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Shariah governance disclosure and its effect on Islamic banks' financial performance: evidence from Malaysia and GCC countries

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Abstract

Purpose – The purpose of this study is to examine the level of Shariah governance disclosure among Islamic banks in Malaysia and the Gulf Cooperation Council (GCC) countries (i.e. Kuwait, Bahrain, United Arab Emirates, Qatar, Oman and Saudi Arabia). On top of that, the effect of Shariah governance disclosure on Islamic banks financial performance is investigated.

Design/methodology/approach – Data underwent quantitative content analysis and a mean comparison of the Shariah governance disclosure mechanisms as well as multiple regression analysis. Shariah governance information is obtained from the Islamic banks' official websites and the Bursa Malaysia Exchange.

Findings – The results of the content analysis revealed that the level of Shariah governance disclosure among Malaysian Islamic banks has been more pronounced than in the GCC countries. Additionally, the multiple regression analysis results specified that of the five Shariah governance disclosure mechanisms, the Shariah committee emerged as the strongest determinant in the financial performance of the Islamic banks, followed by transparency and disclosure.

Practical implications – Islamic banks should emphasise publishing Shariah governance information in annual reports to reflect superior accounting practices as assessed by certified Shariah auditors with an effective monitoring system.

Originality/value – The empirical findings are vital for serving as a guideline for Islamic banks in Malaysia and the GCC countries to disclose their practice of Shariah governance and gain empirical insights into its effect on firms' financial performance. Following that, Islamic banks would improve their accounting practices while adhering to Shariah principles, strengthen internal controls and boost their brand reputation.

Keywords Shariah governance disclosure, Financial performance, Islamic banking, Malaysia, Gulf cooperation council (GCC)

Paper type Research paper

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1. Introduction

Despite the fact that the global Islamic banking industry has strengthened (Al-Smadi *et al.*, 2017; Guizani and Ajmi, 2021; Wahab and Roslan, 2021), weak governance has led to financial failures for Islamic Financial Institutions (IFIs), such as Ihlas Finance in Turkey, Islamic Investment Companies of Egypt and Islamic Bank of South Africa (Bahari and Baharudin, 2016). Indeed, Shaukat and Feroskhan (2018) contended that existing Islamic banking does not fully adhere to Shariah principles and laws. For specific Islamic finance products, some Islamic banks replicated conventional products (Ayub, 2018). Bank Islam Malaysia Berhad, for example, provided an Islamic finance contract loan for Bai' Bithaman Ajil, which is no different from the characteristics of conventional banking products (Hasshan, 2017). Similarly, Ahmed (2014) asserted that some products closely mimic conventional products, not meeting Shariah requirements. Though the conventional and Islamic financial transactions have distinct features, differing from each other (Beck *et al.*, 2013; Hidayat *et al.*, 2021; Majeed and Zainab, 2021; Wahab and Roslan, 2021), some IFIs are adopting conventional principles and instruments, posing IFIs at the risk of Shariah non-compliance (Omar and Hassan, 2019).

Past scholars asserted that Shariah governance practices in IFIs have an impact on firm performance (Abdullah *et al.*, 2013; Musleh Alsartawi, 2021; Wahab and Roslan, 2021). However, Ben Abdallah and Bahloul (2021) stressed that the results of previous studies on this issues were not consistent. Research findings by Albarrak and El-Halaby (2019) revealed that the effect was positive, while Elgattani and Hussainey (2021) indicated no effect. Ahmed (2014) highlighted several reasons why some Islamic banks have a lower level of disclosure than other banks, including weak regulations, inexperienced Board members, inadequate disclosure and information asymmetries. In addition, lack of information and degree of compliance also contribute to the reason why Islamic banks have a low level of governance, leading to a low level of disclosure (Elgattani and Hussainey, 2021). This diversity of perspectives on Shariah governance disclosure and Islamic bank financial performance necessitates additional empirical research beyond Hasan's (2011) descriptive analysis approach on Shariah governance practices in Malaysia, the Gulf Cooperation Council (GCC) countries and the UK. He discovered significant differences and diverse Shariah governance practices in these countries and acknowledged that there are shortcomings and weaknesses in the existing governance framework that require further enhancement and improvement. To bridge the gaps, this study examines the level of Shariah governance disclosure among Islamic banks in Malaysia and the GCC countries (i.e. Kuwait, Bahrain, United Arab Emirates [UAE], Qatar, Oman and Saudi Arabia). On top of that, the effect of Shariah governance disclosure on Islamic banks' financial performance is investigated.

The selection of the aforesaid countries is based on the fact that Malaysia and the GCC countries serve as models for Islamic procedures, structures and methods that others can adopt (Hasan, 2011; Masruki *et al.*, 2020a, 2020b; Musleh Alsartawi, 2021). Indeed, ICD-Refinitiv (2020) noted that Islamic banking held 69% in global Islamic finance assets compare to sukuk, takaful and other islamic funds. Hasan (2011, p. 31) stressed that:

> Within these countries, the study limited the scope of the survey to IFIs in the form of commercial banks and investment banks that offer Islamic financial services including regulatory authorities that had established their own Shari'ah board.

Consequently, the present study's data underwent quantitative content analysis and a mean comparison of the Shariah governance disclosure mechanisms, as well as multiple regression analysis. Shariah governance information is derived from the Islamic Bank's official websites and the Bursa Malaysia Exchange. This study advances extant research by

applying the Central Bank of Malaysia's (BNM) established Shariah Governance Framework (SGF), namely, the SGF 2010 and SGDP 2019, as well as the Exposure Draft of the Joint Islamic Financial Services Board – Accounting and Auditing Organisation for Islamic Financial Institutions (i.e. known as IFSB-AAOIFI) (2022) Revised Shariah Governance Framework (ED-RSGF) as guiding principles. Moreover, the findings furnish vital practical implications for Islamic banks in Malaysia and the GCC countries to improve their management of various levels of Shariah governance disclosure and gain empirical insight into how it affects firms' financial performance. Effective disclosure ensures that investments are managed with the utmost integrity and that the Islamic banks' governance structure is implemented effectively. The findings will serve as a guideline for Islamic banks seeking to enhance their accounting practices while complying with Shariah principles. This will eventually strengthen Islamic banks' internal controls and improve brand reputation.

The following section presents the literature review, the methodology, the results, the discussion and the conclusions.

