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RELIGIOUS COMPLIANCE IN ISLAMIC FINANCIAL INSTITUTIONS

NUNUNG NURUL HIDAYAH

Doctor of Philosophy

ASTON UNIVERSITY

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Thesis Summary

The central goal of this research is to explore the approach of the Islamic banking industry in defining and implementing religious compliance at regulatory, institutional, and individual level within the Islamic Banking and Finance (IBF) industry. It also examines the discrepancies, ambiguities and paradoxes that are exhibited in the individual and institutional behaviour in relation to the infusion and enactment of religious exigencies into compliance processes in IBF. Through the combined lenses of institutional work and a sensemaking perspective, this research portrays the practice of infusion of Islamic law in Islamic banks as being ambiguous and drifting down to the institutional and actor levels. In instances of both well-codified and non-codified regulatory frameworks for Shariah compliance, institutional rules ambiguity, rules interpretation and enactment ambiguities were found to be prevalent. The individual IBF professionals performed retrospective and prospective actions to adjust the role and rules boundaries both in the case of a Muslim and a non-Muslim country. The sensitizing concept of religious compliance is the primary theoretical contribution of this research and provides a tool to understand the nature of what constitutes Shariah compliance and the dynamics of its implementation. It helps to explain the empirical consequences of the lack of a clear definition of Shariah compliance in the regulatory frameworks and standards available for the industry. It also addresses the calls to have a clear reference on what constitute Shariah compliance in IBF as proposed in previous studies (Hayat, Butter, & Kock, 2013; Maurer, 2003, 2012; Pitluck, 2012). The methodological and theoretical perspective of this research are unique in the use of multi-level analysis and approaches that blend micro and macro perspectives of the research field, to illuminate and provide a more complete picture of religious compliance infusion and enactment in IBF.

Key words: *Religious Compliance, Shariah, Ambiguities, Boundaries Adjustments, Islamic Banking and Finance*

Dedication

I dedicate this work for Almighty Allah, my dear family and for those who seeks to learn from The Supreme who establish weight with justice and do not fall short in the balance

Acknowledgement

'Then which of the favours of your Lord will you deny?' My deepest gratitude goes to Almighty Allah for His countless and continuous Blessings on me, who guides me in every part of my life, including this PhD process. He bestows me with help and protection, to enable me to accomplish my goals in this wonderful learning process.

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Glossary of Islamic Terms

Shariah

Shariah is the divine guidance as given by the Holy Quran and the Sunnah of the Prophet Muhammad which covers all aspects of the Islamic faith including practice and beliefs.

Murabahah

Murabahah is a sales contract for purchase and resale of a good purchase at a profit, with a clear price and an agreed profit margin are set and agreed in advance.

Salam

Salam is a sales contract for purchase of goods to be delivered at a specified time in the future. Payment for the goods is made in advance.

Isthisna

Isthisna is a sales contract for manufacturing a product in which the manufacturer agrees to produce a specified product to be delivered at a specified time for a specified price

Ijarah

Ijarah is a contract of leasing where the duration of the lease, as well as the basis for rental, are set and agreed in advance.

Ijarah Munthahiyah bittamlik

Ijarah is a contract of leasing where there is an option to transfer the ownership of asset. The contract for leasing and transfer of asset should be in two separate contract, as in Shari'ah a combination of two contracts (ta'alluq) is not permissible

Mudarabah

Mudarabah is a contract between two parties, one who provides the funds and the other who provides the expertise, with an agreement to the division of any profits made in advance.

Musharakah

Musharakah is a partnership contract, which involves both sharing the risk and reward, with the profit sharing ratio, and proportionate losses to the amount invested are set and agreed in advance.

Qard Hassan

Qard Hassan is a free of profit loan, with one party provides a loan to the other party which has to be paid back the loan without any profit or additional payment.

Takaful

Takaful is an Islamic insurance in which all participants are members and contribute to a pool of funds that provide assistance in the event of loss on the part of any of the participants.

Rahn

Rahn or mortgage or collateral, is defined as possessions of such assets offered as security for a debt so that the debt will be taken from it in case the debtor failed to pay back the due money.

Wa'ad

Wa'ad is defined as promise or unilateral promise. Promises are morally binding, whether they can be enforced is debated, but agreed widely among contemporary Islamic scholars of the Islamic finance industry.

Wakalah

Wakalah is a contract in which one person appoints another person to act as an agent on their behalf in a transaction

Kafalah

Kafalah is a contract in which one party assumes responsibility for the debt of another if the debtor should fail to pay.

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Chapter 1 Introduction

A. Background

The Islamic banking and finance industry (IBF), developed out of a religious imperative to provide alternative financial services in keeping with the principles and teachings of Islam. The religious imperative demands the preservation of ethically based credentials that include the ban on usury (interest) and other exploitative and speculative based activities and promotion of risk-sharing, innovation, entrepreneurship (Archer & Karim, 2007; Diwany, 2010; Iqbal & Mirakhor, 2007; Warde, 2010). The IBF is accountable to shareholders and investors in managing the business in accordance with Islamic principles (Shariah), whilst at the same time providing reasonable profit and loss sharing based rates of return. As a result the IBF faces a unique form of risk - namely religious (Shariah) compliance risk. Shariah non-compliance has (potentially) significant reputational and commercial implications, as customers may withdraw their businesses if products breach the required religious principles.

The global IBF industry is estimated to be worth \$1.3 trillion (£800bn; 1tn Euros), and is growing at a rate of between 15% and 20% per year. Reflecting upon the growing interest in the IBF industry, its appeal covers both Muslim and non-Muslim countries (including the UK which has declared plans to become a leading Islamic finance centre). Perhaps in reaction to the global financial crisis, the values that underpin Islamic finance are believed to appeal not just too practising Muslims but also any party looking for ethical financial products (DiVanna, Sreih, & Ainley, 2009). However, a clear understanding of the process by which Shariah compliance risk is managed is a prerequisite for market success.

IBF compliance, however, is heavily reliant on the views of Shariah scholars, but most of the theological exegeses are based on personal judgment, creating a risk of certifier bias (Dranove & Jin, 2010; Hayat, et al., 2013; Lizzeri, 1999). The interpretation and approval of contracts and financial products is dependent upon scholars' cognitive limits, independence, competence and effectiveness in scrutinizing complex financial instruments (El-Gamal, 2006, 2007; Hayat, et al., 2013; Rammal & Parker, 2010; Shanmugam & Zahari, 2009; Unal, 2011). There is, however, no reason to assume that theological scholars are competent in understanding financial markets. Consequently, it is possible that the financial risks of Shariah compliant financial products are poorly understood at the institutional level.

B. Research Context

It is easy for the uninitiated to underestimate the difficulty of applying the classical Islamic law to modern financial instruments...the outsider may expect to adapt Islamic finance easily to Western practices, simply by observing a short list of do's and don'ts. Instead, on closer examination the outsider finds the applicable classical jurisprudence (fiqh) extraordinarily rich and complex. While this law does harbour profound general principles, it is not stated in those terms but as innumerable detailed rules. The rules and the principles are interconnected at a level rarely made explicit. Moreover, the rules and principles offered are not only legal but moral, defeating at times any hope of legalistic precision. (Vogel & Hayes, 1998, p. 28)

Vogel and Hayes' (Vogel & Hayes, 1998) views above, show the inherent difficulties of grasping classical Islamic law and applying it to the modern social age. The social reality of Shariah compliance monitoring is seen as a product of processes by which social actors negotiate the meaning of actions and situations by translating relevant Shariah principles. Driven by the religious imperative of avoiding and receiving usury (interest), IBF seeks to translate religious dogma into modern financial instruments (Chapra & Ahmed, 2002; Iqbal & Mirakhor, 2007). The interpretation of theological principles and their infusion into a commercial context are rooted in a process of *ijtihad* which refers to an individual interpretation of the Qur'an and Sunnah (Prophet Muhammad's teachings and practices) as the primary source of Law based on acceptable hermeneutic techniques (Diwany, 2010; Iqbal & Mirakhor, 2007; Maurer, 2005; Thomas, Cox, & Kraty, 2005).

