'ah*.

The discussion on human capital in Islamic Banks and Windows in Algeria concludes that human capital still lacks knowledge and knowledge of *Shari'ah* or technical knowledge and skills. There is also a lack of experience between human capital in IBs and Windows. In terms of experience, the staff may either gain their experience from Conventional Banks or fresh graduates enter into the IB without any experience. On one hand, the human capital that possessed experience from CB may be influenced by their experience in doing work in IB. On the other hand, fresh graduates entering the IB will be influenced and taught by their colleagues that had previous experience in IB. The Islamic Windows shared the same human capital with parent banks. Thus, their education, expertise, knowledge, experience, background, way of thinking, paradigm and different worldview influence the way the human capital make decisions, perform their accountability and responsibility, form opinions and appreciation to the real spirit of its establishment, execute operations and objectives and the missions and visions of IB.

Islamic Banking in Algeria has less qualified staff because the Islamic Banking industry is still considered new compared to Conventional Banking. The respondents agreed that there is a need for competent and knowledgeable staff to provide a quality service in the Islamic Banking industry. This view is consistent with the study by Dusuki and Abdullah (2007) who found that knowledgeable and competent personnel, friendly personnel and customer service quality gained highest ranking in patronizing Islamic Banks. In order to understand why there is less qualified staff in the Islamic Banking industry; respondents were asked whether there is enough training in their bank internally. Respondents from all the Windows commented that there is none or very little training in the Islamic Banking environment. This is consistent with the study found in the UK where a lack of professional courses and training tailored for

Islamic Banking has resulted in a lack of qualified staff. (Karbhari et al, 2004). Only respondent from both foreign Islamic Banks in Algeria said that various training courses are organised by the Islamic Banks. Among others, there is internal training, where training is organised inside the bank. The training is organised by the *Shari'ah* committee or *Shari'ah* officers or independent parties. Usually a *Shari'ah* committee and a *Shari'ah* officer carry out the training in the main office. There is also external training where the bank sends out the staff to seek training or knowledge from universities or Islamic Banking institutions. In addition, there are various conferences, forums, and talks organised at the international or national level. Although there are various training courses organised, the effectiveness and efficiency of the training is to be questioned. Thus, the lacking in the qualities or requirements needed from the staff is an evidence for the need for education and training to create awareness and to increase the awareness level of staff.

In addition, knowledge and understanding of *Shari'ah Mu'amalat* will lead staff to appreciate the need and importance of operating and implementing in accordance with *Shari'ah*. It also affects the level of *Shari'ah* compliance practices in Islamic Banks. Lower education and personnel knowledge means greater risk of *Shari'ah* non-compliance. To improve the quality of human capital in IBs, training is introduced to serve as a mechanism for enriching and enhancing staff knowledge. If there is no spiritual awareness, however, it is difficult for them to understand the reason behind it, which has resulted in difficulty in retaining the knowledge and understanding of true Islamic Banking and underlying the importance of ensuring that everything is compliance with *Shari'ah*.

These contribute to a lack of *Shari'ah* appreciation and an absence of capacity to appreciate the theoretical and practical application of Islamic Banks, resulting in instances of non-compliance with *Shari'ah*. Although they may not make a deliberate error in the execution phase, any misconduct of the processes and procedures will lead to the risk of non-compliance with *Shari'ah*. It will contribute to the *Shari'ah* problem that arose and will have an effect on *Shari'ah* compliance accomplishment. The communication between employees and *Shari'ah* committees usually takes place between the department head and *Shari'ah* committee, which makes the HOD more comprehensible compared to middle and lower management levels. Furthermore, it results in (1) no proper explanation is given by the staff, (2) no full disclosure of information before the customer engage with the contract without full knowledge or understanding on the contract, and (3) lack of understanding of the staff on the contract leads to lack of understanding of the customer. Thus, it depicted a lack of appreciation for ensuring *Shari'ah*'s compliance in all transactions between lower-level management.

Human capital's lack of knowledge and understanding of *Shari'ah* and technical issues and the lack of capacity to appreciate the theoretical and practical aspects of IB's products and services, negative public perception and lack of public awareness have resulted. The lack of capability to explain and communicate to customers related to IB's products and services leaves customers and the public with insufficient information and knowledge on the application of *Shari'ah* to products and services. Furthermore, negative public perceptions may also arise from the attitudes of the public and customers who continue to compare the IB and the CB without further understanding the different principles underlying each banking system. Insufficient awareness and knowledge of Islamic Banking have resulted in incorrect interpretation of the information received from IB staff. Customers should also receive a proper and thorough explanation from the banker as to the various steps and costs involved in the conclusion of the IB contract.

In Algeria, the factors of why customers patronise IB is portrayed in the combination of Islamic and financial reputation and quality services offered by the bank (Dusuki and Abdullah, 2007). Also, the customers' choice would consider good social responsibility practices, convenience and product price (Dusuki and Abdullah, 2007).

Despite an SC's anticipated accountability and responsibility, a professional body that regulates *Shari'ah* Scholars or SC is still absent in the sector. The professional body is intended in this context to promote the SC profession where the interests of practitioners and the public are protected. In addition, the organization would guarantee the establishment of a certain standard of professionalism and detail the required training requirements standard of conduct and code of ethics. Thus, with the presence of a professional body, instruction and competent education programs are anticipated to be ensured by the institution. Extending professional certification for experts would also be expected. However, the call to have a professional body is important as the industry is evolving and developing.

The findings show that problems faced by IBs and Windows in terms of their human capital in Algeria are; (1) lack of personnel who leads the Islamic Windows (i.e. head of Islamic Window) with *Shari'ah* background; (2) Lack of middle management capable of assessing the theoretical and practical aspects of the product; (3) Lack of a frontline staff capable of acting as a link between bank management and the customer, being able to explain to the customer; (4) lack of staff with double majoring; (5) lack of staff that know various languages (i.e. at least English and Arabic); (6) lack of staff with specific skills such as, accounting, risk management, process; (7) lack of staff that understand the Islamic spirit; (8) lack of adequacy of human capital to innovate; and (9) lack of mechanism to produce more capable human capital.

In order to ensure compliance of the *Shari'ah* in IB, it involves two periods that are ex-ante and ex-post compliance. In the case of ex-ante compliance, the responsibility lies with the *Shari'ah* experts to approve transactions. However, at this point, the *Shari'ah* Committee needs an explanation of the product development, legal, marketing, and other support departments. The responsibility lies in the hands of the implementer, such as the front-line staff, during ex-post compliance. Between these two stages, the SC depicts greater accountability compared to the frontline. This can be explained by the knowledge and education of the SA, which enables them to extend the approval of the products and services offered by the banks. During implementation, it has been discovered that there are various cases of *Shari'ah* non-compliance. At the implementation stage, when the front-line staff fulfills their duty, they fail to deliver it properly the staff portrays that they are only doing their job, but their awareness to ensure compliance is not portrayed.

The middle management is more concerned with securing that what has been authorized is enforced in the front line appropriately. The issue of greater leadership is that the products and facilities provided by IB will be feasible in the industry and request for them. This is to guarantee that the interests of shareholders and stakeholders in terms of IB's company results are upheld. If it is perceived that the products that have been approved are not viable, the decision to market the products will be delayed or suspended. Furthermore, the awareness of front-line (i.e. Line management) in ensuring that what is being implemented is in accordance with *Shari'ah* seems insufficient as various non- *Shari'ah* compliance cases are being reported to the CEO and SC. Also, it seems that the front-line do not portray their appreciation towards ensuring *Shari'ah* compliance in the transactions. Furthermore, lack of understanding of the staff on the contract leads to the lack of understanding of the customer due to improper explanation and disclosure of information, which should be given by the staff before the customer engage with the contract. This will result in inadequate knowledge or understanding of the contract. Furthermore, the staffs also portray a lack of awareness to the importance of upholding the *Shari'ah* compliance.

In regards to the customer complaints regarding the higher profit rate of Islamic Banks compared to the conventional interest rates, the major reason highlighted was the element of risk. Interviewee's observed that although the complaint seems valid on comparison of the rates alone, Islamic Banks bear higher risk and the customers enter into a transaction being aware of this higher risk. On the other hand, clients may not consider this element of risk and the amount they need to pay in the case of default payment. However, it requires finance knowledge to understand how banks calculate their rate of return or interest and other hidden costs, and hence banks may need to provide further clarification to customers on how the rate charges are computed to avoid this misperception. In addition, interviewee has also highlighted the challenge faced by Islamic finance in that, it operates under a system designed for conventional finance system, which increases the cost for the industry, and this increased cost is reflected in the rate of financing.

Practical Part Conclusion

Conclusion of the Part

This second part of the research aimed to analyse the findings of the practical aspects of the problems and challenges facing the Islamic banks and windows in Algeria.