2. Literature review and hypotheses development

2.1 Accountability theory

Individuals are accountable to Allah, the Creator, as well as to society, according to Islam (Noordin and Kassim, 2019). The act of accountability must be emphasised to ensure that Shariah compliance is fully implemented in the operations of Islamic banks or organisations (Harun and Abdullah, 2017). Effective communication between key individuals is necessary to ensure accountability through the performance of assigned roles and processes, as well as the provision of adequate information and accessibility (Said *et al.*, 2014). First, the Board of Directors is accountable and responsible for ensuring that the organisation complies with Shariah and consults with the Shariah Committee when developing Shariah-related policies. The Shariah Committee is accountable for each decision and opinion expressed, supervises the reporting of other Shariah functions and ensures that stakeholders receive an opinion, statement and sufficient information in the Shariah Committee report. Management is accountable for ensuring that the Shariah Committee is carrying out its responsibilities fairly. The Shariah Committee's ability to produce a high-quality report is contingent upon accurate, complete and transparent information. As a result, there are no complications when disclosing the report. It contributes to the instruments' efficiency and effectiveness while achieving accountability goals (Abduh and AlAgeely, 2015). Accountability contributes to society's trust by using publicly available reporting instruments such as financial and non-financial reports (Abduh and AlAgeely, 2015; Nugraheni and Annuar, 2014), including sustainability and corporate social responsibility reporting.

2.2 Signalling theory

According to signalling theory, organisations are prone to disclose information about their financial performance (Hamrouni *et al.*, 2015). A strong financial performance will attract investors for the benefit of the organisation as they desired to maximise their wealth (Safieddine, 2009). Previous research demonstrates that corporate voluntary disclosure has a significant effect on an organisation's performance via the cost of capital (Omar and Rahman, 2019). These scholars asserted that significant growth can be seen in the market capitalisation, liquidity and growth of the company's stock market as a result of successful reforms to the governance code for disclosure.

2.3 Agency theory

Agency theory refers to situations in which an individual (the agent) acts on behalf of another (the principal) for a fee (Birjandi *et al.*, 2015). While the principal is believed to provide capital for the organisation, he lacks management experience, prompting him to hire an agent to manage the business and make decisions on their behalf (Shamsuddin and Ismail, 2013). However, agents and principals may pursue interests that conflict with one another, resulting in goal conflicts. Nonetheless, the existence of information asymmetry and unethical behaviour exacerbates agency conflicts (Shamsuddin and Ismail, 2013). Poor performance occurs as a result of conflict between agents and principals, insufficient managerial ability, a different attitude towards risk and the pursuit of personal gain. Notably, agency costs vary by organisation, as managers jeopardise their ability to maximise their wealth (Fikri *et al.*, 2017). As a result, governance mechanisms exist to assist in minimising conflicting interests and preventing managerial opportunism (Omar and Rahman, 2019).

2.4 Financial performance

Financial performance is frequently used to quantify an organisation's revenue, profitability and productivity (Huselid, 1995), also referred to as an entity's performance (Al Amosh *et al.*, 2023). Return on assets (ROA) and return on equity are two indicators that have been used in the past to quantify financial performance. ROA provides insight into profitability generated by total assets to profit, whereas return on equity quantifies an organisation's efficiency when it comes to profit generated by equity used (Al Amosh *et al.*, 2023). The efficiency of asset management in generating income can be measured by ROA (Grassa, 2018; Nomran *et al.*, 2018; Srairi, 2015). As assets are defined as financial and material resources, a high ROA demonstrates the organisation's ability to generate profit. The higher the ROA, the more efficient the organisation's asset management is. Agents must disclose financial information to avoid asymmetric information. According to agency theory, this action reduces agency issues. To maintain a bank's credibility, agents and principals must align their interests (Safieddine, 2009).

2.5 Past research on shariah governance disclosure for Islamic financial institutions

Appendix 1 specifics the top four scholarly articles on Shariah governance disclosure in the Scopus database. The top scholars (Abdullah *et al.*, 2013; Hasan, 2011; Kasim, 2012; Obid and Naysary, 2014) highlighted that Shariah governance has been a system or structure that provides duties for the Shariah advisory council, Shariah supervisory board and Shariah committee to perform their tasks adhering to Shariah law. It plays a significant role in monitoring the entire operations of IFIs in compliance with Shariah rulings and principles (Abdullah *et al.*, 2013; Nomran *et al.*, 2017, 2018; Obid and Naysary, 2014). Shariah governance disclosure by IFIs is mandated by the regulatory framework, as their obligation to improve the bank's financial accountability to Allah must begin with adhering to Islamic principles and Shariah regulations (Alam *et al.*, 2021; Alam, 2021; Elgattani and Hussainey, 2021). Accountability can be aided through transparency and disclosure. Complete disclosure is required to enhance Islamic banks' transparency and accountability to the public interest (Grassa *et al.*, 2018). Islamic corporate governance encompasses economics, legal systems and social values, all of which must be compliant with Shariah regulations (Wahyudin *et al.*, 2019). Effective disclosure necessitates that information, such as financial data, is timely, accurate and sufficient, as well as easily accessible to users (Srairi, 2015). Thus, Islamic banks are expected to adhere to good governance models such as the Exposure Draft of the Joint IFSB-AAOIFI's (2022) ED-RSGF and the BNM's SGF 2010 and

SGDP 2019 to protect the interests of stakeholders through increased transparency and accountability. The following sections discuss five disclosure mechanisms for Shariah governance (i.e. Shariah committee, Shariah review, Shariah audit, Shariah risk and transparency and disclosure).

2.6 Shariah committee

The Shariah Supervisory Board, also known as the Shariah Committee, serves as a safeguard mechanism that strengthens the management and operations following Shariah law and principles (Aribi *et al.*, 2019). The Shariah Committee is a vital component of Shariah-based governance systems (Grais and Pellegrini, 2006). Additionally, they act on behalf of the organisation's stakeholders to mitigate management opportunistic behaviour (Hassan *et al.*, 2021), which is a component of agency problems. To effectively run an organisation, the committee must understand Shariah Law and be accountable for directing, reviewing and ensuring that any financial product or service offered to a consumer is legally permissible from an Islamic perspective (Aribi *et al.*, 2019). They contribute to determining IFIs' credibility, ensuring Shariah law compliance (Kusuma and Rosadi, 2019) and risk-taking, as such behaviour is frequently visible in Islamic or conventional banks (Hassan *et al.*, 2021). The function of the Shariah Committee not only is limited to Islamic products and disclosure in the annual report but also controls transactions of Islamic banks by supervising, reviewing and advising the Islamic bank's day-to-day operations and other activities (Masruki *et al.*, 2020a, 2020b; Noordin and Kassim, 2019). Indeed, Hasan (2011) stressed that the Shariah committee's responsibilities are centralised on advisory and supervisory authority, while executive power is held by the board of directors. According to signalling theory, effective disclosure will entice more investors to provide capital, thereby strengthening the organisation's finances (Hamrouni *et al.*, 2015). Such responsibilities have often been translated into the bank's financial performance. The impact of the Shariah Committee on Islamic banks' financial performance is evidenced in the scholarly works of Ben Abdallah and Bahloul (2021). Thus, it is posited that:

H1. Shariah committee has a positive effect on Islamic banks' financial performance.