Ijtihad is exercised through the consensus of the scholarly Muslim community (*ijma*), reasoning by analogy (*qiyas*), judicial preference (*istihsan*), public interest (*maslaha*), and custom (*urf*). The interpretation of Islamic law is thus an entanglement of both individual and institutional perspectives. In order to arrive at a consensus (*ijma*), as one of the most powerful references in Islamic jurisprudence, each scholar within a certain scholarly institution (e.g. International Islamic Fiqh Academy, the UK Islamic Sharia Council, Majelis Ulama Indonesia, Jawatankuasa Fatwa Kebangsaan Malaysia) undertakes an individual interpretation (*ijtihad*). To achieve the *ijma* they then gather to have an in-depth discussion and debate on the authenticity of texts, and their meanings and implications, in order to reach an agreement on a Shariah opinion (*fatwa*).

Different schools of thought play an important role in the interpretation of Islamic law in the modern context. The four most prominent Jurists or *Imam(s)*, Imam Abu Hanifah, Imam Malik, Imam Shafi'i, and Imam Ahmad ibn Hanbal, have different degrees of openness in the interpretation of Islamic law. Historically, geographical location and closeness to the main source of law affected their particular style of interpretation. In spreading Islam effectively all around the world, some Imams travelled to different places or went back to their original country away from

Madinah, where the Prophet Muhammad, the Prophet's companions¹ and all sources of Islamic knowledge are said to be located.

Imam Abu Hanifah (synonymous with the well-known Hanafi school of thought) was originally from and based in Kufa, a city in Southern Iraq. This school of thought is considered to be the most liberal one in its degree of openness of interpretation (Diwany, 2010). In handling new issues and problems outside of the existing *hadiths* (law references derived from the Prophet Muhammad's opinions, life story and behaviour), and verdicts and opinion from the Prophet's companions that need to be addressed in a short length of time, he tends to use *ra'yu* (juristic legal reasoning) and extensively uses *qiyas* (analogical reasoning). His approach reflects the fact that many problems and issues require quick resolutions and verdicts. Besides Iraq, this school of thought has been widely adopted by non-Arab societies in the Indian subcontinent (India, Pakistan and Bangladesh) as well as Iran, Afghanistan, Turkey and Russia (Diwany, 2010; Vogel & Hayes, 1998).

Imam Malik, who was based in Madinah and learnt directly from the Prophet's companions, never travelled outside this city, except to perform the Hajj pilgrimage to Makkah. He is renowned for his narration and compilation of *hadith* called *Muwatta*. The Maliki school of thought is quite strict in its interpretation of the law. One of its governing principles in any dispute is that 'if the community of Madinah agree upon a certain matter then their view takes priority over any other' (Diwany, 2010). This school of thought has been spread by his students travelling to North Africa and Spain, influencing communities in North Africa and Sudan.

Imam Shafi'i was a student of Imam Malik and Imam Abu Hanifah who often travelled to different places to learn from different societies. Through his book *al Risalah*, he was the first scholar and jurist to set out in writing a legal doctrine and systematic analysis of Islamic jurisprudence (Diwany, 2010; Vogel & Hayes, 1998). Shafi'i placed the highest priority on sound *hadith* over analogical reasoning. He did not accept controversial opinions of companions, arguing that an individual opinion might be infused with a personal view. In constructing opinion from Islamic law and in terms of openness of interpretation, Shafi'i is perceived to be in the middle. This school of thought tries to strike a balance between excessively strict and excessively liberal interpretations of Islamic law. Shafi'i's approach matches the cultural background of Asian countries which mostly tend to focus on balance and harmony in their societies and the Shafi'i school of thought is widely accepted in Asia (Indonesia, Malaysia, and some African countries).

The last of the four Imams is Ahmad ibn Hanbal. He was a student of Imam Shafi'i and the famous *hadith* compiler al-Bukhari. Even though he had travelled to different Middle Eastern

¹ Prophet Companions are the earliest followers/scholars who keep accompany with Prophet Muhammad (e.g. Abu Bakar, Umar Bin Khatab, Ali, Usman)

countries, learning from Imam Shafi'i and Imam Ahmad ibn Hanbal (Hanbali school of thought), he was deeply devoted to traditional views on religion, and is often portrayed as the most literal of all schools (Diwany, 2010; Vogel & Hayes, 1998). The Hanbali school of thought is attractive to a substantial portion of society in the Kingdom of Saudi Arabia and its neighbouring countries. In the case of Islamic banking scholars, most Middle Eastern scholars follow this school of thought.

In addition to the influence exercised by the differing views of one of the above mainstream schools of thought, the enactment of Islamic law (Shariah) within the Islamic banking and finance (IBF) context is also linked to a cross-level dynamic between institution and individual interpretations. The decision of an in-house Shariah scholar of an IBF institution will have to refer to the national Shariah institution, and at the same time a certain prominent individual scholar might have a powerful impact on higher level Shariah rulings (fatwa).

I think standardized or centralised Shariah supervision is way ahead.... I think in the concept of Shariah rulings or fatwa, it's inherent...that you have different opinions, and that you don't have a single authority pushing for one single solution for a given question.
(Senior manager of regulatory and compliance services of a Big 4 Accounting Firm)

As highlighted in the above auditor's concern, the differences of Shariah opinion are inherent in scholars' decision making processes. The strength of *ijtihad* – or personal interpretation- of Islamic law in the Islamic banking context is thus 'a by-product of intellectual uncertainty' (Clack, 2008; Jentsch, 1997). Scholars in this case are in a 'borderline experience of intellectual uncertainty' (Clack, 2008, p. 253). It converts them to a 'trembling of belief' (Royle, 2003, p. 35), a liminal condition between the boundary of 'the poles of certainty' associated with Islamic belief and naturalistic rationalism as human beings (Morgain, 2012). The interpretation of Islamic law as a source of guidance for Islamic banking institutions, for instance, is a strategy for responding to existential uncertainty (Clack, 2008; Morgain, 2012).

I think people need to have a more open discussion and more honesty regarding the range of opinions available....There is a much wider range of opinions than the opinions we've been led to believe in by the Islamic banking scholars. So, if we had more honesty and more transparency, then people would possibly have trusted the industry more. If the industry had said It's very difficult to do the halal thing here because of x, y, and z. We're trying, and here is our plan". Then people might have been more convinced, and more trusting. (Ethical investment expert)

As a consequence, from the wider society perspective, IBF raises issues of trust and transparency. People criticize the loss of Islamic constituents in Islamic banking products and services, and sense the distortion of the Islamic bank's value commitment in the structure of Islamic financial products and services. The community with their religious logic expects the fulfilment of the religious imperative, especially in the form of eradication of usury (*riba*), and the

operation of an Islamic bank's philanthropy program and support for the development of society. Conversely, society looks upon the bank as being muddled in balancing their religious and commercial objectives.

C. Motivation of Research

In line with the previous discussion, scholarly works show that there remains a lack of consensus on what constitutes compliance to Islamic law (Shariah). Shariah is subject to different interpretations in various regulatory and institutional settings (DiVanna, et al., 2009; Warde, 2010). Yet, there remains a relative dearth of research on fundamental points, defining what represents compliance to the religious law. Previous studies on Shariah compliance are mostly at the exploratory stage. Issues covered to date include the extent of expectation to fill the gaps of the need and the actual practices of Shariah audit, the normative proposed concept of internal and external Shariah audit, and surveys on Shariah governance practices in several countries (Archer, Abdel Karim, & Al-Deehani, 1998; W. A. Ghoul, 2008; R. A. A. Karim, 1990; Kasim, Ibrahim, & Sulaiman, 2009; Muhamad, 2011; Rahman, 2008; Simpson & Willing, 1996). Hayat, *et al.* (2013) concludes that there is no consensus of what constitutes Shariah compliance due to different schools of thought in Islamic Law.

A focus on audit and control, demands and expectations is one way to ensure religious legal standards are being met in the IBF environment. However, due to a lack of consensus of Shariah compliance criteria, the industry is trapped in a battle of defining critical religious parameters. IBF has been trapped in legal based compliance whilst seeking to build moral commitments to compliance with the religious law. As a consequence, the topic of auditing religious compliance in IBF is flourishing within existing academic research as a consequence of the industry's focus on legitimizing legal compliances to the religious order (Banaga, 1994; Kasim, 2010; Kasim, et al., 2009; Najeeb & Ibrahim, 2013; Rahman, 2008, 2011; Yahya & Mahzan, 2012). As a result, further in-depth study is required to examine the concept of compliance to Islamic law (Shariah). Better understanding of the definition, interpretation and implementation of the compliance concept at regulatory, institutional and individual levels within the Islamic banking industry is clearly required. The motivation for this study is therefore to explore the nature of religious (Shariah) infusion into the Islamic banking sector, and study of some of the apparent discrepancies, ambiguities and paradoxes that are emerging in this understudied yet increasingly prevalent feature of the IBF governance system. I expand further on these issues in the next section.