In regarding to the Shari'ah compliance, the conclusion of the findings and discussion are highlighted as follow:

- All the respondents emphasised the importance of ensuring *Shari'ah* compliance in every aspect of operations, products and services of Islamic Banks.
- In reference to *Shari'ah* scholars, they were more concerned with the differences between theory and practice, since the theory was based on religion and it is crucial to uphold *Shari'ah* principles. The *Shari'ah* principles must be maintained as they are the root of the system. Moreover, upholding *Shari'ah* principles will consequently lead to the achievement of *Shari'ah* objectives, which will then guarantee the welfare of society.
- CEOs had shown their awareness on the need and importance of *Shari'ah* compliance in all aspects of operations. However, in terms of products and services, *Shari'ah* compliance was not the sole criteria in the offered products.
- It is vital to establish a centralized SSB to oversee the governance framework of the *Shari'ah* in IBs. A centralized SSB has the advantage of harmonizing *Shari'ah* rulings, decreasing *Shari'ah* and IB compliance costs.
- Centralising SSBs in Algeria is not an issue at the moment. Currently, Algerian IB only commercialises their product in the local market. In the event that they decide to market their product globally, they will do modification towards the products and services in accordance to the selected jurisdiction.
- The competition exists between foreign Islamic Banks, Islamic Windows, and Conventional Banks.
- In the future, lack of harmonisation will further affect development and globalisation of the industry. Also, calls for the harmonization will assist in terms of financial reporting and users of financial statement to make a comparison of performance between IB in different jurisdictions.

- Another important element was the viability of products and services. If a product that was well-developed and approved in terms of *Shari'ah* compliance was not viable in the market, the offered product would then be held. CEOs are responsible to shareholders and other stakeholders; thus, it is crucial for them to ensure *Shari'ah* compliance and business performance. On the other hand, *Shari'ah* scholars possessed a different aspiration. They were more focused on guaranteeing that the objectives of *Shari'ah* are achieved, and that the public would enjoy the benefits.
- The dichotomy between theoretical and practical aspects of innovating and implementing products and services, resulted in the misunderstanding of *Shari'ah* related matters.
- The existence of non-*Shari'ah* compliance cases heightened the need to have the *Shari'ah* compliance audit in the context of product implementation. Auditing will assist the institution to guarantee what is being deliberated by the *Shari'ah* Advisors, is being implemented correctly and accordingly. Thus, IB requires SA practices, in addition to financial audit practices.
- *Shari'ah* non-compliance where the mistakes were not deliberately done. Various reasons have been discussed earlier such as educational background, experience and lack of knowledge about the operation of Islamic Banks. The problems of non-compliance with implementation of products and services need to be curbed to ensure that IB is able to maintain their credibility as an Islamic financial institution.
- Factors that hinder the IB to offer such products, such as insufficient regulations, or products not favoured by the customers due to its high risk and involvement in long-term financing. However, it is being argued by academician in Islamic economics that, although such products may appeared to be *Shari'ah* compliant, it is lacking of macroeconomic impact that lead to fulfilment of the objective of *Shari'ah*.
- Since, more debt-based product than equity based product, more efforts are needed in order to gradually introduce *Shari'ah* based products and services in order to open up possibilities and opportunities for the public to engage with banking and financial activities.
- In addition, the *Shari'ah* scholars further voiced out that on the need to have IB's products that are more *Shari'ah* compliant. The *Shari'ah* committee term it as greener product. Thus, it is a call to have products that are based on the *Shari'ah* principles (i.e. value based system).

The next practical aspect investigated the Legal and Regulatory Framework findings and discussions of problems and challenges within the legal and institutional framework in Algeria, which is summarised as follow:

- the lack of a *Shari'ah*-compliant legal framework, needed to make interest-free banking acceptable and create sound financial institutions, is the major hindrance behind its low penetration in the financial market. The legislative structure is functioning against the complete growth of Islamic banking in the country.

- The Banking Act, Central Bank Act and other regulations pose the greatest challenge to the development of Islamic Banking in Algeria. The Act does not define or acknowledge the existence of Islamic Banking and does not define its operations.

- Commercial banking and business regulations that are suitable for the application of Islamic banking and economic agreements do not exist. Islamic banking contracts are regarded as buying and selling properties and are therefore taxed twice.

- The *Shari'ah* manual is not fully accessible in all private and state Islamic windows. It is still being developed for some banks. All state Islamic windows pointed out that they were not provided with *Shari'ah* manuals by the government and that the banks still lack them. The interviewees highlighted on the reliability of the *Shari'ah* committee report issued yearly. Also, it was found that, not every Islamic window has the *Shari'ah* manual as a guideline for the staff in carrying out their duties and responsibilities.

- More Regulatory Framework is needed to support the *Shari'ah*-based operation and inexistence of statutory acts for each IB and Islamic windows' products and services to encourage more product development and innovation.

- Regarding financial reporting, IBs in Algeria comply with IFRS. Various researchers are opposed to the idea of complying with IFRS because it is not fully accountable for Islamic banking business activities. However, since the current products and services in IB resemble the CB's products and services, the compliance with IFRS is acceptable.
- However, the industry needs to have an accounting standard that fully support their products and services, especially products based on PLS.

- More regulations are required to support the innovation and development of products based on PLS. In addition, the need for well-defined property rights for efficient PLS function and fairer treatment in taxation, are considered to be a major obstacle in the use of PLS and secondary markets for trading in Islamic financial instruments; *Mudharabah* and *Musharakah* are particularly non-existent (Dar and Presley, 2000).
- The attempt to construct Islamic banks and windows' legal and regulatory structure and prudential supervision is essential, as Islamic banks have distinctive features compared to their conventional counterparts. The development of regulatory and supervisory framework that would address the issues specific to Islamic institutions would further enhance the integration of Islamic markets and international financial markets (Iqbal, 1997). The regulation and the supervision framework of the banking industry is important to increase the information available to investors (transparency), to ensure the soundness and stability of the financial system, and to improve monetary and for *Shari'ah* supervision of IBs (Lopez Mejia et al., 2014). The growth of the Islamic banking system through the history can be concluded that, there is a growing amount of developments in the Islamic banking system linked to the implementation and establishment of regulatory and supervisory structure.
- The main requirement is a sound legal framework. General banking rules (or specific IB laws) have to define the nature of these banks and their connection (if applicable) with the central bank and other conventional banks in order to provide the legal foundation for IB oversight. Jurisdictions have embraced distinct strategies in creating the legal framework that enables IBs to function. These strategies are adopted because IBs function across nations in very distinct legal settings that represent distinct legal traditions and differing opinions on the *Shari'ah* as a source of law.
- The authorities should ensure the regulatory structure for IBs and thus allow them to be on a level playing field with CBs.
- The industry needs law in terms of the Islamic banking law and laws concerned with financial intermediation. Furthermore, a uniform regulatory and legal framework supportive of an Islamic financial system is required and has not yet been developed
- IFIs need regulatory supervision much like Western institutions. The key to successfully regulating IFIs was the establishment of AAOIFI. AAOIFI developed 60 standards covering accounting, auditing, governance and ethics that IFIs need to apply. An alternative approach is to establish objectives based on the spirit of Islam

and its teachings and then consider these established objectives in relation to contemporary thought.

- The adoption of AAOIFI standards is useful as there are areas of differences in reporting IFIs and likewise, the IFIs need to be sustained in this global financial market dominated by conventional banking transactions.
- The choice of whether to adopt AAOIFI accounting standards depends on national regulators. There are a few factors influencing the decisions to adopt AAOIFI standards.
- The effort to build the legal and regulatory framework and prudential supervision of *Islamic* banks is crucial, as there are unique characteristics of *Islamic* banks as compared to their conventional counterparts. The development of regulatory and supervisory framework that would address the issues specific to Islamic institutions would further enhance the integration of Islamic markets and international financial markets.

Accounting procedures in Islamic banks differ little from those in conventional banks. Accounting and auditing are another practical aspect investigated in this part. The main findings and discussions are presented below:

- The *Shari'ah* Committee has started to raise awareness of the significance of accounting and financial reporting. It is an important tool to communicate the financial performance and *Shari'ah* compliance of IB. The financial performance is presented in accordance with the statutory requirement and BA's guidelines and *Shari'ah* compliance is being assured through SC's report.
- Algeria as a MENA 18 member, it complies with the International Financial Reporting Standards (IFRS)).
- Currently, the problems present are pertaining to accounting treatments, which are still tolerable due to the similar nature of products and services with conventional banks.
- More standards and guidelines are needed to support *Shari'ah* based products such as *Musharakah* and *Murabahah*.
- Most the interviewees acknowledge that there is inadequate knowledge of accounting and finance. Accounting and financial understanding and skills are lacking in SCs.
- Knowledge gap and their dependence on technical employees.

- On the other hand, accounting or IB staff lack the understanding of *Shari'ah*. They still experience problems in the system if any issues are arising from any misunderstandings that give rise to the need to narrow the gap between the two sides.
- The gap between *Shari'ah* expertise and technical expertise. Also, SC found that they lack technical knowledge such as accounting and finance. Furthermore, they are aware that more knowledge needs to be acquired by them in order to have a better understanding on the operationalisation of the products and services in terms of accounting and finance.
- Financial accounting procedures in the IB are seen as complying with statutory reporting, and auditing requirements as performed by conventional banks. The external auditor shall comply with the requirements of the leadership, shareholders, stakeholders, and auditing tasks conducted by the external auditor. In fact, as a heavily controlled organization, banking organizations must conform to the local legal framework and global norms.
- The industry is lacking in accounting systems that assist the preparer of the account to communicate the accounting data. Currently the all Islamic banks and windows send their financial reports to the BA according to conventional language; However, Islamic Banks and Windows use different accounting systems.
- Many prior studies (Cooke and Wallace, 1990; El Khatib and Nizami, 2015) argued that the legal system, political system, tax, reporting system, the legal system and globalization have a significant impact on the adoption of accounting reporting standards.
- Both accounting and auditing faced a lack of expertise; *Shari'ah* auditors are expected to serve the needs of the Islamic society whose focus and priorities are different from other contemporary views.
- *Shari'ah* auditors are expected to be qualified in both *Shari'ah* and conventional auditing and accounting matters. They must have adequate knowledge in all finance and accounting related areas including auditing in order to effectively play the role as *Shari'ah* auditors for IFIs.
- Empirical finding shows that there are very few audit practitioners that are qualified in *Shari'ah* auditing as well as the conventional auditing.