2.7 Shariah review

Shariah review is a regular screening process that involves all operations, including but not limited to contracts, agreements, policies, transactions and products, to ensure that the IFI operates following the fatwa, Shariah rulings and guidelines issued by the Shariah Committee (Kunhibava, 2012; Zain and Amanullah, 2018). According to Bahari and Baharudin (2016), Shariah review involves multiple procedures, including creating review programmes, executing review processes, preparing documentation related to review processes, reviewing products from beginning to end and disclosing the results. The findings should be communicated to the Shariah Committee, senior management and the Board. To sustain Shariah's compliance culture in IFIs, non-compliance occurrences must be noted while reporting. The process is mainly concerned with internal consultation (Bahari and Baharudin, 2016). Shariah review members are held accountable for their reports, views and opinions. Because Shariah's review must be reported to the Shariah Committee, the Board of Directors and senior management, Shariah's review is accountable to them through adequate disclosure and transparency. It was to minimise the asymmetric information that occurs between agents and principals regularly. Past research has found a

minimally positive effect of Shariah review on financial performance (Tazilah *et al.*, 2017; Zain and Shafii, 2018). Accordingly, the following hypothesis is postulated:

H2. Shariah review has a positive effect on Islamic banks' financial performance.

2.8 Shariah audit

A Shariah audit is a periodic review undertaken by an independent auditor, that is, a qualified internal auditor with knowledge of finance and Shariah law, to ensure IFIs' compliance with BNM's Shariah governance framework, and audit quality occurs when accounting data is transparent (Bahari and Baharudin, 2016; Tazilah *et al.*, 2017; Zain and Shafii, 2018). By pursuing managers' interests, agency problems caused by misconduct can be avoided. This is because ownership is segregated. A qualified internal auditor's primary objective is to maximise the principal's wealth while ensuring Shariah compliance within the organisation (Hassan *et al.*, 2021). To ensure that fraud and other forms of misconduct can be avoided, IFIs must conduct a thorough background and experience check before entrusting Shariah auditors with the audit. The absence of qualified Shariah auditors can have a negative impact on the quality of the annual report and Shariah compliance (Shahar *et al.*, 2018, 2020). High audit quality assures an organisation's financial performance (Ndaba *et al.*, 2021; Nguyen and Kend, 2021). Similarly, a high-quality Shariah audit not only enhances IFIs' accountability but also influences their financial performance (Odia, 2014). Based on these researchers' assertions, the following can be hypothesised:

H3. Shariah audit has a positive effect on Islamic banks' financial performance.

2.9 Shariah risk

The IFIs are exposed to the Shariah non-compliance risk because of fulfilling commercial purposes (Omar and Hassan, 2019). BNM has established control functions which are comprised of Shariah risk management, Shariah review and Shariah audit, while AAOIFI with Shariah compliance function caters for the risk (IFSB-AAOIFI, 2022). Shariah risk management has been established as a tool for monitoring compliance in banking, financing and investing activities, thereby assisting in the protection of individuals or their properties from losses (Noor *et al.*, 2018). Risk management is a process that aims to understand the key risk factors, develop risk measures and monitor the risk (Hassan *et al.*, 2017). Risk management is critical to ensure institutional stability and financial performance success, as failure in risk management would result in bankruptcy (Tazilah *et al.*, 2017; Zain and Shafii, 2018). According to agency theory, managers exhibit risk-taking behaviours that are distinct from those of owners. Managers are risk-averse to avoid unemployment, but owners are risk-averse to generate more cash flow (Fayed and Ezzat, 2017). IFIs are exposed to various risks, including Shariah risk, credit risk, liquidity risk, market risk and others (Noor *et al.*, 2018). Shariah's risk control or Shariah compliance function shall perform Shariah risk management control key processes such as risk identification, risk measurement and risk monitoring (Hassan *et al.*, 2017; Ramly and Nordin, 2018). Indeed, investors and shareholders are extremely concerned about the Shariah compliance manner where their fund is (Safieddine, 2009). Through Shariah's risk management, agency issues can be minimised. Common risks, such as Shariah non-compliance risk, have a negative influence on financial performance (Bhatti, 2019). As Shariah's non-compliance risk is a component of operational risk, if it is not adequately managed, then it can lead to severe outcomes such as

a negative reputation and insolvency concerns (Rosly *et al.*, 2017; Yunas Ali and Hassan, 2019). Hence, it is posited that:

H4. Shariah risk has a positive effect on Islamic banks' financial performance.

2.10 Transparency and disclosure

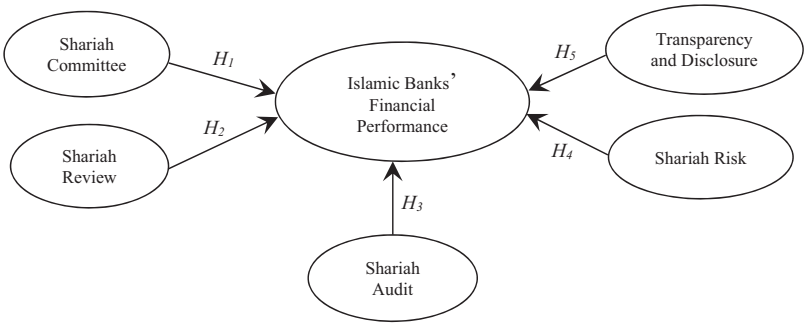
Transparency and disclosure improve the effectiveness of Shariah governance (Rosman *et al.*, 2017). Full disclosure, transparency and accountability will enhance compliance with Shariah rulings and fatwas about Islamic finance. Transparency is necessary to strengthen stakeholders' assurance and confidence as well as to reduce problems such as information asymmetry between principals and agents (Zain and Shafii, 2018). The principal is the organisation's shareholder, or owner, whereas an agent is a manager, director or the management of the organisation. If information, details and data are easily accessible, then no suspicion of noncompliance will exist in Islamic banking (Rosman *et al.*, 2017). It is to ensure that instances of depositor money being misappropriated do not occur as a result of the separation of cash flow and control rights (Grais and Pellegrini, 2006; Safieddine, 2009). When preparing the annual report, the nature, size and number of violations of Shariah rulings, the number of zakat contributions and the remuneration of Shariah Board members must be disclosed (Shafiai and Rosle, 2018). An organisation that provides good disclosure and transparency will achieve high market and operating performance (Mardini and Lahyani, 2022; Srairi, 2015). According to a study conducted by Grais and Pellegrini (2006), agency issues concerning transparency and disclosure are likely to impede the bank's performance. Previous researchers posited that transparency and disclosure have a positive relationship towards performance whether financial performance or non-financial performance (Albarrak and El-Halaby, 2019; Omar and Rahman, 2019). Consequently, the following can be hypothesised:

H5. Transparency and disclosure have a positive effect on Islamic banks' financial performance.