D. Contributions of Research

The research provides an opportunity to develop both theoretical and empirical accounts of religious (Shariah) compliance work in Islamic banks. This study seeks to develop a sensitizing concept, a tool to facilitate better understanding of what constitutes Shariah compliance, and the dynamic of Shariah compliance definitions and implementation across the Islamic banking industry. The sensitizing concept proposes a theoretical account that is absent in the current body of literature.

This research contributes empirically by exploring the process of religious compliance infusion in the Islamic banking industry in two different cultural, social, and regulatory settings. The methodological and theoretical perspective of this research are unique in the use of multi-level analysis and approaches that blend micro and macro perspectives of the research field, to illuminate and provide a more complete picture of religious compliance infusion and enactment in IBF. The findings might help the Islamic banking industry to evaluate their practices, products and services and revisit both the regulatory framework and institutional level strategic decision making in respect of Shariah compliance. In addition, Islamic banking institutions could use the findings to evaluate the effectiveness of their religious (Shariah) governance practices and the resources devoted to compliance.

In order to address these challenges and build a more comprehensive understanding of Shariah compliance and the dynamics in its implementation in Islamic Finance literature, this thesis seeks to examine the following research questions.

E. Research Questions

1. How does the Islamic banking industry define and implement religious compliance concepts at regulatory, institutional, and individual level?
2. At the individual bank, what are the key issues affecting the infusion and enactment of religious compliance principles within their operation?

F. Research Objectives

Within the overall aims of the research, the objectives of this research will be described below:

1. To explore the dynamic approach of the Islamic banking industry in defining and implementing religious compliance concepts at regulatory, institutional, and individual level.

2. To examine the discrepancies, ambiguities and paradoxes in individual and institutional behaviours of religious compliance infusion and enactment within Islamic banking institutions.

G. Research Philosophy

The philosophical assumption that inspires social inquiries may be defined as a seeking after 'the nature of the world and the way in which it may be investigated (Burrell & Morgan, 1979). It attempts to approach a more complete view of reality, or way of seeing, that influences the researcher to relate the socially constructed phenomena to theory, and how to deconstruct the theory to reflect on the reality in a social setting. Research literature (Carter & Little, 2007; Crotty, 1998; A. Kaplan, 1973) explores the importance of *ontology* (the nature and structure of social phenomena/reality) and *epistemology* (a certain way of understanding what it means to know) which tend to be inseparable. Additionally, the other three important aspects are the *theoretical perspective* (theoretical stance informing the methodology, context of process, and its grounding logic and criteria), *methodology* (assumption, principles, and procedures of analysis/reconstructed logic in particular approach to inquiry), and *methods* (technique/procedures to gather and analyse data).

Morgan and Smircich (1980) describes the range of ontological positions, epistemology, and human nature in social science. The ontological positions ranged between subjective-objective continuum from the perspective that sees social phenomena and reality as a projection of human imagination to another extreme perspective that consider reality as a concrete structure. There are two most common ontological perspectives in social science that widely refer to objectivism and constructionism in the context of organization and culture (Bryman, 2012, pp. 32-33). In an objectivism perspective, social phenomena is seen as 'external facts that are beyond researcher's reach or influence, whilst in a constructionism perspective the meanings of social phenomena are 'continually being accomplished by social actors'.

Within Morgan and Smircich's (1980) subjective-objective continuum, human assumptions explain the nature of what constitutes adequate knowledge. At one point of the extremes of the continuum in an objectivist view that see himself and the social world as a responder to concrete structure. The objectivist tends to support positivism as an epistemological stance that emphasizes an emphasis on 'the empirical analysis of concrete relationships in an external social world' and regards and measures social facts as a 'knowledge that specifies the precise nature of laws, regularities, and relationships among phenomena' (Morgan & Smircich, 1980, p. 493).

In the other extreme, subjectivists view themselves as human beings with spirit and consciousness that ‘concretize their relationship to their world’ as an epistemological perspectives (Morgan & Smircich, 1980, p. 493). Thus, as represented in Table 1.1 below, within the IBF setting, constructionism emerges as a valid ontological position in understanding the social actors at both individual and collective levels at which Islamic Law is interpreted and enacted. In other words, a key issue is the social construction of Shariah compliance implementation.

Table 1.1 Elements of Research Process and Level of Reflexivity
Sources: (M. Alvesson & Sköldberg, 2009; Bryman, 2012; Crotty, 1998)

Elements/Level	Focus
Epistemology	Constructionism
Theoretical Perspective	Interpretivism
Interaction with Empirical Material	Accounts in triangulated empirical materials which include texts/documents, interviews, observation of situation, and other materials.
Interpretation	Underlying meanings
Critical Interpretation	Ideology, power, social reproduction
Reflection on text production and language use	Research diary (own text), claims to authority, selectivity of the voices represented in the text

Besides ontology, an epistemological perspective is needed to clarify ‘what is regarded as acceptable knowledge’ within the research philosophy (Bryman, 2012, p. 27). In exploring the translation and enactment of Shariah compliance control systems in the Islamic banking industry, both the ontological and epistemological elements of this research are derived from the interpretive theoretical perspective as a philosophical stance. It lies behind the methodology which provides a context for the process and grounds its logic and criteria, which is represented in the table 1.1 above. In interpretative research, knowledge is considered as the outcome of complex and many layered social and cultural constructions. It requires my reflexive ability, as a researcher to consider how their assumptions and views impacted on the research process and products in order to interpret the complexity of multiple realities involved (M. Alvesson & Sköldberg, 2009).

In line with this, De Loo & Lowe (2012) acknowledge that authors should be aware of their role in the constitution of the research object and the impact of researcher’s interest in understanding knowledge. Applying reflexive practices dictates that this research seeks to understand the underlying meaning of the phenomena. It takes into account some aspects of critical interpretation which focus on the concepts of ideology, power and social reproduction in a social structure. By adopting reflexive accounts, it provides me the opportunity to reflect on my own research notes to reconsider earlier interpretations, the claims to authority of the researcher

in presenting a certain version of reality, and the selection of voices represented in the text. Thus, I as a researcher should be contemplative about the implication of their methods, values, biases, and decisions for the knowledge of the social world they generate. This requires sensitivity to their cultural, political, and social context (Bryman, 2012). It involves what Lynch (2000) considered as philosophical self-reflection (introspection, an inward-looking, sometimes confessional and self-critical examination of one's own beliefs and assumptions) and methodological self-consciousness (to be conscious of their own assumptions and prejudices, and to focus upon uncertainties, possible sources of bias, and problems of access and reactivity).

H. Outline of the Thesis

In pursuit of the research objectives and in order to answer the above-mentioned research questions, the thesis is made up of the following chapters:

Chapter 2: Islamic Banking Institution: The Research Context

The objective of this chapter is to outline and discuss the underlying context, which is the nature and historical development of Islamic banking Institutions, and the core principles which underpin their operation. It shows the comparison between Islamic banks with their conventional counterparts, the differences of principles, products, services, governance structure and the control system. The chapter focuses in particular on the issues on governance and religious compliance in Islamic banks, in relation to Shariah scholars' roles and their function, and the interpretation and the implementation of religious compliance principles in every aspects of banking operation. This chapter also explores the development of standards and regulatory guidance for the Islamic banking industry, to show the existing standards, and to examine how the standard has not captured a reference to resolve the existing issues.

Chapter 3: Literature Review

This chapter provides an understanding of compliance from a broader research perspective, to examine the way compliance is understood in academic discourse. It concludes that individual and institutional moral and normative values based compliance has been the subject of limited academic research.

It explores reflections on the moral and normative issues of compliance from a theoretical perspective to show that the concept of moral and normative duty and compliance has been acknowledged in philosophical scholarly works, but there remains a need to provide a sensitizing

concept to understand the nature and dynamics of religious compliance. This chapter also discusses the development of research in Shariah governance, compliance and audit in Islamic financial institutions. It argues that the current research focus is on the audit of religious compliance principles but there remains a need to shed light on understanding Shariah compliance in practice and the dynamic process of its infusion and enactment in Islamic banking operations. In addition, this chapter explores the impact of the lack of academic literature and regulatory guidance on current practice of Islamic banking industry. I reveal the absence of a clear operational definition of what constitutes Shariah compliance and its subsequent impact on both current practice and wider criticism of the Industry.