- The lack of auditing practitioners that is qualified or experienced in both *Shari'ah* and conventional auditing could negatively affect the growth of *Shari'ah* auditing and Islamic Financial Industry as a whole.
- Crucial need of the IFIs of having competent auditors that is *Shari'ah* qualified with the accounting and auditing background needs to be address promptly.
- There is no external *Shari'ah* auditor that oversees the practice. Though, there is a need for an external *Shari'ah* auditor in IB, the regulator is still checking whether it should be compulsory.
- The insufficiency of auditing standards that cater for *Shari'ah* principles may lead to misinterpretation of *Shari'ah* rulings and could offer a legitimate platform for any case against the regulation of IFIs to be made.
- The independence of the SSB is impaired as they are involved in supervising the products and operations of IFIs while at the same time conducting *Shari'ah* review or *Shari'ah* audit.
- Have to reassess the needs for clear separation of duties to avoid the misperception of stakeholders of the SSB or *Shari'ah* auditor independence.
- Lacking in implementation procedures. In addition, the existence of non-*Shari'ah* compliance cases heightened the need to have the *Shari'ah* compliance audit in the context of product implementation. Auditing will assist the institution to guarantee what is being deliberated by the *Shari'ah* Advisors, is being implemented correctly and accordingly.
- Thus, IB requires SA practices, in addition to financial audit practices.

The last chapter of the practical part discusses the findings related to the management. The following points are the result obtained from interviews.

- The industry needs the willingness of players and customers, or potential customers, to enrol in the implementation of the IB operation under its theoretical framework to achieve the true IB.
- There is also a need to shape the information and views to raise awareness among stakeholders. The objectives of setting up Islamic Banks to assist identify the direction of Islamic banking. It would also assist the bank in streamline its activities and decisions. Thus, the Islamic bank should also concentrate on achieving the

Maqasid as-Shari'ah, which is the pillars of its institution, in addition to concentrating on returns.

- According to the interviewees, an organization that offers platforms and players themselves should be sufficiently innovative in terms of *Shari'ah*, and well versed in banking activities that do not follow conventional bank activities.
- Factors that may hinder Islamic banks from moving towards real Islamic banking are the general willingness of the public and players, cooperation between Muslim countries, cooperation and collaboration between all stakeholders, economics, political, religious and social will, and absence of a map. Therefore, players must play their roles to ensure that their establishment's true goals are reached.
- The willingness of the sector to adopt the conceptual or theoretical approach of the Islamic banking business for the industry to move towards real Islamic Banks.
- Cooperation between Muslim countries to conduct business activities and further strengthen, grows, and promotes the Islamic banking and finance sector. The sector is still deprived of collaboration between other Muslim countries at the time.
- To guarantee that Islamic banks move towards proper Islamic objectives; the industry needs a religious, economic, political, and social will.
- Lacks understanding and knowledge of *Shari'ah* or technical knowledge and skills. There is also a lack of experience between human capital in IBs and Windows. In terms of experience, the staff may either gain their experience from conventional banks or fresh graduates enter into the IB without any experience. On one hand, the human capital that possessed experience from CB may be influenced by their experience in doing work in IB. On the other hand, fresh graduates entering the IB will be influenced and taught by their colleagues that had previous experience in IB.
- The Islamic windows shared the same human capital with parent banks. Thus, their education, expertise, knowledge, experience, background, way of thinking, paradigm and different worldview influence the way the human capital make decisions, perform their accountability and responsibility, form opinions and appreciation to the real spirit of its establishment, execute operations and objectives and the missions and visions of IB.
- Islamic banking in Algeria has less qualified staff because the Islamic banking industry is still considered new compared to Conventional Banking.

- The respondents agreed that there is a need for competent and knowledgeable staff to provide a quality service in the Islamic Banking Industry.
- Only respondent from both foreign Islamic banks in Algeria said that various training courses are organised by the Islamic banks. Among others, there is internal training, where training is organised inside the bank. The training is organised by the *Shari'ah* committee or *Shari'ah* officers or independent parties. Usually a *Shari'ah* committee and a *Shari'ah* officer carry out the training in the main office. There is also external training where the bank sends out the staff to seek training or knowledge from universities or Islamic Banking Institutions. In addition, there are various conferences, forums, and talks organised at the international or national level. Although there are various training courses organised, the effectiveness and efficiency of the training is to be questioned. Thus, the lacking in the qualities or requirements needed from the staff is an evidence for the need for education and training to create awareness and to increase the awareness level of staff.
- Lack of Knowledge and understanding of *Shari'ah Mu'amalat*. It affects the level of *Shari'ah* compliance practices in Islamic banks. Lower education and personnel knowledge means greater risk of *Shari'ah* non-compliance.
- Training must be introduced to serve as a mechanism for enriching and enhancing staff knowledge. If there is no spiritual awareness, however, it is difficult for them to understand the reason behind it, which has resulted in difficulty in retaining the knowledge and understanding of true Islamic banking and underlying the importance of ensuring that everything is compliance with *Shari'ah*.
- Human capital's lack of knowledge and understanding of *Shari'ah* and technical issues and the lack of capacity to appreciate the theoretical and practical aspects of IB's products and services.
- Negative public perception and lack of public awareness. The lack of capability to explain and communicate to customers related to IB's products and services leaves customers and the public with insufficient information and knowledge on the application of *Shari'ah* to products and services.
- Negative public perceptions may also arise from the attitudes of the public and customers who continue to compare the IB and the CB without further understanding the different principles underlying each banking system.

- Insufficient awareness and knowledge of Islamic banking have resulted in incorrect interpretation of the information received from IB staff. Customers should also receive a proper and thorough explanation from the banker as to the various steps and costs involved in the conclusion of the IB contract.

Despite an SC's anticipated accountability and responsibility, a professional body that regulates *Shari'ah* Scholars or SC is still absent in the sector. The professional body is intended in this context to promote the SC profession where the interests of practitioners and the public are protected. In addition, the organization would guarantee the establishment of a certain standard of professionalism and detail the required training requirements standard of conduct and code of ethics. Thus, with the presence of a professional body, instruction and competent education programs are anticipated to be ensured by the institution. Extending professional certification for experts would also be expected. However, the call to have a professional body is important as the industry is evolving and developing.

The findings show that problems faced by IBs and windows in terms of their human capital in Algeria are; (1) lack of personnel who leads the Islamic windows (i.e. head of Islamic window) with *Shari'ah* background; (2) Lack of middle management capable of assessing the theoretical and practical aspects of the product; (3) Lack of a frontline staff capable of acting as a link between bank management and the customer, being able to explain to the customer; (4) lack of staff with double majoring; (5) lack of staff that know various languages (i.e. at least English and Arabic); (6) lack of staff with specific skills such as, accounting, risk management, process; (7) lack of staff that understand the Islamic spirit; (8) lack of adequacy of human capital to innovate; and (9) lack of mechanism to produce more capable human capital.

General Conclusion

General Conclusion

To conclude this study, a set of key results from participants' responses are provided. It begins, reviewing steps adopted in the interview findings, and next it checks hypotheses results. Then, several recommendations for players to enhance Algeria's Islamic banking are introduced. Finally, the study's limits and suggestions are outlined.

Steps Adopted in the Interview Findings

The objective of this study is to investigate the theoretical and practical aspects of problems and challenges facing Islamic Banks and Windows in Algeria. The study emphasizes aspects of four issues: *Shari'ah* compliance, legal and regulatory framework, accounting and auditing, and management. This research is composed of two parts, theoretical part and practical part.

The theoretical part outlines the theoretical aspect of the Islamic banking and finance. It contains three chapters.

Chapter One discussed the theoretical perspectives underlying Islamic banking and finance. The fundamental *Shari'ah* principles explained are consisted of the prohibition of interest; trade and commerce and its underlying principles; the profit and loss-sharing framework; prohibition of *Gharar*; and payment of *Zakat*. These principles were derived from the Islamic law. Furthermore, when engaging in financing or investment in Islam, both parties are allowed to conduct permissible types of trade-based activities that are approved in Islam. Moreover, the principles of *Shari'ah* prohibit the uncertainty that leads to the forbiddance of any speculative practices and excessive leveraging. Uncertainty may be caused by a lack of clarity existing in the contractual agreement or transactions concerning the buyer and seller, price, object of sale, delivery and quality. Furthermore, the occurrence of uncertainty will lead to *Dhulm*, which encompasses unjustified gains, injury to contracting parties and disputes. Thus, contractual obligations and the disclosure of information are highly regarded. A believer's behaviour is governed by Islamic moral values and ethics. In Islam, there are concepts central to Muslim beliefs such as the unity of Allah, vice regency, justice and the accountability of resources entrusted by Allah. The accountability in Islam is beyond private and societal accountability, as it extends to the accountability to Allah. The underlying principles governing its operations are employed to ensure that the business activities engaged by the public are in accordance to the teachings of Islam, with the aim of obtaining the benefits of the objectives of *Shari'ah* (*Maqasid as-Shari'ah*). It also presents an overview of the global historical background of the Islamic banking and finance industry, followed by the historical of Algerian banking system since the independence in 1962 until today, which went through different stages of development. In addition it discusses the recent development of Islamic banking and finance industry in Algeria.