Based on the above review, Figure 1 presents the conceptual framework of the present study.

3. Methodology

Quantitative content analysis and a close-ended survey were used to assess the level of Shariah governance disclosure and its effect on the Islamic banks' financial performance, respectively.



Source: Zain and Shafii (2018)

Figure 1. Conceptual framework

3.1 Procedure for assessing the level of shariah governance disclosure

The total population of Islamic banks in Malaysia and the GCC countries is 16:27, as reported by Basu *et al.* (2018). Following the scholarly works of Martínez-Mesa *et al.* (2016), this study used a census sampling technique to collect data for Malaysian Islamic banks. Census sampling techniques are designed to capture the entire population. In Malaysia, this sampling technique is used by all Islamic banks. A stratified random sampling technique was used to select the Islamic banks from the GCC countries, following Taherdoost's (2018) study. The population of this study is classified into subgroups of the countries of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE and Islamic banks are selected using random sampling within each subgroup. It did, however, exclude newly established Islamic banking to avoid insufficient data. Three years are used as the sampling period for each Islamic bank. As detailed in Table 1, the observation period for the level of Shariah disclosure was from 2016 to 2018, with a total sample size of 105 (i.e. 16 banks × 3 years = 48 Malaysian IFIs; 19 banks × 3 years = 57 IFIs for the GCC countries). The information on Shariah governance was obtained from the official websites of Islamic banks and the Bursa Malaysia Exchange. Content analysis was used to assess the level of Shariah governance disclosure. Five factors contribute to the total score of 46:

(1) Shariah committee;
(2) Shariah review;
(3) Shariah audit;
(4) Shariah risk; and
(5) Transparency and disclosure.

The factors of disclosed items were scored binary, with a score of "1" if Shariah governance information was disclosed and "0" if it was not disclosed in the annual report. Prior scholars have also used this technique to demonstrate the level of disclosure for each factor (Albarrak and El-Halaby, 2019; Aribi *et al.*, 2019; Masruki *et al.*, 2020a, 2020b; Noordin and Kassim, 2019; Srairi, 2015).

3.2 Procedure for examining the effect on Islamic banks' financial performance

The instruments of the five Shariah governance disclosure mechanisms listed in Appendix 2 were designed using the following sources: the Exposure Draft of the Joint IFSB-AAOIFI's (2022) ED-RSGF, including the Guidance on Key Elements in the Supervisory Review Process of Institutions offering Islamic Financial Services (Excluding Islamic Insurance (Takaful) Institutions, the Guiding Principles on Corporate Governance for Institutions

Category	Frequency	%	Category	Frequency	%
Year of annual Report assessed			Country		
2016	35	33.3	Malaysia	48	45.7
2017	35	33.3	Bahrain	12	11.4
2018	35	33.3	Kuwait	9	8.6
Region			Oman	6	5.7
Malaysia	48	45.7	Qatar	9	8.6
GCC countries	57	54.3	Saudi Arabia	9	8.6
			United Arab Emirates (UAE)	12	11.4

Source: Table by authors

Table 1. Distribution of samples

Offering Only Islamic Financial Services (Excluding Islamic Insurance [Takaful] Institutions and Islamic Mutual Funds), the Exposure Draft Guiding Principles on Shariah Governance System and the BNM's SGF 2010 and SGDP 2019. Precisely, the Shariah committee composed 15 items, the Shariah review encompassed 5 items, the Shariah audit comprised 6 items, the Shariah risk contained 4 items and the transparency and disclosure consisted of 16 items. Next, the measurement of financial performance of Islamic banks (i.e. ROA) was measured based on net income and total assets. The ROA has been used in other similar studies (Ben Abdallah and Bahloul, 2021; Elgattani and Hussainey, 2021).

Using the Statistical Package for the Social Sciences computer programme version 23.0, descriptive analyses were used to find the mean score for Shariah governance disclosure mechanisms. After that, multiple regression analysis, which permits prediction from multiple predictors (Sekaran and Bougie, 2016), was performed to investigate the effect of five independent variables (i.e. Shariah committee, Shariah review, Shariah audit, Shariah risk and transparency and disclosure) on the dependent variable (i.e. Islamic banks' financial performance). Additionally, Hofstede's cultural dimensions, such as the year and country dummy, were included as control variables in the regression model.

4. Results

4.1 Level of shariah governance disclosure

As displayed in Table 2, the 35 Islamic banks, that is, 16 from Malaysia and 19 from the GCC countries, were scrutinised for their Shariah governance disclosure between 2016 and 2018. The data has been sorted by the total average disclosure: highest to lowest. Precisely, most banks had more than 50% of the annual average disclosure. Among all banks, the highest average disclosure is 93% by Bank Islam Malaysia Berhad, Malaysia. This is followed by another two Malaysian Islamic banks, namely, Hong Leong Islamic Bank Berhad and OCBC Al Amin Bank Berhad, with a 91% average disclosure. The lowest disclosure was identified in the annual reports of Sharjah Islamic Bank, located in the UAE, with 48% of the average disclosure. On an annual basis, besides Sharjah Islamic Bank and Affin Islamic Bank Berhad, Malaysia had a 0% disclosure in 2018, as no audited annual report was published on the website.

The average level of Shariah governance disclosure among Islamic banks in Malaysia and the GCC countries, as detailed in Table 3, shows that Malaysia (83.3%) topped the list. This suggests that Islamic banks in Malaysia have had strong governance as a result of the implementation of disclosure frameworks such as the Shariah governance framework statute by the Exposure Draft of the Joint IFSB-AAOIFI's (2022) ED-RSGF and the BNM's SGF 2010 and SGDP 2019. Each Islamic bank must have its own Shariah Committee and must not own Shariah Committee's position in other Islamic banks to assure the independence of the committee's views (Bank Negara Malaysia, 2019). This requirement has resulted in a high level of Shariah governance disclosure because of the size and diversity of Shariah Committee members' backgrounds (Noordin and Kassim, 2019). Indeed, Islamic banks with strong governance are commonly associated with a high level of voluntary disclosure (Abdullah *et al.*, 2013).