Chapter 4: Theoretical Framework: A Sensitizing Concept of Religious Compliance

This chapter explores the sensitizing concept as a useful tool for understanding what constitutes Shariah compliance and the nature and dynamics of its implementation. Emerging from the need for a formal tool to analyse compliance in IBF context, the chapter explores the concept of duality of compliance from a religious perspective in Islam and other religions. It concludes with the need to set up a framework to facilitate understanding of the nature and dynamics of religious compliance. The chapter develops a framework of analysis using Giddens consciousness concept, and formulates a sensitizing concept of religious compliance, which argues that the level of compliance in both societal and transcendental perspectives is a product of the enactment process, and the dynamic of the discrepancies, ambiguities and paradoxes that emerge in the process of implementing Shariah compliance.

Chapter 5: Theoretical Framework: Theoretical Lens for the Research

This chapter presents the theoretical perspective for this study, thus becoming a tool to signify and support the empirical data that represents the phenomena in the field. I first of all explore how religious compliance is infused in Islamic banking institutions by arguing that both individual and institutional strategic conduct is grounded in sociology of practice theories. It then links religious compliance with and institutional theory based research but notes the limitations of this theory to deal with issues from a micro perspective. The latter is managed explaining how a sensemaking perspective is useful to analyse the case study evidence on individual responses to the ambiguity of rules and how existing boundaries are moved to accommodate differing viewpoints. I conclude by arguing that both institutional research and sensemaking are useful theoretical perspectives that need to be combined in order to fully portray the complexity of the process by which Shariah law is infused in Islamic banking institutions.

Chapter 6: Method Chapter

This chapter introduces and outlines key aspects of research design, research strategy, and the empirical techniques applied based on the philosophical assumptions underpinning my thesis. I explain the processes of the field research conducted in two countries, in a Muslim and a non-Muslim country. The negotiation for access, the case studies, the collection of data, and the analyses, are explored to show the novelty of research process. I also explain my effort to maintain trustworthiness and ethical preservation in order to build trust on the research processes, the findings and the conceptualisation being offered.

Chapter 7: Empirical UK Chapter

This chapter describes and explores the case study I carried out in an Islamic Bank in the UK. The 'Ethical Trust Bank' (ETB, hereafter) is an Islamic bank in a non-Muslim country. I explore the multiple perspectives of religious rules interpretation, and ambiguity in the interpretation of rules is demonstrated at the regulatory, institutional and individual levels in the process of individuals and institutions formalising, maintaining, and transforming the Islamic bank's values and identity.

Chapter 8: Empirical Indonesia Chapter

This chapter describes and explores the case study I carried out in an Islamic Bank in Indonesia. The 'Pure Sharing Bank' (PSB, hereafter) is an Islamic bank in a Muslim country as in the preceding chapter; I provide evidence ambiguity in the interpretation of rules is demonstrated at the regulatory, institutional and individual levels.

Chapter 9: Discussion and Conclusion

This chapter presents a discussion and conclusion of the two case studies in the UK and Indonesia. Through the discussion, I compared and contrast the rules ambiguity in different regulatory environments. The first case (Indonesia) operates in an environment with well codified Shariah rules but the second (UK) operates in a country without any specific Shariah compliance rules at all. I also explore how the ambiguity of religious compliance rules remains unresolved at institutional and individual levels. I demonstrate the theoretical, empirical, and practical contributions of the thesis and conclude with a reflection on the whole research process, and the resulting analysis.

Chapter 2 Islamic Banking Institution: The Research Context

A. Introduction

The objective of this chapter is to provide the underlying context, nature and historical growth of Islamic banking Institutions, and its principles and development. The contrasts between Islamic banks with its conventional banking counterparts, the key differences is highlighted in their principles, products, services, governance structure and the control system. In addition, the various operational practices in different banks in different countries, the issues on governance and religious compliance in Islamic banks, in relation to Shariah scholars' roles and their function, and the interpretation and implementation of religious compliance principles in every aspect of banking operations. This chapter also explores the development of standards and regulatory guidance for the Islamic banking industry, showing the existing standards and examines how the standard has missed an opportunity to resolve its existing issues.

B. The Historical Development of Islamic banking Institutions

Economic activities are human natural interactions and practices as a form of survival in the world. The Islamic financial instrument was brought from the original investments transaction from medieval traders known as *commenda*². It was in a form of a joint capital and effort partnership with proportionate profit and loss sharing (*mudharaba*). This partnership-based financial model was meant to encourage entrepreneurship. It, accordingly, expects to empower the active partner to have an equal position as partners and capital providers (*musharaka*). All participants in the later mode of investment bear equally distributed risks, and any increasing value are justified by the risks taken. In theoretical perspective, the two forms of pure investment vehicles will trigger real economic productive activity.

Goitein (1967) and Diwany (2010) explore the practice of advance technique of payment transfer as one of the forms of trade and investment in the Muslim world where it flourished from the tenth century onwards. At that time Ahmad ibn 'Alī al-Maqrīzī (1364-1442) who was a scholar trained in the religious sciences, with writing specialization and the primary objective to ensure that 'the management of monetary affairs' argued for a monetary reform in line with the Islamic precedent and practice in Muslim society in the past (Meloy, 2003, p. 187). He published a book

² *Commenda* was one of five forms of business association practiced by Maghribi traders in the medieval era besides sea loan (with fixed interest upon arrival of a ship voyage), partnership, formal friendship, and factor provided with a commission for trade service to an absentee trader (i.e. represent trader in a court). *Commenda* was a joint capital and effort partnership in the form of selling and trading merchandise overseas (Çizakça, 2011; Greif, 1989, pp. 871-872)

entitled 'Helping the Community by Examining the Causes of its Distress' (*Ighāthat al-umma bi-kashf al-ghumma*) in 1405 was dedicated to examining famine and inflation since 1404 (Kato, 2012).

Al-Maqrīzī criticized the economic crisis that occurred due to 'political corruption, the rise of land prices and the circulation of copper money', which as an impact, affected 'the distribution of income and wealth between social classes' (Kato, 2012, p. 36). Al Maqrizi thus proposed an idea of monetary reform in the Mamluk period in Egypt (1250 -1517) which was to foster similar activities to those modern banking practices in a more Shariah compliant way. He was referring to the practice of joint capital effort partnerships (*mudharabah*) which was one of the approved transactions during Umar bin Khattab (a very close companion of Prophet Muhammad), besides the empowerment of *zakah* and *waqf* institutions to play a main role in funding public works (Diwany, 2010; Goitein, 1967; Meloy, 2003; Sabra, 2000).

The Islamic banking institution was incarnated into a modern form, when Dallah al Barakah and Dar al Mal al Islami banking group were founded in the 1970's, as sought to Islamise western banking without changing its business model and institutional framework (Diwany, 2010, p. 250). In the further development of Islamic banking instrument, a pioneer of modern Islamic banking and founder Jordan Islamic Bank, Dr Sami Hassan Homoud, in 1976 discovered *murabaha* instrument which represents sale with mark up (Iqbal & Mirakhor, 2007). This vehicle was originally a sale contract dedicated for entrepreneurs to fulfil the needs of capital expansion of their business, i.e. commodity or raw materials will be provided by the bank. In further practice, however, the sale contract turned into a financing contract which is dominated by Islamic banking products portfolio. In recent practice, often *murabaha* is combined with leasing (*ijara*) contract with a deferred payment scheme, which appears as 'Shariah compliant' in its structure, but substantially looks like a standard loan. As a consequence the concept of money that should be created from productive activity in its ideal state, turn into a result of debt-based transactions. Islamic bank that in theory was not highly leveraged and sustains from liquidity crisis then shows a different facade.