Chapter Two presented the literature review of the problems and challenges facing IBs. This chapter was categorised into four themes: *Shari'ah* compliance, legal and regulatory frameworks, accounting and auditing practices and management.

Chapter Three presented and discussed the research methodology of this study. This study was conducted using a semi-structured interview aimed at *Shari'ah* board members, the Heads of the *Shari'ah* department, the Head of Participatory of Islamic Windows. This study undertook a qualitative methodology and chose the semi-structured interview method. The semi-structured interview was conducted to inquire from interviewees the problems and challenges facing IBs and Windows through their experiences and involvement in the industry. The study employed the interpretive research process which includes inductive and deductive approaches.

The second part is the practical part; it underlines the findings and analysis obtained from the semi-structured interviews, which investigated problems and challenges facing the Islamic banking and finance industry in the context of Algeria. This chapter is divided into four chapters.

Chapter four also presented the consideration of *Shari'ah* compliance in management, accounting and accountability and the auditing system. It starts by outlining some *Shari'ah* issues such establishing and harmonization SSB, *Shari'ah* interpretation and implementation. It carried with an explanation on the perceptions of the interviewees relating to *Shari'ah* compliance and commercial viability, and how *Shari'ah* compliance was implemented in IBs and Windows. The discussion continued with the dichotomy between the theoretical framework of IBs and Windows and its implementation, unresolved *Shari'ah* matters and the solutions for *Shari'ah* non-compliance cases.

Chapter Five presented the findings from the interviews conducted in this study. It highlights and analyses results on legal and regulatory frameworks issues and challenges. It begins with a brief Overview of Legal and Institutional Structure in Islamic Banks, and presented the IB's industry in Algeria as it operated under the Conventional Banking System. The Islamic banking is facing competition and monetary policy issues since the industry is heavily influenced by the Conventional Banking System. Next, it highlights the need to have independent or specific legal and regulatory structures to Support the *Shari'ah* Operation; it also discusses the debate about the Need of Standardising and Harmonising the Accounting Standards. The chapter concludes by summarizing the findings and discussions.

Chapter Six focuses on the results of the semi-structured interview and analyses them in regards to the Islamic Bank's accounting and auditing scheme. This chapter is divided into three sections besides the introduction; the first section outlines the lack of impact of accounting practices and reporting on the disclosure of reliable and credible information. It begins by highlighting the role of accounting and financial practices and reporting in the communication of reliable and credible information. It then describes the current accounting situation and practices in the Islamic Banks and Windows of Algeria. The section continues to underline the lack of *Shari'ah* expertise among SSBs and scholars and concludes with the issue of having separate SA standards for Islamic banking; the second section analyses and discusses the findings of the *Shari'ah* audit. It discusses the lack of *Shari'ah* audit experts and the lack of external *Shari'ah* auditors; the final section summarizes the findings and the discussion of the chapter.

Chapter Seven, it is the last chapter in this part outlines the findings and discussions on management issues in the Islamic banking system in Algeria. It begins to discuss the findings in Human Capital (HC), highlighting certain issues related to human capital; the role of the players in ensuring the direction of IB; The lack of expertise of IBs and Windows; the lack of awareness among staff; the negative perception of the public. Next, it analyses the result from the implementation of *Shari'ah* approval procedures including pre and post-compliance processes; then, discussing the knowledge gap between scholars of *Shari'ah* and technical people concerning product approval. Finally, the section examines the results and analyses identified in management area.

Conclusion of the Findings

The study aims to identify the problems and difficulties associated with Islamic banking in Algeria, which hinder the growth of Islamic Banks and Windows in Algeria. In analysing and discussing the problems and challenges we have retained the main points that impede Islamic Banks and Windows in Algeria from developing. The points are as follow:

Firstly: Legal and regulatory framework

- The lack of a *Shari'ah*-compliant legal framework is the major hindrance behind its low penetration in the financial market. The legislative structure is functioning against the complete growth of Islamic banking in the country.
- Absence of political will.
- The Banking Act, Central Bank Act and other regulations pose the greatest challenge to the development of Islamic Banking in Algeria. The Act does not define or acknowledge the existence of Islamic Banking and does not define its operations.
- None existence of Commercial banking and business regulations that are suitable for the application of Islamic Banking and economic contracts.
- Islamic banking contracts are regarded as buying and selling properties and are therefore taxed twice.
- *Shari'ah* manual; not every Islamic Window has the *Shari'ah* manual as a guideline for the staff in carrying out their duties and responsibilities.
- Inexistence of statutory acts for each IB and Islamic Windows' products and services to encourage more product development and innovation.
- Various researchers are opposed to the idea of complying with IFRS because it is not fully accountable for Islamic banking business activities. However, the industry needs to have an accounting standard that fully support their products and services, especially products based on PLS.
- No regulations to support the innovation and development of products based on PLS. PLS function and treatment in taxation are considered to be a major obstacle in the use of PLS and secondary markets for trading in Islamic financial instruments; *Mudharabah* and *Musharakah*.
- Jurisdictions have embraced distinct strategies in creating the legal framework that enables IBs to function. These strategies are adopted because IBs function across nations in very distinct legal settings that represent distinct legal traditions and differing opinions on the *Shari'ah* as a source of law.

- The authorities should ensure the regulatory structure for IBs and thus allow them to be on a level playing field with CBs.
- The choice of whether to adopt AAOIFI accounting standards depends on national regulators. There are a few factors influencing the decisions to adopt AAOIFI standards.

Secondly: *Shari'ah* Compliance

- The importance of ensuring *Shari'ah* compliance in every aspect of operations, products and services of Islamic banks.
- *Shari'ah* scholars were more concerned with the differences between theory and practice, since the theory was based on religion and it is crucial to uphold *Shari'ah* principles.
- Political environment affected the *Shari'ah* Compliance.
- CEOs had shown their awareness on the need and importance of *Shari'ah* compliance in all aspects of operations. However, in terms of products and services, *Shari'ah* compliance was not the sole criteria in the offered products.
- Some Windows do not have SSB.
- There is not a centralized SSB to oversee the governance framework of the *Shari'ah* in Islamic Banking in Algeria.
- Centralising SSBs in Algeria is not an issue at the moment. Currently, Algerian IB only commercialises their product in the local market. The competition exists between foreign Islamic banks, Islamic Windows, and Conventional Banks.
- In the future, lack of harmonisation will further affect development and globalisation of the industry. Also, calls for the harmonization will assist in terms of financial reporting and users of financial statement to make a comparison of performance between IB in different jurisdictions.
- Another important element was the viability of products and services. If a product that was well-developed and approved in terms of *Shari'ah* compliance was not viable in the market, the offered product would then be held. CEOs are responsible to shareholders and other stakeholders; thus, it is crucial for them to ensure *Shari'ah* compliance and business performance. On the other hand, *Shari'ah* scholars possessed a different aspiration. They were more focused on guaranteeing that the objectives of *Shari'ah* are achieved, and that the public would enjoy the benefits.

- The dichotomy between theoretical and practical aspects of innovating and implementing products and services, resulted in the misunderstanding of *Shari'ah* related matters.
- The existence of non-*Shari'ah* compliance cases heightened the need to have the *Shari'ah* compliance audit in the context of product implementation. Thus, IB requires SA practices, in addition to financial audit practices.
- *Shari'ah* non-compliance with implementation of products and services were mistakes not deliberately done.
- Factors that hinder the IB to offer such products, such as insufficient regulations, or products not favoured by the customers due to its high risk and involvement in long-term financing. However, it is being argued by academician in Islamic economics that, although such products may appeared to be *Shari'ah* compliant, it is lacking of macroeconomic impact that lead to fulfilment of the objective of *Shari'ah*.

Thirdly: Accounting and auditing

- The *Shari'ah* Committee has started to raise awareness of the significance of accounting and financial reporting. It is an important tool to communicate the financial performance and *Shari'ah* compliance of IB. The financial performance is presented in accordance with the statutory requirement and BA's guidelines and *Shari'ah* compliance is being assured through SC's report.
- Algeria as a MENA member, it bound to comply with the International Financial Reporting Standards (IFRS).
- Currently, the problems present are pertaining to accounting treatments, which are still tolerable due to the similar nature of products and services with Conventional Banks.
- No standards and guidelines to support *Shari'ah* based products such as *Musharakah* and *Murabahah*.
- Lack of knowledge; Accounting and financial understanding and skills.
- Knowledge gap and their dependence on technical employees.
- Accounting or IB staff lack the understanding of *Shari'ah*. They still experience problems in the system if any issues are arising from any misunderstandings that give rise to the need to narrow the gap between the two sides.
- The gap between *Shari'ah* expertise and technical expertise. Also, SC found that they lack technical knowledge such as accounting and finance.