With a score of 81.5%, Oman has the highest average level of Shariah governance disclosure among the six GCC countries. This standing is consistent with Al-Sartawi's (2020) findings that Oman has the highest level of disclosure because of stringent Shariah regulations despite its late entry into the Islamic finance industry. This is trailed by Bahrain (75.7%) and Kuwait (74.7%), both of which have managed to provide a high

Name of Islamic Banks	Level of disclosure by year 2016 (%)	2017 (%)	2018 (%)	Average disclosure (%)
Bank Islam Malaysia Berhad (BIMB)	96	89	93	93
Hong Leong Islamic Bank Berhad	90	91	93	91
OCBC Al-Amin Bank Berhad	91	91	91	91
AmBank Islamic Berhad	91	87	93	90
RHB Islamic Bank Berhad	89	89	89	89
Alliance Islamic Bank Berhad	89	89	87	88
Maybank Group Islamic banking	87	87	87	87
Bank Muamalat Malaysia	83	89	85	86
Public Islamic Bank Berhad	85	85	85	85
Kuwait Finance House (Malaysia)	83	85	85	84
Al Rajhi Banking and Investment Corporation (Malaysia)	83	78	87	83
Standard Chartered Saadiq Berhad	85	83	83	83
ABC Islamic Bank	83	83	83	83
Alizz Islamic Bank	83	83	83	83
CIMB Islamic Bank Berhad	83	80	80	81
Bahrain Islamic Bank	78	80	85	81
Kuwait International Bank	78	78	83	80
Bank Nizwa	80	80	80	80
MBSB Bank Berhad	62	76	76	75
Boubyan Bank	72	72	78	74
Abu Dhabi Islamic Bank	72	74	72	73
HSBC Amanah Malaysia Berhad	70	70	70	70
Khaleeji Commercial Bank	70	70	72	70
Warba Bank	67	72	72	70
Bank Al Bilad	67	70	70	69
Al Baraka Islamic Bank	63	67	74	68
Bank Al Jazira	65	70	70	68
Noor Bank	65	65	63	64
Qatar Islamic Bank	61	61	61	61
Qatar International Islamic Bank	59	59	59	59
Alinma Bank	59	59	59	59
Affin Islamic Bank Berhad	91	87	0	59
Masraf Al Rayan	57	59	59	58
Dubai Islamic Bank	59	59	57	58
Sharjah Islamic Bank	41	41	61	48

Notes: *The 2018 annual report was not published on the bank website. Thus, no disclosure could be ascertained
Source: Table by Elgattani and Hussainey (2021)

Table 2.
Level of shariah governance disclosure among Islamic banks

level of Shariah governance disclosure. However, this result contradicts the findings of Al-Sulaiti *et al.* (2018) that Bahrain has relatively low AAOIFI governance disclosure because of the possibility of overlapping between two regulations (Elgattani and Hussainey, 2021). The average level of Shariah governance disclosure in Saudi Arabia and the UAE is 65.3% and 60.7%, respectively. Surprisingly, this analysis revealed that Qatar has the lowest average degree of disclosure at 59.5%, even though Al-Sulaiti *et al.* (2018) claimed that Qatar has strong compliance, especially concerning Mudaraba and Murabaha disclosures.

4.2 Mean comparison of the shariah governance disclosure mechanisms between Malaysia and the Gulf Cooperation Council countries

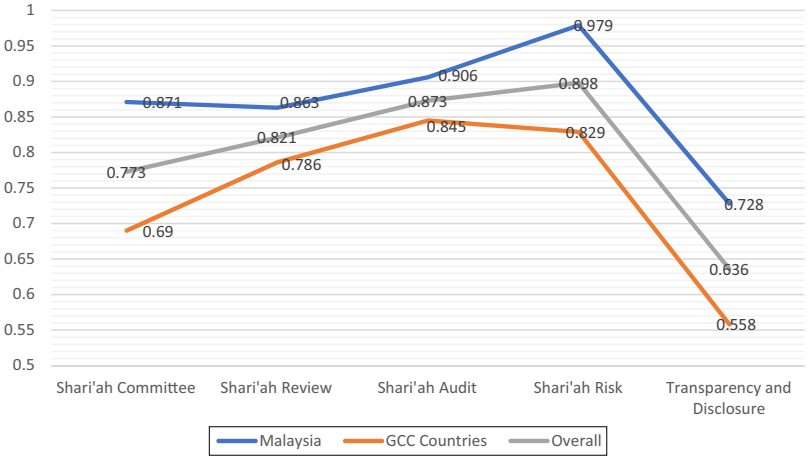
This study conducted a mean comparison of the Shariah governance disclosure mechanisms between Malaysia and the GCC countries. As illustrated in Figure 2, of the five Shariah governance mechanisms, Islamic banks in Malaysia placed the highest priority on Shariah risk (M = 0.979), followed by Shariah audit (M = 0.873), Shariah review (M = 0.821) and Shariah committee (M = 0.773). Surprisingly, Islamic banks in Malaysia placed the lowest emphasis on transparency and disclosure, with a satisfactory mean value of 0.728, implying that this factor should be improved to enhance accountability and disclosure quality by Islamic banks.

In the context of Islamic banks in the GCC countries, they heavily focused on the Shariah audit (M = 0.845), followed by the Shariah review with a mean value of 0.786. Furthermore, Islamic banks reported Shariah risk (M = 0.829) as the third most important Shariah governance disclosure mechanism. The Shariah Committee is next, with a mean value of 0.69. The lowest level of Shariah governance disclosure was in the transparency and

Countries	Level of disclosure by year 2016	2017	2018	Average disclosure (%)
Malaysia	84.8	84.8	80.3	83.3
Oman	81.5	81.5	81.5	81.5
Bahrain	73.5	75.0	78.5	75.7
Kuwait	72.3	74.0	77.7	74.7
Saudi Arabia	63.6	66.3	66.3	65.3
United Arab Emirates (UAE)	59.2	59.8	63.2	60.7
Qatar	59.0	59.6	59.6	59.5

Source: Table by Elgattani and Hussainey (2021)

Table 3. Average level of shariah governance disclosure between Malaysia and the Gulf Cooperation Council countries



Source: Figure by authors

Figure 2. Mean comparison of Shariah governance disclosure between Malaysia and the Gulf Cooperation Council countries

disclosure component (M = 0.558). This mean is slightly higher than the usual mean value, implying that more work is required to enhance accountability and quality of Shariah governance disclosure among Islamic banks in the GCC countries.

4.3 Effects of shariah governance disclosure mechanisms on Islamic banks' financial performance

4.3.1 Reliability and validity analysis. Reliability testing was carried out to assess the internal consistency of the measurement items with their associated factors. Cronbach's alpha value topped 0.70, denoting higher reliability (Hair *et al.*, 2010). Table 4 details the readings of Cronbach's alpha that surpass the aforesaid cut-off value, that is, vary from 0.722 to 0.807, inferring higher reliability among the indicators. Next, Pearson correlations were performed to inspect the association between all constructs (i.e. Shariah committee, Shariah review, Shariah audit, Shariah risk, transparency and disclosure and Islamic banks' financial performance). The results demonstrated that all constructs were significantly correlated with each other with coefficients less than 0.850, signifying there were no multicollinearity concerns in this study.