C. The comparison between Islamic banks with the conventional counterparts

Islamic principles (Shariah) govern IBF just as it governs individuals and their actions. The Qur'an and the Sunnah as the sources of the Islamic law (Shariah) govern IBF operations. Those sacred references put emphasis on the importance of honesty, transparency, documentation, accountability and ethics (DiVanna, et al., 2009; Diwany, 2010; Iqbal & Mirakhor, 2007; Thomas, et al., 2005; Warde, 2010). The religious imperative to infuse Shariah into financial institutions

dictates IBF practices that avoid exploitations and injustice treatment to the shareholders and customers (Shanmugam & Zahari, 2009). The religious imperative demands IBF's responsibilities, dedication to work on empowering society through partnership and philanthropic activities (Shanmugam et al., 2005). In a later process, IBF has been developing into different types of institutions, that includes Islamic banking institutions, Islamic insurance (*takaful*), Islamic microfinance, and Islamic non-financial institutions (e.g. *wakaf*, *zakah* and other charitable institutions)

a. Islamic Banking Principles

Islamic bank held sacred principles that differentiate the institution with its conventional counterparts. The sacred rules guided IBF to follow the fundamental principles to avoid interest based activities, trading of forbidden objects (e.g. pigs production, sale and distribution of alcohol, gambling business etc.), excessive uncertainty, taking gain without either performing effort or accepting liability, and promoting equally distributed risks and obligations (Khir, Gupta, & Shanmugam, 2008). In addition, Chapra (1992:234) highlighted the concept of engaging stakeholder's participation (*Shura*) in the affairs of the corporation either directly or via representatives. In the governance context, the concept of *Shura* represented by the existence of Shariah Supervisory Committee/Board (SSC/SSB) to interpret and to monitor the implementation of Islamic law (Shariah) into a banking operation.

b. Islamic Bank Product and Services

Shariah principles guided the permissibility of any commercial activities unless those prohibited aspects discussed above are proven. The teachings of the Qur'an and Sunnah that represents as Islamic commercial law guided the importance of interactions, transactions, and exchanges between individuals facilitated through formal and informal contracts within the society (Diwany, 2010; Iqbal & Mirakhor, 2007; Vogel & Hayes, 1998). Through a contract, the objective and the obligation of each party involved are stipulated, and it represents the legal as well as transcendental aspects of an exchange (Iqbal & Mirakhor, 2007, p. 35). '*O you believe, fulfil (all) contracts*' the Qur'an (QS 5:1) explains the importance to fulfil the objective and obligations of a contract. It also represents a covenant between a human being and God, which imposed on the contracting parties 'the duty of being faithful to his word'(Iqbal & Mirakhor, 2007, p. 35).

A contract is deemed lawful and permissible under Shariah Law as long as it avoids the involvement of interest (*riba*) in the transactions, and excessive uncertainty (*gharar*). The permissible contracts consists of transactional, financing, intermediation and social welfare

contracts. The purpose of those contracts is to facilitate various forms of economic activity, ranging from sales and purchases of goods, exchanges, arrangement of credit and financing, collateral and guarantee, as well as to support society's empowerment through investments and creation of opportunities (Diwany, 2010; Iqbal & Mirakhor, 2007; Vogel & Hayes, 1998). The four categories and the contracts in Islamic commercial law are represented in Table 2.1 below.

Table 2.1 Contracts under Islamic Commercial Law
Sources: (Diwany, 2010; Iqbal & Mirakhor, 2007; Vogel & Hayes, 1998)

<i>Type</i>	<i>Contract/Instruments</i>	<i>Specifications</i>
Transactional	Sale (<i>Bay'</i>) Exchange (<i>Sarf</i>) Sale of Right to use/Usufruct (<i>Ijarah/Isthisna</i>)	Spot, on Deferred basis, Promise to pay Spot Money exchange Leasing/Manufacturing financing
Financing	Trade Financing (<i>Murabahah</i>) Asset-Backed (<i>Ijarah/Isthisna</i>) Equity Partnership (<i>Musharakah</i>)	Sales with agreed margin asset financing Leasing/Manufacturing financing Co-ownership or Diminishing partnership
Intermediation	Partnership: Equity Partnership (<i>Musharakah</i>) Joint Capital Effort Partnership (<i>Mudharabah</i>) Fee Based Services: Guarantee (<i>Kafalah</i>) Fee-Based Service (<i>Ju'alah</i>) Custody (<i>Amanah</i>) Representation (<i>Wakalah</i>) Insurance (<i>Takaful</i>)	Co-ownership or Diminishing partnership Trustee finance contract Guarantee service (e.g. Letter of Credit) Compensation based/agency service Safe keeping (e.g. Safe Deposit Box) Trading representation Insurance based on <i>mudharabah</i> , <i>murabahah</i> , <i>musharakah</i> and <i>waqf</i>
Social Welfare	Gratuitous Loan (<i>Qardhul Hassan</i>) Trust/Endowment (<i>Waqf</i>)	Loan for community service Asset transfer for community service

The transactional contracts are meant for any sales or exchange on spot, deferred and future payment. A special treatment applies on paper money exchange, which should be on a spot basis; otherwise it falls into interest based transactions. IBF under the guidance of Shariah has a uniqueness compared to its conventional counterparts, which lies in promotion partnership through both joint effort and equity partnerships. In the case of Islamic banks, customers are treated as partners or investment account holders in the partnership contract. The partnership contracts could be applied in both financing and intermediaries' instruments.

Islamic banks are founded on the principle of sharing profit and losses consistent with the Islamic concept of "profit is for that who bears risk". Islamic banks reject interest as a cost for the use of money and loans as investment vehicles. (Previous definition of Islamic Banks in the AAOIFI Standards which recently omitted in the newest version)

The contracts above become a basis of products and services offered by Islamic banks today. As represented in the previous AAOIFI standard above, loans are deemed as rejected from the Islamic banks' investment vehicle. Along with the changes in the standard, the practice of Islamic banking products and services are changed as well. In the current banking practise, however, sales plus agreed margin or widely applied in the form of cost plus asset financing are dominating their products. In turn, those products are akin to interest based loan in the interest based banking system. The contracts that represent social welfare through gratuitous loan and collection of trust and endowment fund are also gradually disappearing from banking products. The Islamic bank products and services are relatively similar to their conventional counterparts. The deposits, financing, and leasing products are merely mimicking the conventional banking products. As concluded by Hanif (2010), Islamic banks are very much alike to modern conventional banking.

c. The Shariah Governance of Islamic Bank

Shariah board plays critical role to ensure that all corporation activities are in line with the Shariah principles, while shareholders also play a substantial role as active participants in the process of decision making. The other stakeholders including the community should also take part in providing mutual cooperation to protect the interest as a whole and to stimulate the social wellbeing function for social welfare. All of these processes are concentrated on toward fulfilling the ultimate objective of Islamic corporate governance of complementing the private and social goals via upholding the principle distributive justice (Choudury and Hoque, 2004: 85-88).

Therefore, it is clearly defined that in IFI the core attributes not merely limited in ensuring that actions of the management are kept in line with the interests of shareholders and stakeholders, but also in fulfilling religious values and Shariah requirements based on the Qur'an and Sunnah. Afterwards, if it is implemented, the spirit of governance will be in accordance with

the objective (*maqasid*) of Shariah, which is to bring about social welfare via upholding the principle of distributive justice for the organisation and society as well.

Looking at the broader perspective and objective of corporate governance in IFI, the conventional governance standards can therefore be paired with Shariah requirements essential to IFI to create a corporate governance structure that is suited to IFI. There is a difference that adds another dimension to corporate governance in IFI compared to the conventional one. Therefore, to add Shariah compliance assurance as an essential requirement of corporate governance in IFI, the role and function of Shariah Committee or Shariah Supervisory Board is considered as an important aspect of governance.

In Islamic banks, there are two categories of owners, the shareholders, as in conventional institutions, and the investment account holders, or depositors. The relationship between the investment account holder and the bank is similar to that of a collective investment scheme, in which participants (the investment account holders) have authorised their fund manager (the IFI) to manage their investments (Stanley, 2006). In *mudharabah* contract, the depositor which categorised as the investment account holders is seen as the owners of capital (*rab-al-maal*), whilst Islamic bank is the agent (*mudarib*). The depositors and the bank shared the risks and rewards equally. Consequently, the investment account holders are legally responsible to incur unexpected losses in the same way as shareholders. There is effectively no cushion, as of the equity provided by the shareholders in any modern institutions.

To cope with such uncertainties, Islamic banks have adopted the use of a profit equalisation reserve (PER) as a process of smoothing out returns to their unrestricted investment account holders. The Shariah guided *mudharabah* contracts compete against the guaranteed returns offered by conventional banks. Even though, in some jurisdictions the use of this guarantee scheme is mandatory in a sense. The PER is a method to maintain a consistent level of Islamic banks' rate of return. The Islamic bank will offset the Islamic banks' poor performance, when their profits are below the market return. However, the transparency of such practices is somewhat questionable in a good governance perspective. Therefore, corporate governance in IFI must be customised to address such issues and protect the rights and needs of the investment account holders.

d. Three Lines of Defence in Islamic Financial Institutions

In January 2013, The Institutes of Internal Auditor (IIA) proposed a position paper on the Three Lines of Defence model, which provides a simple and effective way to help organizations delegate and coordinate essential control system, risk management, and independent assurance duties with a systematic approach. This will enhance communications on risk management,

control, and audit as an independent assurance process by clarifying essential roles and duties. It provides a comprehensive consideration at operations, helping to assure the ongoing success of control and risk management initiatives supported by audit function, which is appropriate for any organization regardless of size or complexity. Even in organizations where a formal risk management framework or system does not exist, the Three Lines of Defence model can enhance clarity regarding risks and controls and help improve the effectiveness of risk management systems (IIA, 2013).