- Financial accounting procedures in the IB are seen as complying with statutory reporting, and auditing requirements as performed by Conventional Banks.
- As a heavily controlled organization, banking organizations must conform to the local legal framework and global norms. The external auditor (conventional) shall comply with the requirements of the leadership, shareholders, stakeholders, and auditing tasks conducted by the external auditor.
- The industry is lacking in accounting systems that assist the preparer of the account to communicate the accounting data.
- Currently the all Islamic Banks and Windows send their financial reports to the BA according to conventional language.
- Islamic Banks and Windows use different accounting systems.
- Many prior studies (Cooke & Wallace, 1990; El Khatib & Nizami, 2015) argued that the legal system, political system, tax, reporting system, the legal system and globalization have a significant impact on the adoption of accounting reporting standards.
- Both accounting and auditing faced a lack of expertise; *Shari'ah* auditors are expected to serve the needs of the Islamic society whose focus and priorities are different from other contemporary views.
- Lack of *Shari'ah* auditors qualified in both *Shari'ah* and conventional auditing and accounting matters.
- Empirical finding shows that there are very few audit practitioners that are qualified in *Shari'ah* auditing as well as the conventional auditing
- The lack of auditing practitioners that is qualified or experienced in both *Shari'ah* and conventional auditing could negatively affect the growth of *Shari'ah* auditing and Islamic Financial Industry as a whole.
- There is no external *Shari'ah* auditor that oversees the practice.
- The insufficiency of auditing standards that cater for *Shari'ah* principles may lead to misinterpretation of *Shari'ah* rulings and could offer a legitimate platform for any case against the regulation of IFIs to be made.
- The independence of the SSB is impaired as they are involved in supervising the products and operations of IFIs while at the same time conducting *Shari'ah* review or *Shari'ah* audit.

- Lacking in implementation procedures. In addition, the existence of non-*Shari'ah* compliance cases heightened the need to have the *Shari'ah* compliance audit in the context of product implementation. Thus, IB requires SA practices, in addition to financial audit practices.

Finally: Management.

- Lack of willingness of players and customers, to join in the implementation of the IB operation under its theoretical framework to achieve the true IB.
- There is also shortage of information and views to raise awareness among stakeholders. The objectives of setting up Islamic banks to assist identify the direction of Islamic banking.
- Insufficiently of innovation in terms of *Shari'ah*, and well versed in banking activities that do not follow Conventional Bank activities.
- Factors that may hinder Islamic banks from moving towards real Islamic banking are the general willingness of the public and players, cooperation between Muslim countries, cooperation and collaboration between all stakeholders, economics, political, religious and social will, and absence of a map. Therefore, players must play their roles to ensure that their establishment's true goals are reached.
- The unwillingness of the sector to adopt the conceptual or theoretical approach of the Islamic banking business for the industry to move towards real Islamic banks.
- Lacks understanding and knowledge of *Shari'ah* or technical knowledge and skills.
- The Islamic Windows shared the same human capital with parent banks. Thus, their education, expertise, knowledge, experience, background, way of thinking, paradigm and different worldview influence the way the human capital make decisions, perform their accountability and responsibility, form opinions and appreciation to the real spirit of its establishment, execute operations and objectives and the missions and visions of IB.
- Islamic banking in Algeria has less qualified staff because the Islamic banking industry is still considered new compared to Conventional Banking.
- Lack of competent and knowledgeable staff to provide a quality service in the Islamic banking industry.

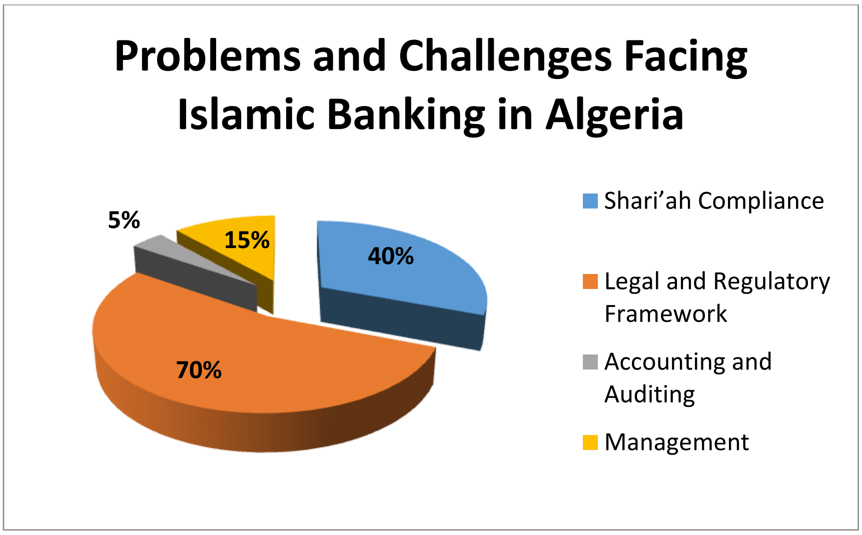
- Shortage of Knowledge and understanding of *Shari'ah Mu'amalat.* It affects the level of *Shari'ah* compliance practices in Islamic banks. Lower education and personnel knowledge means greater risk of *Shari'ah* non-compliance.
- Lack of training to serve as a mechanism for enriching and enhancing staff knowledge.
- Negative public perception and lack of public awareness.
- The lack of capability to explain and communicate to customers related to IB's products and services leaves customers and the public with insufficient information and knowledge on the application of *Shari'ah* to products and services.
- Negative public perceptions may also arise from the attitudes of the public and customers who continue to compare the IB and the CB without further understanding the different principles underlying each banking system.
- Insufficient awareness and knowledge of Islamic banking have resulted in incorrect interpretation of the information received from IB staff.
- Absence of a professional body that regulates *Shari'ah* Scholars or SC is still absent in the sector.

The findings show that problems faced by IBs and Windows in terms of their human capital in Algeria are:

- Lack of personnel who leads the Islamic Windows (i.e. head of Islamic Window) with *Shari'ah* background.
- Lack of middle management capable of assessing the theoretical and practical aspects of the product.
- Insufficient of a frontline staff capable of acting as a link between bank management and the customer, being able to explain to the customer.
- Shortage of staff with double majoring.
- Lack of staff that know various languages (i.e. at least English and Arabic)
- Lack of staff with specific skills such as, accounting, risk management, process.
- Shortage of staff that understand the Islamic spirit.
- Lack of adequacy of human capital to innovate.
- Shortage of mechanism to produce more capable human capital.

The pie chart 8.1 below shows the results of the problems and challenges facing Islamic banking in Algeria. The portions represent the problems of the four issues investigated in our research.

Figure 8.1 Problems and Challenges Facing Islamic Banking in Algeria



***Source*: Elaborated by the researcher

Hypotheses and Empirical Results

From the conclusions of the above findings, we can verify that the hypotheses below are correct or incorrect.

H1: The political and economic environments affect the *Sharia'ah* compliance in Islamic Banking.

Valid → *Shari'ah* Compliance, Legal and regulatory framework

H2: The Islamic Banking is operating under specific legal and regulatory framework.

Non-valid → Legal and Regulatory framework

H3: The Islamic Banking has its own accounting and auditing system.

Non-valid → Accounting and Auditing

H4: The staff of IBs is well trained and informed in Islamic Banking procedure and operations.

Non-valid → Management

General Conclusion

From the above, we attributed the results of the finding of each hypothesis to the four issues investigated in this research.

Recommendations

In an attempt to develop an appropriate environment for Islamic Banking in Algeria, our research has led us through the findings to suggest recommendations to the four areas of our research as follows:

Legal and regulatory framework

- Needs to create a sound legal and regulatory framework.
- Involvement and willingness of all the players.
- Government will to enhance IBs in Algeria.
- The need of a *Shari'ah* manual.
- More regulatory framework is needed to support the *Shari'ah*-based operation and inexistence of statutory acts for each IB and Islamic Windows' products and services to encourage more product development and innovation.
- However, the industry needs to have an accounting standard that fully support their products and services, especially products based on PLS.
- More regulations are required to support the innovation and development of products based on PLS. In addition, the need for well-defined property rights for efficient PLS function and fairer treatment in taxation, are considered to be a major obstacle in the use of PLS and secondary markets for trading in Islamic financial instruments; *Mudharabah* and *Musharakah* are particularly non-existent (Dar and Presley, 2000).
- The attempt to construct Islamic Banks and Windows' legal and regulatory structure and prudential supervision is essential, as Islamic Banks have distinctive features compared to their conventional counterparts. The development of regulatory and supervisory framework that would address the issues specific to Islamic institutions would further enhance the integration of Islamic markets and international financial markets (Iqbal, 1997). The regulation and the supervision framework of the banking industry is important to increase the information available to investors (transparency), to ensure the soundness and stability of the financial system, and to improve monetary

and for *Shari'ah* supervision of IBs (Lopez Mejia et al., 2014). The growth of the Islamic Banking system through the history can be concluded that, there is a growing amount of developments in the Islamic Banking system linked to the implementation and establishment of regulatory and supervisory structure.

- The main requirement is a sound legal framework. General banking rules (or specific IB laws) have to define the nature of these banks and their connection (if applicable) with the Central Bank and other Conventional Banks in order to provide the legal foundation for IB oversight. Jurisdictions have embraced distinct strategies in creating the legal framework that enables IBs to function. These strategies are adopted because IBs function across nations in very distinct legal settings that represent distinct legal traditions and differing opinions on the *Shari'ah* as a source of law.
- The authorities should ensure the regulatory structure for IBs and thus allow them to be on a level playing field with CBs.
- The industry needs law in terms of the Islamic Banking law and laws concerned with financial intermediation. Furthermore, a uniform regulatory and legal framework supportive of an Islamic financial system is required and has not yet been developed
- IFIs need regulatory supervision much like Western institutions. The key to successfully regulating IFIs was the establishment of AAOIFI. AAOIFI developed 60 standards covering accounting, auditing, governance and ethics that IFIs need to apply. An alternative approach is to establish objectives based on the spirit of Islam and its teachings and then consider these established objectives in relation to contemporary thought.
- The adoption of AAOIFI standards is useful as there are areas of differences in reporting IFIs and likewise, the IFIs need to be sustained in this global financial market dominated by Conventional Banking transactions.
- The development of regulatory and supervisory framework that would address the issues specific to Islamic institutions would further enhance the integration of *Islamic* markets and international financial markets.