Table 5 also summarises the correlations among variables. Shariah committee had a significant and positive correlation with Islamic banks' financial performance ($r = 0.424$ and $p < 0.05$). However, the correlations between Shariah review and Islamic banks' financial performance were not statistically significant ($r = 0.179$ and $p > 0.05$). In similar tandem, Islamic banks' financial performance also was not significantly associated with the Shariah audit ($r = 0.154$ and $p > 0.05$). On the other hand, Shariah risk had a significant correlation with Islamic banks' financial performance ($r = 0.372$ and $p < 0.05$). Additionally, the linkages of transparency and disclosure on Islamic banks' financial performance were significant, with $r = 0.226$ at $p < 0.01$. Further assessment showed means for all constructs ranging between 0.636 and 0.923, whereby transparency and disclosure had the highest mean value, while Islamic banks' financial performance had the lowest mean value.

4.3.2 Hypothesis testing via multiple regression analysis. Multiple regression analysis was performed to test the strength of the five hypothesised relationships by checking the standardised beta coefficients (β), t-statistics and coefficient of determination (R^2). In the present study, five hypotheses were put forth, of which independent variables encompassed the five Shariah governance disclosure mechanisms, namely, Shariah committee, Shariah review, Shariah audit, Shariah risk and transparency and disclosure, while Islamic banks' financial performance represented the dependent variable. Table 5 specifics that the tolerance value ranges from 0.285 to 0.521 and is exceeded by 0.10, and the variance inflation

Variables	1	2	3	4	5	6	Cronbach's α
(1) Shariah committee	1.000						0.807
(2) Shariah review	0.552**	1.000					0.770
(3) Shariah audit	0.617**	0.806**	1.000				0.722
(4) Shariah risk	0.684**	0.487**	0.599**	1.000			0.782
(5) Transparency and disclosure	0.688**	0.413**	0.480**	0.489**	1.000		0.758
(6) Financial performance	0.424**	0.179	0.154	0.372	0.226*	1.000	0.799
Mean	0.773	0.821	0.873	0.898	0.636	0.923	
SD	0.175	0.177	0.158	0.192	0.156	0.683	

Notes: *$p < 0.05$; **$p < 0.01$
Source: Table by authors

Table 4.
Descriptive statistics and correlations among variables

Variable	Standard beta Coefficients	Significance	Collinearity statistics Tolerance	VIF
Direct effects				
H1 Shariah committee → Islamic banks' financial performance	0.472*	0.002	0.338	2.961
H2 Shariah review → Islamic banks' financial performance	0.088^{ns}	0.558	0.344	2.910
H3 Shariah audit → Islamic banks' financial performance	0.299^{ns}	0.073	0.285	3.514
H4 Shariah risk → Islamic banks' financial performance	0.238^{ns}	0.064	0.480	2.083
H5 Transparency and disclosure → Islamic banks' financial performance	0.108*	0.379	0.521	1.920
Control variables				
Year	0.152^{ns}	0.772		
Country	0.163^{ns}	0.854		
Constant	1.725^{ns}	0.721		

Notes: *$p < 0.05$; ns = not significant; VIF = variance inflation factor
Source: Table by authors

Table 5.
Impacts on Islamic banks' financial performance

factor value varies between 1.920 and 3.514, which is below the threshold of 5.00. Henceforth, there are no issues with multicollinearity in the study. Next, heteroscedasticity was examined using the scatter plot in Figure 3, which shows that the majority of the value is concentrated in the graph's centre, implying that residuals are normally distributed in relation to the predicted values of the independent variables affecting Islamic banks' financial performance. However, a small number of values are dispersed around the central value.

Hofstede's cultural dimensions, such as the year and country dummy, were added as control variables in the regression model. The control variables could only explain 1.7% of the variance in the dependent variable. As a result, the independent variables explain 51.6% of the variance. Indeed, all of the control variables were found to have a statistically insignificant relationship with the dependent variable. Together, the R^2 of the proposed model was 0.533, inferring that 53.3% of the variance in Islamic banks' financial performance is explained by the five independent variables, namely:

(1) Shariah committee;
(2) Shariah review;
(3) Shariah audit;
(4) Shariah risk; and
(5) Transparency and disclosure.

The readings of *t*-values in Table 5 indicate support for the study hypotheses: *H1* and *H5*, except for *H2*, *H3* and *H4*. For the first hypothesis (*H1*), the standardised beta coefficients and *t*-statistics show that the Shariah committee had a positive and significant effect on Islamic banks' financial performance ($\beta_1 = 0.472$, *t*-values = 3.116 and $p < 0.05$). However, the result of testing the second hypothesis (*H2*) indicated that the Shariah review does not

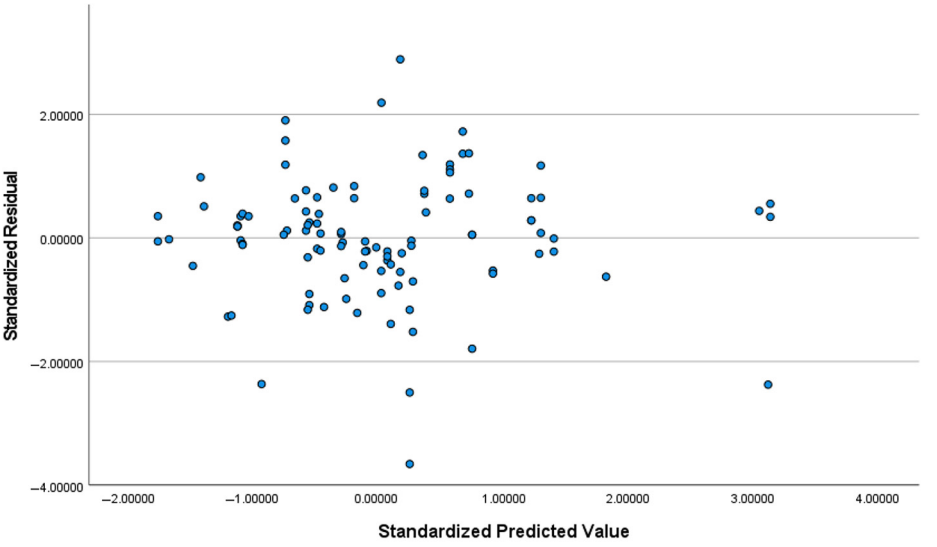


Figure 3.
Scatterplots with financial performance as the dependent variable

Source: Figure by authors

affect Islamic banks' financial performance, with a standardised beta value of $\beta_2 = 0.088$, with a t-values = 0.558 and $p > 0.05$. In a similar vein, the testing of the third hypothesis (*H3*) revealed that the Shariah audit had an insignificant effect on Islamic banks' financial performance ($\beta_3 = 0.299$, t-values = 1.812 and $p > 0.05$), giving no support for *H3*. For the next hypothesis (*H4*), the standardised beta coefficients revealed that Shariah risk insignificantly influenced Islamic banks' financial performance ($\beta_4 = 0.238$, t-values = 1.876 and at $p > 0.05$). On the other hand, the final hypothesis (*H5*) was supported, confirming that transparency and disclosure had a positive effect on Islamic banks' financial performance ($\beta_5 = 0.108$, with a t-values = 0.885 and at $p < 0.05$).