Committee of Sponsoring Organisations (COSO) have developed a model of internal control emphasises on the need for good corporate governance in organisations, and recommends that effective control systems should contain the elements of control environment, which includes the company's strategy for dealing with risk, culture, codes of conduct, human resource policies and performance reward systems, which eventually should support the business objectives. It also needs to perform an assessment of risk and providing control to achieve company's objectives.

The control activities should reflect the practice of segregation of duties, authorisation, and reconciliations. Moreover, communication and information are deemed important to ensure that all levels of management in the organisation are aware of any progress against objectives in a timely manner, in the form relevant and reliable reports. After all, monitoring and corrective action processes should be embedded in the organisational systems to ensure the effective application of policies and other control mechanisms (Norton & Hughes, 2009).

Based on the IIA paper on three lines of defence, and COSO framework of internal control, it is obvious that control, risk management assessment and monitoring are now seen as fundamental to an effective control system. The integrated three important aspects will increase the effectiveness of achieving objectives, by ensuring that the significant risks are addressed, costs are reduced by ensuring that necessary control is in place, and continually monitored through audit as an independent assurance function. In the case of Islamic financial institutions, the three lines of defence would be much more complex than in any other organization. Islamic principles or Shariah and ethical culture attached to the concept of Islamic banking and finance provides an underlying principle to shape the system of defence of Islamic financial institutions. It also needs to be integrated to their operational and control system in order to achieve the business, ethical, and social objectives which governs their operation.

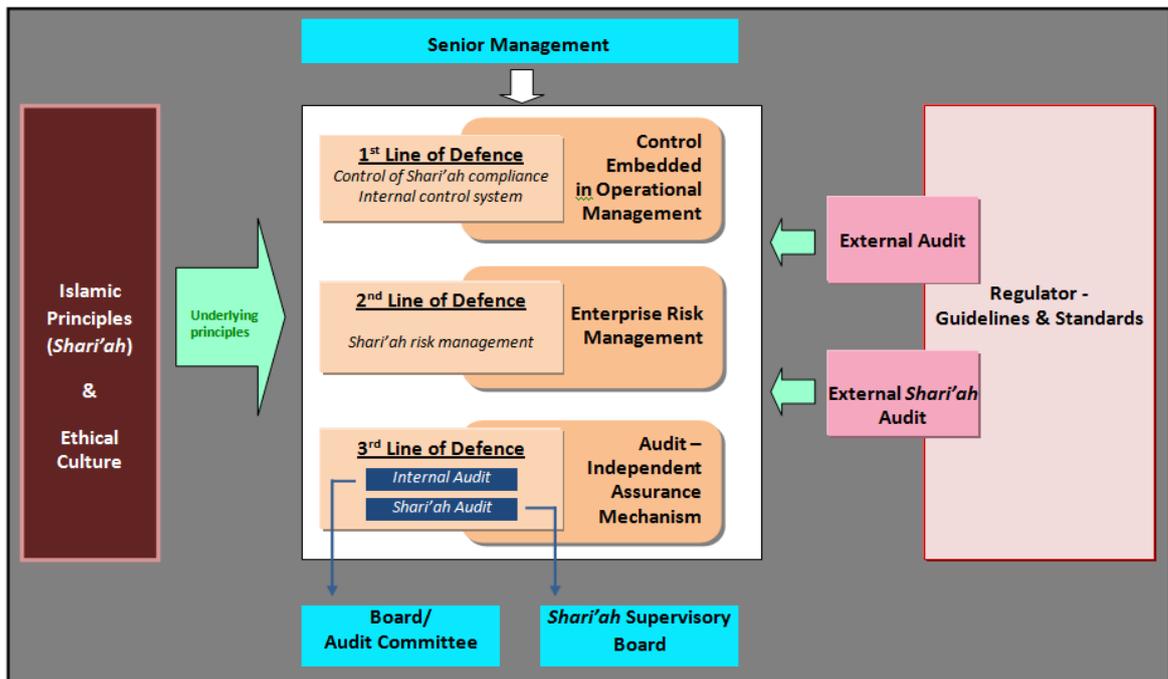
Therefore, ideally corporate governance in IFI in general and in Islamic bank, in particular, has a unique internalized stakeholders' value combined with Shariah compliance principles (W Grais & M Pellegrini, 2006). It should provide participation for all stakeholders including

investment account holders, with a strong fiduciary duty to both stakeholders and Shariah Supervisory Board, to achieve their objective of complying with the Shariah principles and provide excellent service to the community as a whole. Following closures of 6 markets of HSBC Amanah, Barclays and Deutsche Bank, practitioners think that Islamic retail banking model is fundamentally troubled. They decided to reinvent its global network as corporate and investment banking (Jenkins & Hall, 2012).

In order to protect the original values linked to Islamic financial institutions, and at the same time maintain its sustainability, this concept of Three Lines of Defence is illustrated in the Figure 2.1 below. The abovementioned framework provides a basis of understanding how an Islamic financial institution maintains its sustainability, while instilling and integrating Shariah aspects in their operation. *In the first line of defence*, business unit and operational managers are the risk owners, responsible for managing risks, implementing corrective actions to address process and control deficiencies.

Figure 2.1 Modified Three Lines of Defence in Islamic Financial Institutions
Based on COSO Framework and IIA Position Paper 2013

Sources: COSO Framework and IIA Position paper (Ciorciari & Blattner, 2008; IIA, 2013; Norton & Hughes, 2009)



They are responsible for maintaining effective internal and Shariah compliance controls, and for executing risk and control procedures on a day-to-day basis. Both general and Shariah compliance aspects in the operation needs to be identified. They should assess, control, and mitigate risks, guiding the development and implementation of internal Shariah compliance

driven policies and procedures and ensuring that activities are consistent with goals and objectives.

The second line of defence is the enterprise risk management function that provides independent oversight of the risk management activities of the first line of defence. Combined with the compliance functions, various risk management functions build and monitor the first line of defence controls. The specific functions will vary by organization and industry, but typical function of risk management is important to facilitate and monitor the implementation of effective risk management practices by operational management as the risk owners in defining the target risk exposure and reporting adequate risk related information throughout the organization (IIA, 2013).

In Islamic financial institutions, it is necessary to have important functions to monitor day-to-day Shariah compliance and the possibility of Shariah non-compliance risk occurrence. The Shariah compliance review is required to provide direction and guidance in implementing Shariah pronouncements disseminated by SSB. It is deemed important to mitigate a unique risk within their operation, a risk where their customer will withdraw their fund, if they perceive there is any aspects of non-compliance to the underlying principles.

The governance structures of Islamic financial institutions are distinguished from conventional governance structures by the addition of a Shariah advisory/supervisory body. Its role is as an in-house religious advisor with responsibility to ensure that the institution's business practices and products conform to Islamic law, and to minimise the institution's exposure to fiduciary and reputational risks related to Islamic standards of compliance. Thus, in *the third line of defence* entails independent assurance in the key controls to add value and enhance effectiveness of the company's operation, including the Shariah compliance aspect.

This independent and objective assurance in Islamic financial institutions usually covers a broad range of objectives, including efficiency and effectiveness of operations; safeguarding of assets; reliability and integrity of reporting processes; and compliance with Islamic laws and other rules and regulations in all policies, procedures, and contracts. It also covers all elements of the risk management and internal control framework, which includes: internal control environment; all elements of an organization's risk management framework including risk identification, risk assessment, and response, information and communication; and monitoring.

It should also examine the business processes of overall entity, divisions, subsidiaries, operating units, and functions including marketing, operations, supporting functions as of accounting, human resources, asset management, and information technology. To fulfil the third defence line, both internal and external audit and Shariah audit should be performed to challenge

the level of assurances provided by business unit and oversight functions, both in operational and Shariah compliance perspectives. The reporting of risk will be forwarded to the enterprise risk management function for review.