Shari'ah compliance

- Ensuring *Shari'ah* compliance in every aspect of operations, products and services of Islamic Banks.

- The *Shari'ah* principles must be maintained as they are the root of the system. Moreover, upholding *Shari'ah* principles will consequently lead to the achievement of *Shari'ah* objectives, which will then guarantee the welfare of society.
- It is vital to establish a centralized SSB to oversee the governance framework of the *Shari'ah* in IBs. A centralized SSB has the advantage of harmonizing *Shari'ah* rulings, decreasing *Shari'ah* and IB compliance costs.
- The need to have the *Shari'ah* compliance audit in the context of product implementation. Auditing will assist the institution to guarantee what is being deliberated by the *Shari'ah* Advisors, is being implemented correctly and accordingly. Thus, IB requires SA practices, in addition to financial audit practices.
- The problems of non-compliance with implementation of products and services need to be curbed to ensure that IB is able to maintain their credibility as an Islamic financial institution.
- Since, more debt-based product than equity based product, more efforts are needed in order to gradually introduce *Shari'ah* based products and services in order to open up possibilities and opportunities for the public to engage with banking and financial activities.
- The need to have IB's products that are more *Shari'ah* compliant. The *Shari'ah* committee term it as greener product. Thus, it is a call to have products that are based on the *Shari'ah* principles (i.e. value based system).

Accounting and auditing

- More standards and guidelines are needed to support *Shari'ah* based products such as *Musharakah* and *Murabahah*.
- Needs of more accounting and financial understanding and skills in SCs.
- More knowledge needs to be acquired by SC in order to have a better understanding on the operationalisation of the products and services in terms of accounting and finance.
- The need of Islamic accounting systems that assist the preparer of the account to communicate the accounting data.
- The adoption of Islamic accounting reporting standards.
- *Shari'ah* auditors should be qualified in both *Shari'ah* and conventional auditing and accounting matters. They must have adequate knowledge in all finance and accounting

related areas including auditing in order to effectively play the role as *Shari'ah* auditors for IFIs.

- Training *Shari'ah* auditors in the conventional auditing
- Crucial need of the IFIs of having competent auditors that is *Shari'ah* qualified with the accounting and auditing background needs to be address promptly.
- There is a need for an external *Shari'ah* auditor in IB.
- The independence of the SSB.
- Have to reassess the needs for clear separation of duties to avoid the misperception of stakeholders of the SSB or *Shari'ah* auditor independence.
- The need to have the *Shari'ah* compliance audit in the context of product implementation. Auditing will assist the institution to guarantee what is being deliberated by the *Shari'ah* Advisors, is being implemented correctly and accordingly.
- IB requires SA practices, in addition to financial audit practices.

Management

- The industry needs the willingness of players and customers, or potential customers, to enrol in the implementation of the IB operation under its theoretical framework to achieve the true IB.
- There is also a need to shape the information and views to raise awareness among stakeholders. The objectives of setting up Islamic Banks to assist identify the direction of Islamic Banking. It would also assist the bank in streamline its activities and decisions. Thus, the Islamic Bank should also concentrate on achieving the *Maqasid as-Shari'ah*, which is the pillars of its institution, in addition to concentrating on returns.
- A map to enhance the public and players, cooperation between Muslim countries, cooperation and collaboration between all stakeholders, economics, political, religious and social will. Therefore, players must play their roles to ensure that their establishment's true goals are reached.
- Adoption of the conceptual or theoretical approach of the Islamic Banking business for the industry to move towards real Islamic Banks.
- Cooperation between Muslim countries to conduct business activities and further strengthen, grows, and promotes the Islamic Banking and finance sector.
- The need a religious, economic, political, and social will.

- There is a need for competent and knowledgeable staff to provide a quality service in the Islamic Banking industry.
- More training courses inside and outside the bank should be organised by the Islamic Banks.
- The training should be organised by the *Shari'ah* committee or *Shari'ah* officers or independent parties.
- Also external training national or international should be for staff to get training or knowledge from universities or Islamic Banking institutions.
- Leaderships should attend and perform conferences, forums, and talks organised at the international or national level.
- Training must be introduced to serve as a mechanism for enriching and enhancing staff knowledge. If there is no spiritual awareness.
- Need serious work in public awareness.
- Customers should also receive a proper and thorough explanation from the banker as to the various steps and costs involved in the conclusion of the IB contract.

Despite an SC's anticipated accountability and responsibility, a professional body that regulates *Shari'ah* Scholars or SC is still absent in the sector. The professional body is intended in this context to promote the SC profession where the interests of practitioners and the public are protected. In addition, the organization would guarantee the establishment of a certain standard of professionalism and detail the required training requirements standard of conduct and code of ethics. Thus, with the presence of a professional body, instruction and competent education programs are anticipated to be ensured by the institution. Extending professional certification for experts would also be expected. However, the call to have a professional body is important as the industry is evolving and developing.

Limitations and Suggestions for Future Research

This study included a qualitative research design in which it used a semi-structured interview to explore the problems and challenges facing Islamic Banking and finance in Algeria. It focused on the problems and challenges related to the *Shari'ah* compliance, legal and regulatory frameworks, accounting and finance, and management. Besides, semi-structured interviews with the *Shari'ah* Board members, the Head of *Shari'ah* Departments (or *Shari'ah* officers), Heads of Participatory Finance, and CEOs were conducted based on convenient sampling, and limited to several Islamic Commercial Banks and Windows.

The first limitation of this study was that the qualitative research intended to achieve theoretical generalisation rather than statistical generalisation. In addition, lack of literature, data and information concerning our topic of Islamic Banking in Algeria. Besides, the participants did not answer to all questions and their answers where either general or brief. Another problem that limited our research was the access to banks websites, and the lack of updated information. In order to avoid such limitations in the future, researchers should examine different settings, such as Islamic Financial Institutions in different countries or different types of Islamic financial institutions. Future research in Islamic financial institutions may provide theoretical and associated thoughts in this field of studies. The limitation of this research was that the results were obtained through semi-structured interviews with *Shari'ah* Board members, the Head of *Shari'ah* Departments (or *Shari'ah* officers), Heads of Participatory Finance, and CEOs. Future studies should explore the same context of research by interviewing the technical expertise personnel in Islamic Banks and Windows in order to obtain their views in accordance to their experiences.

Semi-structured interviews in this research were used to clarify the problems and challenges confronting Islamic Banks and Windows in aspects of *Shari'ah* compliance, legal and regulatory frameworks, accounting and auditing, and management; this has helped the researcher to understand the theoretical and practical problems and problems facing this sector. In fact, the use of semi-structured interviews in this research may encourage other researchers to embrace such a technique to investigate a wide range of comparable or other situations in the Islamic Banking Industry.

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Appendices

Appendix I

OFFICIAL JOURNAL OF THE REPUBLIC ALGERIAN NO. 73, Aouel Rabie Ethani 1440, 9 December 2018, 18, BANK OF ALGERIA

Regulation No. 18-02 26 Safar 1440 corresponding to November 4, 2018, with conditions for the exercise of Bank operations under participatory finance by banks and financial institutions.

The Governor of the Bank of Algeria.

See order No. 75-58 on 26 September 1975, amended and supplemented, civil code;

Given order No. 75 - 59 on 26 September 1975, amended and supplemented, dealing with code of trade;

Seen the order No. 03-11 of 27 Jumada Ethania 1424 corresponding to August 26, 2003, amended and completed on the currency and credit, including its articles 66 to 69.

Seen the order No. 96-09 of 19 Chaabane 1416 corresponding to January 10, 1996, amended and supplemented, on leasing;

Given law No. 05-01 27 Dhou El Hidja 1425, corresponding to February 6, 2005, amended and supplemented, on the prevention and the fight against money laundering and the financing of terrorism;

Given law No. 18 - 07 25 Ramadhan 1439 matches June 10, 2018 on the protection of natural persons in the processing of the personal data;

Seen the Presidential Decree of 24 Dhou El Kaada 1424 corresponding to January 14, 2004 on the appointment of the members of the Council of money and credit of the Bank of Algeria;

Seen the Presidential Decree of 5 Jumada El Oula 1427, corresponding to June 1, 2006 on the appointment of a Deputy Governor of the Bank of Algeria;

Seen the Presidential Decree of the 24 Chaabane 1437 corresponding to 31 May 2016 on the appointment of the Governor of the Bank of Algeria;

Seen the Presidential Decree of 17 Safar 1438 corresponding to November 17, 2016, on the appointment of the Bank of Algeria vicegouverneurs;

Seen the Regulation No. 04-03 of 12 Moharram 1425, corresponding to March 4, 2004, amended and supplemented, on the system of guarantee of bank deposits.

Considering Regulation No. 06 - 02 of the Aouel Ramadhan 1427 corresponding to September 24, 2006, laying down the conditions of creation of Bank and financial institution and installation branch bank and foreign financial institution;

See Regulation No. 09 - 04 of the Aouel Castillo 1430 corresponding to July 23, 2009 plan of bank accounts and accounting rules for banks and financial institutions;

See Regulation No 11 - 08 Moharram 1433 3 corresponding to November 28, 2011 on the internal control of banks and financial institutions;

Seen the Regulation No. 12-03 of 14 Moharram 1434 corresponding to November 28, 2012, relative to the prevention and the fight against money laundering and the financing of terrorism;

Seen the Regulation No. 13-01 Jumada El Oula 26 1434 corresponding to April 8, 2013, laying down the General rules on bank terms for bank operations;

After deliberation by the Council of money and credit as of November 4, 2018;

Enacts the law whose content follows:

Article 1. - This regulation was intended to define the rules applicable to "participatory" products leading to perception or interest payment.