5. Discussion

This study examined the level of Shariah governance disclosure among Islamic banks in Malaysia and the GCC countries via content analysis and mean comparison. On top of that, the effect of five components of Shariah governance disclosure on Islamic banks' financial performance was investigated using multiple regression analysis. The result reveals that the Shariah committee has a significant effect on Islamic banks' financial performance. As a result, *H1* is supported. The findings imply that the more efficient the composition of Shariah committee members, the more likely Islamic banks will have better financial performance. They are qualified and experienced in Shariah and have appropriate knowledge of finance and Islamic finance to provide Shariah counsel. They are held accountable for the opinions they express and evaluate the work of Shariah review and Shariah audit. They also endorse the Shariah policies and procedures and validate the relevant documentation. Most importantly, the Shariah committee plays a robust and noteworthy role in impacting the financial performance of Islamic banks among the five components of Shariah governance disclosure. To be more specific, the respondents in Malaysia and the GCC countries have placed the second-lowest priority on this element (i.e. the Shariah committee). The result is analogous to those obtained in earlier studies (Masruki *et al.*, 2020a, 2020b; Zain and Shafii, 2018). The meaningful findings also complement those reported in the scholarly works of Ben Abdallah and Bahloul (2021) and Noordin and Kassim (2019).

Opposite to the Shariah committee, the impact of the relationship between Shariah review and Islamic banks' financial performance suggests that this component was perceived as insignificantly influential on the Islamic banks' financial performance. Therefore, *H2* is not supported as expected. The insignificant effect implies that the Shariah review does not directly impact Islamic banks' financial performance. Shariah reviewers, who are well-versed in Shariah guidelines, are responsible for reviewing the overall IFI's documentation of the process and business operations. Their input will be communicated to the Board, the Securities Commission Malaysia (SC) and senior management on the Shariah review outcomes. Yet, the Shariah review is more focused on the internal consultative nature, which is not directly involved with ensuring a level of disclosure among Islamic banks (Bahari and Baharudin, 2016). Precisely, both groups (i.e. Malaysian banks and the GCC banks) appeared to place this component (i.e. Shariah review) at varying levels of priority. Malaysian banks seem to consider the Shariah review mechanism as the third priority, whereas the GCC banks portray it as the second priority. The present result contradicts the findings of past studies by Tazilah *et al.* (2017) and Zain and Shafii (2018).

Moreover, the empirical results show that the lack of support for the impact of Shariah audit on Islamic banks' financial performance was discovered in this research. Thus, it is not sustaining *H3*. The insignificant finding indicates that the dimension of Shariah audit has little influence on Islamic banks' financial performance, even though the auditors, who are among internal auditors with sound Shariah knowledge, provide independent

assessment and objective assurance with respect to the audit of Islamic banks' financial statements. Indeed, the Shariah audit is performed regularly by examining whether Islamic banks apply Shariah governance and undertake Shariah compliance disclosure. More specifically, the Shariah audit element was perceived as the most important by Islamic banks in the GCC nations and the second most important by those banks in Malaysia. The current finding contrasts with those of Ndaba *et al.* (2021), Nguyen and Kend (2021) and Shahar *et al.* (2018, 2020).

Additionally, Shariah's risk which is part of Shariah compliance was revealed to not have a substantial impact on Islamic banks' financial performance. Hence, *H4* is not reinforced. The insignificant findings imply that Shariah risk has no impact on Islamic banks' financial performance in terms of whether Shariah governance disclosure is conducted by competent risk officers or whether professionals devise and recommend risk mitigation strategies. Lack of reporting in the annual report can lead to Shariah accountability issues (Masruki *et al.*, 2020a, 2020b), whereas risk-taking control is necessary to enhance company performance with the help of Shariah committee expertise (Bhatti, 2019; Ramly and Nordin, 2018; Yunas Ali and Hassan, 2019). Therefore, Islamic banks must consider how they will manage Shariah risk as well as create and implement a comprehensive Shariah governance disclosure method. Past scholars (Tazilah *et al.*, 2017; Zain and Shafii, 2018) have highlighted that Shariah risk needs to be prioritised in the current system of Islamic banks because of the increasing complexity of operations among those banks. Descriptively, the aspect of Shariah risk has been viewed as the highest priority among Malaysian Islamic banks but is the third most important among those in the GCC countries. The present empirical findings are inconsistent with earlier studies' findings (Hassan *et al.*, 2017; Ramly and Nordin, 2018).

Over and above that, transparency and disclosure had a positive effect on Islamic banks' financial performance. Consequently, *H5* is strengthened as postulated. The significant results indicate that Islamic banks are more likely to continuously uphold transparency and disclosure of information because they are fully aware that the aim and operation of Islamic banking must be free of Shariah non-compliance. They disclose its profile, roles and responsibilities, as well as the security commission's and the board's view on the IFI's Shariah compliance. They also provide details about the type of involvement, the rationale for involvement and the quantity of involvement in non-permissible activities. In addition, as a matter of transparency and disclosure of Islamic banks' financial performance, the zakat requirements payable to the company, shareholders and depositors are made known to others. The enhanced disclosure would be in line with Srairi's (2015) assertion that disclosure, as well as the implementation of a governance framework, will improve internal control and boost the brand reputation of Islamic banks. More precisely, the transparency and disclosure factor was given the least priority for all Islamic banks across groups in Malaysia and the GCC countries. The significant result is consistent with past studies (Albarrak and El-Halaby, 2019).

6. Conclusions

In conclusion, the content analysis reveals that the level of Shariah governance disclosure among Malaysian Islamic banks has been more pronounced than in the GCC countries. Moreover, the mean comparison of the Shariah governance disclosure mechanisms between Malaysia and the GCC countries shows that Islamic banks in the GCC countries highly recognised Shariah audit as the leading Shariah governance mechanism compared to Islamic banks in Malaysia. On the other hand, Shariah risk appeared to be the most important disclosure among Islamic banks in Malaysia than in the GCC countries. These scenarios suggest that Shariah audit among Islamic banks in the GCC countries and Shariah

risk among those in Malaysia are the anchors of the Shariah governance mechanism. In addition to that, the multiple regression analysis performed on the five hypotheses indicates that the Shariah committee emerged as the strongest determinant of the financial performance of Islamic banks, followed by aspects of transparency and disclosure. They confirm the great influence of the Shariah committee on financial performance across frameworks. Consequently, this study advances prior research by applying the Exposure Draft of the Joint IFSB-AAOIFI's (2022) ED-RSGF and the BNM's SGF 2010 and SGDP 2019 as guiding principles.