The information of Shariah non compliance risk is then collated with other risk reports, assessed and reported, both independent upward risk committee who are responsible in representing stakeholders in respect to risk issues. The internal audit findings should be reported to the Board of audit committee who have the responsibility to maintain oversight and monitor the effectiveness of internal control, risk management processes and internal audit activities. On the same level, Shariah audit findings are reported to the Shariah Supervisory Board (SSB) which has a role monitor and render opinion based on the effectiveness of Shariah compliance control system, Shariah non compliance risk processes, and Shariah audit activities.

Furthermore, with a full support of senior management, the role of external auditor and external Shariah auditor within related regulatory environment will complete the third line of defence by providing independent assurance on both business operations and Shariah oversights. Even though the practice of external Shariah audit is still at discourse level, Sultanate of Oman through their central bank produces a very strict and robust framework from a Shariah compliance perspective. It requires all Islamic banks operating in their jurisdiction to perform an external Shariah review after 3 years of operation to ensure its compliance to Islamic principles. It also regulates an obligation for Islamic bank to hire an independent body to perform external Shariah audit.

D. Shariah Governance: to whom and for what it is designed?

Shariah compliance principles provides a set of rights and obligations that enables Islamic banks to gain credibility and integrity as an ethical and religious based financial services provider. Indeed, after nearly 45 years since the first initiative, originally providing *halal* financial alternatives and profitable ethical investment instruments, it was developed to promote partnership based financing and community empowerment. Based on Islamic law as its underpinning principles, in the theoretical perspective, Islamic financial institution (IFI) offers an asset-backed financing system based on interest free contract. In the contractual perspective, customers in IFI are known as investment account holders (IAH), hence any profits and losses are subject to be shared proportionately based on a predetermined rate of return.

Therefore, ideally corporate governance in IFI as general and Islamic bank particularly has a unique internalized stakeholders' value combined with Shariah compliance principles (W Grais & M Pellegrini, 2006). It should provide participation rights for all stakeholders including IAH,

with a strong fiduciary duty to both stakeholders and SSB, to achieve their objective of complying with Shariah principles and provide excellent service to the community as a whole. Eventually, an interesting question arises. Where does the partnership value go? Do they follow the sense of community service? Or the logic of business profit drives them in a different direction?

This industry is facing a challenge of internalizing stakeholders value into their decision making process. However, it is appealing to explore how the logic of normativity produced by rules and regulations. To what extent and what perspective the governance standards and guidelines try to provide framework of guidance for IFI? Table 2.2 below shows the definition of Islamic bank and corporate governance which represented the value of rules creation and for whom it is created.

Table 2.2 Islamic Bank Objective and Corporate Governance Definition
Sources: Guidelines/Standards of AAOIFI, IFSB, Central Bank of Bahrain, State Bank of Pakistan, Bank Negara Malaysia, and Bank Indonesia

Regulators	Definition of Islamic bank's objective	Definition/Purpose of corporate governance guidelines/standard
AAOIFI	Omitted in the current version of accounting standard In the previous version it is defined as: Islamic banks are founded on the principle of sharing profit and losses consistent with the Islamic concept of "profit is for that who bears risk". Islamic banks reject interest as a cost for the use of money and loans as investment vehicles.	The overall aim of the statement is to encourage the efficient use of economic resources by IFIs and equally to require accountability for the stewardship of those resources. It seeks to ensure that those charged with governance and those employed by and associated with an IFI shall perform their respective roles effectively , and in a manner that is consistent with Shariah
IFSB	Essential feature of IIFS is the requirement to comply with Islamic Shariah rules and principles	The Guiding Principles are designed to facilitate IIFS in identifying areas where appropriate governance structures and processes are required, and to recommend best practices in addressing these issues. This document also aims to empower stakeholders with better knowledge and awareness of governance issues surrounding IIFS by becoming an authoritative reference that can also be used as a monitoring and advocacy tool in promoting good governance in IIFS.
Bank Indonesia (BI)	A commercial bank that operates under Shariah principles. This term is used by Bank Indonesia in its Banking Acts. A common international term for sharia bank is Islamic Bank. Shariah banking in Indonesia is a realization of the needs of the public seeking an alternative banking system that is both capable of delivering sound banking/financial services and compliant with sharia rules . (Blueprint of Indonesia Islamic banking development, and IB Act 2008)	Good Corporate Governance defined as a governance system of bank based on principles of transparency, accountability, responsibility, professionalism and fairness based on Shariah compliance principles to protect stakeholders' interest, compliance to the rules and regulations , general ethical principles
Bank Negara Malaysia (BNM)	Islamic banking business means banking business whose aims and operations do not involve any element which is not approved by the Religion of Islam (Islamic banking Act 1983) Comprehensive compliance with Shariah principles would bring confidence to the general public and the financial markets on the credibility of Islamic finance operation (Shariah Governance Framework – BNM)	Provides a comprehensive guidance to the board, SSB, and management to ensure all operation are in accordance with Shariah (Shariah Governance Framework – BNM)

<p>Central Bank of Bahrain (CBB)</p>	<p>Islamic bank licensees and approved persons must observe high standards of integrity and fair dealing. They must be honest and straightforward in their dealings with customers, and provide full disclosure of all relevant information to customers, as required by the CBB's Regulations and Directives. Banks' management must safeguard not only the interests of shareholders of the bank, but also those of the Profit Sharing Investment Account (PSIA) holders.</p>	<p>CBB draws banks' attention to the Basel papers as benchmarks of best practice for corporate governance standards and high-level controls to be followed by banks operating in the Kingdom of Bahrain.</p> <p>Islamic bank licensees' Boards of Directors and Shariah Boards (where applicable) and management must take reasonable care to ensure that their affairs are managed effectively and responsibly, with appropriate systems and controls in relation to the size and complexity of their operations. Islamic bank licensees' systems and controls, as far as is reasonably practical, must be sufficient to manage the level of risk inherent in their business and ensure compliance with the CBB Rulebook. In particular, the CBB requires that banks comply with all AAOIFI issued accounting standards as well as the Shariah pronouncements issued by the Shariah Board of AAOIFI.</p>
<p>State Bank of Pakistan (SBP)</p>	<p>Islamic banking has been defined as banking in consonance with the ethos and value system of Islam and governed, in addition to the conventional good governance and risk management rules, by the principles laid down by Islamic Shariah. Interest free banking is a narrow concept denoting a number of banking instruments or operations, which avoid interest. Islamic banking, the more general term is expected not only to avoid interest-based transactions, prohibited in the Islamic Shariah, but also to avoid unethical practices and participate actively in achieving the goals and objectives of an Islamic economy. (Handbook of Islamic banking, SBP)</p>	<p>Islamic banks must exhibit unique fiduciary responsibilities towards investment account holders, ensure Shariah conformity and select investments that are Shariah compliant (avoiding products / businesses that are haram) as well as implement sound internal risk management. As such, they will be required to follow a distinct corporate governance framework in line with the IFSB's Guiding Principles on Corporate Governance.</p>
<p>Central Bank of Oman (CBO)</p>	<p>Islamic banking is faith based. It is obliged to have appropriate conduct of business based upon strong ethical principles, practices and conviction. Islamic banking is collaborative banking; financial inclusion, fairness, and risk sharing are important hallmarks. It is not profit sharing per se but profit sharing with values, and where principle comes before profit.</p>	<p>Shariah governance can be defined as a system whereby an Islamic financial institution attempts to comply with Shariah in all its activities. The main objective of Shariah governance framework are to provide a structure and system to govern all the business activities of the license in order to ensure Shariah compliance at all times and at all levels.</p> <p>There are many stakeholders besides the shareholders, and including investment account holders looking for and sensitive to Shariah compliance.</p>

From the objective and definition of an Islamic bank perspective, BNM, BI, CBB, and IFSB are signifying the importance of prudential aspect, credibility, and the need to bring confidence to the public and financial market. From a different perspective, SBP and CBO put emphasis on the importance of faith based values and the need to achieve the goal of Islamic political economy. The two regulators defined a provision for Islamic banking to provide excellent services for stakeholders in a broader sense.

On the contrary, AAOIFI which previously in their former version of standards described Islamic bank's objectives and functions in a comprehensive manner, and explained both objectives in business and societal perspectives, has omitted this important part from their standard. They replaced it with conceptual framework which follows the logic of other

international standards to achieve a larger scale of acceptance. The author through an interview tries to confirm the background of these changes to one of AAOIFI's chairman.