It was also intended to define the conditions of prior authorization by the Bank of Algeria, Bank operations under participatory finance, banks and approved financial institutions.

Art. 2 - within the meaning of this regulation, are considered Bank operations under participatory finance, all operations of banks and financial institutions that fit into the categories of operations covered by articles 66 to 69 of order No. 03-11 of 26 August 2003, amended and supplemented, on the currency and credit, namely, receipt of funds, investment, financing and investment, operations that do not give rise to the perception or the payment of interest. These operations include the following product categories:

-the Murabaha,

-the Musharaka

-the Mudaraba,

-the Ijara,

-the Istisna'a.

-the Salam,

-as well as deposits in investment accounts.

These participatory finance products are subject to the provisions of article 3 of the Regulation n ° 13-01 of 26 Jumada El Oula 1434 corresponding to April 8, 2013, laying down general rules on Bank conditions applicable to the operations of Bank.

Art. 3. - the Bank or the financial institution authorized activity, wishing to implement participatory finance products, must produce, in support of the request addressed to the Bank of Algeria, the information below:

-the description of the product;

-the opinion of the head of the control of the compliance of the Bank or other financial institution, in accordance with the provisions of article 25 of the Regulation n ° 11-08 of the Moharram 1433 corresponding to November 28, 2011, 3 above;

ANNOUNCEMENTS AND COMMUNICATIONS OFFICIAL JOURNAL OF THE REPUBLIC ALGERIAN NO. 73, Aouel Rabie Ethani 1440, 9 December 2018, 19

-the procedure to follow to ensure the administrative and financial independence of the "participatory finance window" compared to the rest of the activities of the Bank or the financial institution, in accordance with the provisions of articles 5, 6 and 7 below.

Art. 4 - after prior authorization of the Bank of Algeria, banks and financial institutions approved, wanting to get for their products, a certification of compliance with the precepts of the Shariah, must submit the goods to the appreciation of the authorized national body.

Art. 5. - it is understood by "window participatory finance", a Department within a bank or a financial institution licensed, exclusively providing services and participatory finance products, purpose of the regulation.

"Participatory finance window" must be financially independent from other departments and branches of the Bank and the financial institution.

The accounting separation between the "participatory finance window" and other activities of the Bank or the financial institution, is concretized by the independence of customer accounts of "participatory finance window" compared to the rest of the accounts of their clientele.

The existence of an accounting section or own the "participatory finance window" financial Department's main objective, the establishment of dedicated financial statements, including the establishment of a balance sheet showing the assets and liabilities the "participatory finance window" as well as a breakdown of revenues and expenses is related.

Art. 6. — L’indépendance du « guichet finance participative » par rapport à l’organisation de la banque ou de l’établissement financier est assurée par une organisation et un personnel exclusivement dédiés.

Art. 7. — En cas de pluralité de « guichets finance participative » au sein d'une même banque agréée ou d'un même établissement financier agréé, ces « guichets finance participative » doivent être traités comme étant une seule entité.

Un état financier consolidé sera établi et figurera en annexe des états financiers publiables de la banque ou de l'établissement financier concerné.

Art. 8. — Les banques et les établissements financiers ayant reçu l'autorisation préalable pour commercialiser ces produits, doivent informer leur clientèle des barèmes et des conditions minimales et maximales qui leur sont applicables.

Les banques doivent également informer les déposants, en particulier ceux titulaires des comptes d'investissement, sur la nature de leurs comptes.

Art. 9. — Les dépôts de fonds reçus par les « guichets finance participative » sont régis par les dispositions de l'ordonnance n° 03-11 du 27 Joumada Ethania 1424 correspondant au 26 août 2003, susvisée, à l'exclusion des dépôts en compte d'investissement qui sont soumis à un accord écrit conclu avec le client, autorisant la banque à fructifier ses dépôts dans le portefeuille des projets et opérations du « guichet finance participative » que la banque accepte de financer.

Le déposant ouvre droit à une part des bénéfices dégagés par le « guichet finance participative » et supporte une part des pertes éventuelles enregistrées par le « guichet finance participative » dans les financements engagés par la banque.

Art. 10. — Les dépôts et autres sommes assimilables aux dépôts remboursables collectés par les « guichets finance participative » des banques, à l'exclusion des dépôts en comptes d'investissement, sont couverts par les dispositions du règlement n° 04-03 du 12 Moharram 1425 correspondant au 4 mars 2004, modifié et complété, relatif au système de garantie des dépôts bancaires.

Art. 11. — En sus des dispositions du présent règlement et sauf stipulations contraires, les produits de finance participative sont régis par toutes les dispositions légales et réglementaires relatives aux banques et établissements financiers.

Art. 12. — Le présent règlement sera publié au *Journal officiel* de la République algérienne démocratique et populaire.

Fait à Alger, le 26 Safar 1440 correspondant au 4 novembre 2018.

Mohamed LOUKAL

Règlement n° 18-03 du 26 Safar 1440 correspondant au 4 novembre 2018 relatif au capital minimum des banques et établissements financiers exerçant en Algérie.

Le Gouverneur de la Banque d'Algérie,

Vu l’ordonnance n° 03-11 du 27 Joumada Ethania 1424 correspondant au 26 août 2003, modifiée et complétée, relative à la monnaie et au crédit, notamment ses articles 62, 63, 64, 65 et 88 ;

Vu le décret présidentiel du 24 Dhou El Kaâda 1424 correspondant au 14 janvier 2004 portant nomination des membres du conseil de la monnaie et du crédit de la Banque d’Algérie ;

Vu décret présidentiel du 5 Joumada El Oula 1427 correspondant au 1er juin 2006 portant nomination d’un vice-gouverneur de la Banque d’Algérie ;

Vu le décret présidentiel du 5 Safar 1437 correspondant au 17 novembre 2015 portant nomination de membres du conseil d’administration de la Banque d’Algérie ;

Vu le décret présidentiel du 24 Chaâbane 1437 correspondant au 31 mai 2016 portant nomination du gouverneur de la Banque d’Algérie ;

Vu le décret présidentiel du 17 Safar 1438 correspondant au 17 novembre 2016 portant nomination de vice-gouverneurs de la Banque d’Algérie ;

Appendix II

République Algérienne Démocratique et Populaire

Ministère de l'Enseignement Supérieur et de la Recherche Scientifique

Ecole Supérieure de Commerce - Koléa

Interview pour cas pratique en vue de la préparation d'une thèse de doctorat en Sciences de Gestion option Comptabilité

Titre: « Problems and Challenges facing Islamic Banking in Algeria »

Questions de sondage pour les fonctionnaires des banques et fenêtres islamiques

Elaborées par ***Mme.ZIANI Imen Hiba***

Introduction

Merci aux participants pour leur temps.

Nous vous remercions d'avoir accepté d'être interviewé.

Donner de l'assurance que les détails fournis seront traités dans la plus stricte confidentialité.

Tous les résultats divulgués seront effectués de manière sous forme agrégée et les banques / organismes individuels ne seront pas identifiés.

Mention nature et la pertinence de la recherche

Informations d'arrière-plan

Nom de la Banque islamique : Date de création :

Nom du participant : Position :

Nombre d'années dans les banques islamiques :

Nombre d'années dans l'établissement bancaire :

Nombre d'employés dans cette banque :

Nombre des membres du SSB dans cette banque :

Nombre des membres de l'unité de révision de la *Shari'ah* islamique (URSI) :

Nombre des membres de l'unité de conformité à la *Shari'ah* islamique (UCSI) :

Nombre approximatif du personnel avec qualification en *Shari'ah* :

Nombre approximatif du personnel avec qualification technique et en *Shari'ah* :

APERÇU GÉNÉRAL

1. Pouvez-vous décrire les problèmes et les défis actuels auxquels font face les banques islamiques ou l'industrie de la finance islamiques ?
2. Pourriez-vous décrire les principaux problèmes rencontrés par le service de la comptabilité et des finances, le Conseil de Supervision en *Shari'ah* (CSS) ainsi que la conformité à la *Shari'ah* dans une banque islamique ?
3. Y at-il un (des) problème(s) pertinent (s) résultant des pratiques des banques islamique ? Si oui, pourriez-vous l’expliquer ?
4. Pouvez-vous nous signaler le(s) problème(s) qui est (sont) votre source de préoccupation ?
5. Y at-il des informations supplémentaires ou des questions ayant trait au fonctionnement des pratiques de l’industrie de la finance islamique en Algérie ?

Développement et opportunités

6. Pouvez-vous partager votre connaissance sur la mise en place des fenêtres islamiques ainsi que vos observations sur le développement et les opportunités des banques islamiques et l’industrie de la finance islamique en Algérie ?

Produits et services

Le développement actuel de la finance islamique a connu le développement de plus de produits islamiques.

7. Pourriez-vous commenter le niveau de développement et de l'innovation dans l'industrie ainsi que son avenir ?

Problèmes liés à la Shari’ah

8. Pouvez-vous décrire les problèmes relatifs à la *Shari'ah* qui vous préoccupent ?
9. Pouvez-vous commenter des questions non résolues vous préoccupant à propos de la *Shari'ah* ?