Practically, the findings are imperative to serve as a guideline for Islamic banks in Malaysia and the GCC countries to better manage different levels of Shariah governance disclosure, gain empirical insights into its effect on firms' financial performance and improve governance mechanisms and accounting practices. Indeed, Islamic banks should continuously implement transparency and information disclosure to improve their performance and governance, especially from the angle of Shariah auditors. It would result in a better Islamic bank management monitoring system, with favourable outcomes for Shariah governance disclosure. Omar and Rahman (2019) asserted that Islamic banks need to improve their monitoring and control of banking activities while obtaining external funding. Therefore, assessing Islamic banks' Shariah governance is critical to improving consumer confidence.

In terms of policy implications, this empirical study confirms that the Shariah committee and transparency and disclosure of information are the two most important predictors of the financial performance of Islamic banks. The existing frameworks, namely, the Exposure Draft of the Joint IFSB-(2022) AAOIFI's ED-RSGF and the BNM's SGF 2010 and SGDP 2019, assist organisations in achieving higher accountability and minimising potential conflict of interests that lead to poor financial performance. Indeed, these Shariah governance disclosure mechanisms are vital to reduce the imbalance of information asymmetry and protect the stakeholders' interests, thereby improving the public's interest and boosting the financial performance of Islamic banks. This study, therefore, encourages Islamic banks to take appropriate measures to improve their Shariah governance disclosure compliance level.

Future research is suggested to examine the effect of Shariah governance disclosure on Islamic banks' financial performance by using mechanisms such as Board responsibilities, senior management, Shariah compliance culture and remuneration in addition to the five Shariah governance disclosure mechanisms listed in Appendix 2. Aside from that, further research should be conducted on the levels of Shariah governance disclosure among other categories of IFIs, such as Takaful, Islamic insurance firms and Islamic investment firms, to which Shariah governance standards can also be applied. Moreover, it is suggested that the sample size be increased. These efforts would enhance the current study's limitations and generalizability.

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Appendix 1

Table A1.
Top four articles on shariah governance disclosure in the Scopus database

Authors	Document title	Publication name (Source)	Times cited	Key findings
Abdullah, Percy, and Stewart (2013)	"Shari'ah disclosures in Malaysian and Indonesian Islamic banks: the Shari'ah governance system"	*Journal of Islamic Accounting and Business Research*	43	"Shari'ah Supervisory Board (SSB)-related and zakat disclosures are still limited, with only four banks disclosing more than half of the SSB Index. What is noticeable is the low level of disclosure on sensitive matters. Among the factors associated with SSB-related disclosures are cross-membership with other SSBs and the expertise of SSB members in accounting, banking, economics or finance"
Hasan (2011)	"A survey on Shari'ah governance practices in Malaysia, GCC countries and the UK: critical appraisal"	*International Journal of Islamic and Middle Eastern Finance and Management*	43	"There are significant differences and diverse Shari'ah governance practices in the case countries. This position acknowledges that there are shortcomings and weaknesses to the existing governance framework which needs further enhancement and improvement"
Kasim (2012)	"Disclosure of Shariah compliance by Malaysian takaful companies"	*Journal of Islamic Accounting and Business Research*	24	"Disclosure of Shariah compliance by the Shariah Committee (SC) reflects high conformance to the Bank Negara Malaysia guidelines. Although the high level of conformance promotes comparability, it does not necessarily fully address disclosure issues such as providing adequate and relevant information. Shariah compliance by takaful companies seems to develop in much the same manner as other disclosure practices, that is, a tendency to comply with rules rather than with principles. Related to the disclosure issue, SC members are constrained by the advisory role and part-time basis of appointment from fully participating in every stage of product process from its conception to its implementation"
Obid and Naysary (2014)	"Toward a comprehensive theoretical framework for Shariah governance in Islamic financial institutions"	*Journal of Financial Services Marketing*	14	"Shariah boards of IFIs comprise of caliber scholars in Islamic Commercial laws (fiqhmuamalat) who are entrusted with the duty of directing, reviewing, and supervising the functions of IFIs to ensure their compliance with Shariah"

Source: Appendix by authors

Appendix 2

Variable	Shari'ah governance disclosure checklist	
Shariah committee	(1)	Majority members are qualified and experience in Shari'ah
	(2)	Sufficient knowledge on finance and Islamic finance
	(3)	Independent view without any undue influence
	(4)	Shariah Committee's report
	(5)	Must not be appointed from other IFI's Shari'ah Committee (SC)
	(6)	Composition of SC members must not less than five (5)
	(7)	Chairman of SC must be direct liaison with the Board
	(8)	Accountable for view provided
	(9)	Advice regarding Shari'ah matters
	(10)	Endorse Shari'ah policies and procedures
	(11)	Endorse and validate relevant documentations
	(12)	Assess work carried out by Shari'ah Review and Shari'ah Audit
	(13)	Disclosure number of meeting in SC
	(14)	Disclosure no attendees in SC's meeting
	(15)	Each member of Shari'ah Committee must have at least 75% attendance of total meeting
Shariah review	(1)	Qualified Shari'ah officers
	(2)	Review overall IFI's business operations
	(3)	Review documentation of the process
	(4)	Communicate to the Board, SC and senior management on outcomes
	(5)	Review IFI's officers were provided with adequate training and guidelines on Shari'ah
Shariah audit	(1)	Provide independent assessment and objective assurance
	(2)	Performed by internal auditors whom have Shari'ah knowledge
	(3)	Audit of financial statement
	(4)	Disclosure on Shari'ah compliance
	(5)	Review Shari'ah governance
	(6)	Conduct Shari'ah audit on periodical basis
Shariah risk	(1)	Facilitate the process of Shari'ah risk
	(2)	Formulate and recommend risk mitigation measures
	(3)	Report to the Board, SC and senior management
	(4)	Develop and implement process
Transparency and disclosure	(1)	Disclosure of SC on responsibilities
	(2)	Disclosure of opinion on IFI's compliance with Shari'ah by SC
	(3)	Disclosure of the Board on oversight accountability

(*continued*)

Table A2.
Shariah governance disclosure checklist

Variable	Shari'ah governance disclosure checklist
	(4) Disclosure of opinion on IFI's compliance with Shari'ah by the Board
	(5) Zakat obligations payment on business
	(6) Zakat obligations payment on shareholders
	(7) Zakat obligations on depositors
	(8) Profile of SC
	(9) Financial information
	(10) Aim and operation must free from Shari'ah non-compliance
	(11) Disclosure on Shari'ah non-compliance
	(12) Zakat amount
	(13) Involvement in non-permissible activities
	(14) Amount of involvement in non-permissible activities
	(15) Reason on non-permissible activities
	(16) Disclosure must be signed by not less than 2 SC members

Sources: Shariah Governance Framework (2010); Shariah Governance Framework (2019); IFSB-AAOIFI Revised Shariah Governance Framework (2022)

Table A2.

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