SECTION 1 : CONFORMITE A LA *SHARI'AH*

Centralisation des superviseurs de Shari'ah

10. Est-ce que la mise en place du Conseil consultatif de *Shari'ah* (CCS) montre une différence ou une amélioration dans la structure du CSS en Algérie ?
11. Pourriez-vous commenter l'expertise de votre CSS ?
12. Pensez-vous que l'existence du CCS et du CSS dans votre établissement a amélioré la gestion, l'exploitation et la conformité à la *Shari'ah* des produits et services offerts ? Pourriez-vous décrire l'amélioration qui se produit ?
13. Pouvez-vous expliquer la relation entre CSS et le service de la comptabilité et des finances (y compris l’Audit de *Shari'ah*) au service des banques islamique ?

Interprétations de la Shari'ah

14. Pourriez-vous commenter les interprétations de la *Shari'ah* et les décisions prises par le CSS ?
15. Comment percevez-vous l'effet que les interprétations de la *Shari'ah* ont sur les pratiques comptables et sur l'information comptable ?
16. À votre avis, comment les différentes interprétations de la *Shari'ah* influencent les pratiques d’audit de la *Shari'ah* ?
17. À votre avis, est-il nécessaire de normaliser ou d'harmoniser les interprétations de la *Shari'ah* ?
18. Quelle est l'utilité de la normalisation et de l’harmonisation des interprétations de la *Shari'ah* pour le développement des banques islamique et de l'industrie de la finance islamique ?
19. Quel est le facteur qui entrave la consolidation ou la convergence des interprétations de la *Shari'ah* qui sont différentes selon les juridictions ?

20. Quel est votre commentaire sur les efforts de l'Algérie pour combler les lacunes dans les interprétations de la *Shari'ah* par rapport à la conduite des affaires des banques islamiques parmi les spécialistes de la *Shari'ah* dans différentes parties du monde à travers CMSS (Comité mondial de supervision de la *Shari'ah*) ?
21. Quelle est l'importance de la conformité à la *Shari'ah* dans votre établissement ?
22. Quels sont les facteurs qui influencent la conformité à la *Shari'ah* ?
23. Pouvez-vous expliquer la « base primaire » du processus de conformité à la *Shari'ah* par les banques islamiques ?
Pourquoi avoir adopté cette base en particulier ?
Qu'implique ce processus ?
Comment fonctionne-t-il ?
24. Comment mesurez-vous le risque de conformité à la *Shari'ah* ? Y a-t-il un moyen de mesurer le risque de conformité à la *Shari'ah* ? S'il n'y a pas de mesure de risque de conformité à la *Shari'ah*, Y a-t-il une caractéristique principale qui est prise en considération ?
25. Comment vos institutions gèrent-elles la conformité ex-ante et ex-post ?
26. À quelle fréquence CCS / URSI / UCSI discutent-ils le plan de conformité à la *Shari'ah* et les questions financières liées au service de la comptabilité et de la finance ?
27. Quels sont les problèmes et les défis accompagnant la procédure de conformité à la *Shari'ah* (c.-à-d. ex-ante et ex-post) ?

SECTION 2 : CADRE JURIDIQUE ET REGLEMENTAIRE

L'industrie de la finance islamique a connu diverses initiatives de développement comme IFSB, AIIOFI et diverses initiatives telles que la directive de la Banque d'Algérie (BA), les normes comptables et d'autres actes législatifs sont lancés pour soutenir le développement des banques islamiques en Algérie.
28. Y'a-t-il des initiatives de développement qui ont été mises au point pour améliorer le fonctionnement des banques islamiques en Algérie .Pourriez-vous dire lesquelles de ces initiatives sont en cours d'exécution ou renvoyées par votre établissement ?
Pourriez-vous décrire le cadre juridique et règlementaire dans lequel vous travaillez actuellement ?
Quels sont les efforts fournis et les méthodes empruntées afin de travailler dans ce cadre ?

29. À votre avis, les banques islamiques et le secteur bancaire ainsi que l'industrie de la finance islamique, ont-ils besoin d'un ensemble distinct (c.-à-d. jeu supplémentaire) du cadre réglementaire ? Pourquoi donc ?
30. Avez-vous un manuel *Shari'ah* ? Lequel ?
31. Y at-il un soutien des organismes de réglementation, la banque centrale et décisions nationales pour assurer la normalisation ou l'harmonisation ?

SECTION 3 : PRATIQUES COMPTABLES ET AUDIT DE LA *SHARI'AH*

32. Y at-il besoin pour les banques islamique et l'industrie de finance islamique de normaliser ou harmoniser les normes comptables ou d'autres normes pertinentes (normes islamiques internationales ou les normes conventionnelles) afin d'obtenir une plus grande transparence, la divulgation et la responsabilité ?
33. Pourriez-vous expliquer les pratiques comptables actuelles dans vos institutions ?

34. Quelle est l'incidence des pratiques comptables sur les opérations de banque islamique ?

35. Les pratiques actuelles en matière de comptabilité et de finance sont-elles "différentes" du système bancaire commercial classique existant ? Avons-nous besoin d'un type de comptabilité différent ? Si oui, cela vaut-il la peine ?

36. Comment percevez-vous l'effet des pratiques comptables et de l'information comptable ont sur l'exploitation ?

37. Quel est l'impact des pratiques comptables actuelles sur les opérations de l'industrie de la finance islamique si elle opérait dans un marché financier mondial dominé par les normes comptables occidentales ?

38. Les conventions comptables choisies par les banques islamiques, ont-elles été officiellement examinées et approuvées par le conseil de la *Shari'ah* ?

39. Qui est responsable du suivi des procédures comptables ?

40. Si la sélection ou la mise en œuvre des méthodes comptables posent un problème, y a-t-il une référence à la CSS ?
41. Pouvez-vous décrire le comité d'audit de la *Shari'ah* et ses procédures ? (C.-à-d. Comment est-il établi ? Quel sont ses membres ? Quels sont les critères et qualifications des membres du comité d'audit de la *Shari'ah* ?)

42. Quel est le but principal de l'encadrement de l'audit ?
43. Avez-vous des objectifs explicites dans le cadre de l'audit de la *Shari'ah* ?
44. Est-ce que les responsabilités d'audit de la *Shari'ah* suivent celles de la comptabilité à un niveau managériale et public ?
45. En outre, existe-il une évaluation interne ou un soutien concernant le système de conformité à la *Shari'ah* dans votre institution ?
46. Avez-vous rencontré des problèmes majeurs ou mineurs avec CSS / UCSI / URSI par rapport à la conformité à la *Shari'ah* (à savoir un personnel ne mettant pas en œuvre les produits et services comme ils ont été approuvé) ? Quel est le plan d'action pour la non-conformité à la *Shari'ah* ?
47. Avez-vous un Audit externe conforme à la *Shari'ah* ?

SECTION 4 : MANAGEMENT

48. Quel est le rôle des différentes parties prenantes pour atteindre l'objectif de conformité de la *Shari'ah* ?
49. Quelle est l'influence que pourrait avoir le gouvernement sur votre orientation *Shari'ah* ?

La Qualité de L'information

50. Comment évaluez-vous la qualité de l'information par les rapports financiers des banques islamiques ? (En ce qui concerne leur pertinence, fiabilité, compréhensibilité, comparabilité, rapidité et importance)
51. Pensez-vous que l'information financière produite par les banques islamiques peut être améliorées ? Si oui, veuillez nous l'expliquer.

Utilisation de L'information

52. Pouvez-vous expliquer l'utilité du rapport comptable ainsi que l'information comptable dans le fonctionnement des banques islamiques ?

53. Pouvez-vous expliquer la mesure dans laquelle votre organisation applique-t-elle les normes comptables commerciales ?

54. Quels sont les principaux utilisateurs des rapports annuels de votre organisation ?

55. À votre avis, dans quelle mesure les états financiers de la banque islamique sont-ils utiles pour la détermination du processus comptable ?

56. Pourriez-vous expliquer les informations et d'autres éléments requis par l'investisseur individuel et institutionnel en matière d'investissement dans le secteur bancaire islamique ?

57. Quelle mesure peut être améliorée pour fournir de meilleurs rapports aux parties prenantes ?

Expertise du Capital Humain

58. Pourriez-vous commenter le manque d'expertise du capital humain dans les banques islamiques ?

59. Sur la base de votre expérience, quelles sont les suivantes :

a. les attentes des praticiens ?

b. les attentes des chercheurs et les attentes à l'égard du système d'éducation ?

c. les limites du système éducatif et de recherche ?

d. la communication des attentes entre les praticiens et les académiciens ?

60. Dans quelle mesure avons-nous besoin de divers efforts tels que la recherche et le développement, la formation, l'enseignement, afin d'améliorer les compétences du capital humain au niveau des banques islamiques en Algérie ?

Défis

57. Pouvez-vous décrire les défis auxquels sont confrontées les banques islamiques et l'industrie de la finance islamique en Algérie ? Que pensez-vous de ces défis ? (Mondialisation - rôle du développement des banques Islamiques au milieu de la mondialisation, l'internationalisation, la concurrence, le maintien du financement par actions et les risques).

Vues sur l'avenir de la Banque et Finance Islamique

58. Pourriez-vous commenter l'effet des initiatives et du développement en cours sur le progrès et la croissance des banques islamiques ?

59. Comment entrevoyez-vous l'avenir de la finance islamique et son industrie en Algérie et celui de son fonctionnement ?

List of Contents