Apparently, they did not realize the fact that they had left out the basic aspect which addresses the tenets of IFI within the logic of their standards. It reflects Habermas' view on factual and concrete force. A socially integrative force which provides de facto restriction by imposing obligation to the addressee, is fundamental for a law to be legitimated and socially integrated, which makes people feel compelled to adapt their behaviour in the desired way, and comply (Power & Laughlin, 1996). The need to get a legitimate power over IFI forces AAOIFI to adapt their standards according to the normativity produced by other international standards. Shifting of paradigm is happening both to regulators and IBF's practitioners following a changing in the business objective.

In terms of governance objective, CBO, SBP and BI defined governance system from stakeholders' perspective. They consider the objective of governance is broader than just protecting the shareholders' interest. The rest of the other regulators tend to define their governance system to serve fiduciary responsibility for the shareholders. In his *Muqadimmah*, Ibnu Khaldun (Khaldūn, Rosenthal, & Dawood, 1969), stated that authority is obtained through the acceptance of group feeling, which means affection and willingness to support for each other. The strength of the bond of cohesion among Islamic finance community to develop the industry and reach a larger market share strengthens its unity to achieve the business objective more than its societal goals. Therefore to enhance the power of the authority, guidelines for governance system move towards the need of the business, to get a bonding of acceptance of their users.

E. The Development of Standards and Regulatory Guidance for Islamic Banking Industry: How the Demands are Being Made

Governments and regulatory bodies have committed to develop formal regulations for Islamic banks. On the international level, the Accounting and Auditing Organizations of Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB) have issued a number of governances and auditing standards and guidelines. In 2000, AAOIFI developed Shariah Standards for the benefit of the governance committee, accountants, financial auditors and all the employees, as well as the customers of the institutions and the supervisory authorities. These serve as working guidelines to regulate the steps, activities, and procedures required by Islamic principles for the conduct and supervision of Islamic banking enterprises.

In 2009, the IFSB also prepared Shariah Governance System to ensure that there is an effective independent oversight, through issuance and implementation of relevant

pronouncements or resolutions that govern its whole operation coupled with internal Shariah compliance review and audit to verify that Islamic principles have been satisfied. The work of IFSB intended to complement that of the Basel Committee on Banking Supervision, International Organisation of Securities Commissions, and the International Association of Insurance Supervisors. IFSB has issued seventeen standards, guiding principles, and technical notes for the Islamic financial services industry. One of the most important standards is Guiding Principles of Shariah Governance System (IFSB-10). Moreover, some of the IFSB guidelines in risk management for IFI, Shariah review process, and business conduct are very important standards for Islamic finance industry.

Several central banks, such as Bank Negara Malaysia (BNM), Bank Indonesia (BI), Central Bank of Bahrain (CBB), and State Bank of Pakistan (SBP), have issued governance and auditing guidelines to raise the confidence of the users of financial statements in the information contained in them. It also aims at encouraging them to invest and deposit their funds with Islamic financial institutions and to make use of their services. Each of these different guidelines vary and so the current positions are of multiple governance and disclosure. BNM as a financial regulatory agency of Malaysian Government gives full support to the Islamic finance industry.

Putting an objective and vision as the hub of the Islamic finance industry, has induced Malaysia to develop a supervisory, regulatory infrastructure and facilities for this growing industry. Guidelines and standards for IFI have been produced, especially through the role of BNM as the central bank of Malaysia. In terms of governance standards, BNM has made an advance step compared to other central banks in many countries by establishing Shariah Governance Framework for IFI. This standards set up to complete previous standards of governance for Shariah committee, in order to enhance the confidence of Islamic finance Industry. Coupled with a series of Shariah parameter references in many specific contracts, the Shariah governance framework brings about a new hope to assure the effort of the Islamic finance industry to achieve the objective (*maqasid*) of Shariah.

In a different way of supervisory and regulatory infrastructure growth, Indonesia builds up the Islamic finance industry via a snowball process based on the idea and effort of community development. Started without any support, it continuously gains government support through the development of current supervisory and regulatory infrastructure. In terms of governance system, started from January 2010, BI has implemented a specific governance standard for IFI based on BI regulation No. 11/33/PBI/2009. It also regulated the detail roles and functions of SSB, including *ex ante* and *ex post* Shariah audit.

The other two central banks which represent the MENA region has declared its full adoption of AAOIFI standards. Hence, their regulatory and supervisory infrastructure, especially in a governance system, will provide the same picture of AAOIFI's governance system. To strengthen the Islamic finance industry, SBP and CBB has developed their own guidelines and standards in order to enhance their governance system. SBP have developed specific guidelines and instructions of Shariah Compliance and Risk Management for Islamic financial institutions. Started in January 2011, CBB has emphasised their mandatory requirement of governance standards including the additional governance disclosure in the bank's annual report based on High Level Control and Public Disclosure Modules. CBB also requires banks to prepare "comply or explain report" related to corporate governance disclosure.

Besides the progressive effort of international regulatory bodies and central banks in developing governance system suitable for IFI, a lack of unified Islamic governance model in Islamic Financial Institutions creates a problem on the measurement and monitoring process on their compliance with Islamic principles. The lack of consensus of a governance model in this industry has added a level of operational risk, since it will endanger the growth and stability of the industry. The governance system guidelines and standards are explored in Table 2.3 next.

Table 2.3 Regulatory Framework for Generic of Governance Infrastructure
Sources: Guidelines/Standards of AAOIFI, IFSB, Central Bank of Bahrain, State Bank of Pakistan, Bank Negara Malaysia, and Bank Indonesia

Generic Governance Infrastructure	Oman	Bahrain	Pakistan	Malaysia	Indonesia	AAOIFI	IFSB
Board of Directors	Available	Available	Available	Available	Available	Available	Available
Board of Audit Committee	Available	Available	Available	Available	Available	Available	Available
Board of Risk Management Committee	Available	included in BOD	risk management function	Available	Available	included in BOD	risk management function
Nomination & Remuneration Committee	Not Available	Not Available	Not Available	Available	Available	Not Available	Not Available
Internal Audit	Available	Available	Available	Available	Available	Available	Available
External Audit	Available	Available	Available	Available	Available	Available	Available

The content of the regulatory framework could be divided into 5 themes, which cover the generic governance infrastructure, the Shariah governance function, responsibility and restriction of Shariah governance organs, additional guidelines, and implementation factors. In terms of *generic governance infrastructure*, all key organs are required to be existed in the governance

system of IFI. Most of the key organs in conventional governance standard are regulated as the internal governance control, including the Board of Directors, Board of Audit Committee and Management including their functions and existence in the structure and organ of governance.

In terms of risk management, only Malaysia and Indonesia require the availability of Board of Risk Management, the other regulators structured it as a support function of Board of Directors. Moreover, Indonesian governance standards of IFI articulated the importance of managing potential conflict that possibly arises from the activity of nomination and remuneration of Directors, and formulated this function in the role of Board of Nomination and Remuneration Committee. Even though Safieddine (2009) highlighting its existence is encouraged in Mena Region. Based on the literal content of standards there is no formal encouragement for the availability of Nomination and Remuneration Committee, for example CBB only highlighted its importance as a potential of conflict of interest.

Table 2.4 Regulatory Framework for Shariah Governance Function
Sources: Guidelines/Standards of AAOIFI, IFSB, Central Bank of Bahrain, State Bank of Pakistan, Bank Negara Malaysia, and Bank Indonesia

Shariah Governance Functions	Oman	Bahrain	Pakistan	Malaysia	Indonesia	AAOIFI	IFSB
a. Responsibility, Independence and Competency of Key Organ	Available	Available	Available	Available	Available	Available	Available
b. Specific Model of Shariah Governance Framework	Not Available	Not Available	Not Available	Available	Not Available	Not Available	Not Available
c. Guidelines for Shariah Committee	Available	Available -AAOIFI	Available – AAOIFI & Shariah compliance Instr.	Available	Available	Available	Available – embedded
c. Shariah Supervisory Committee (SSC)	Available Bank level	Available Bank level	Available Two tier	Available Two tier	Available Bank level & National Board	Available Bank level	Available Bank level
d. Shariah Audit Function (SAF)	Available	Available -AAOIFI	Available – AAOIFI & Shariah compliance Instr.	Available	embedded in internal audit function	Available	Available
e. Shariah Research Function	Not Available	Not Available	Not Available	Available	Not Available	Not Available	Not Available
f. Shariah Compliance Unit (SCU)	Available	Not Available	Available	Available	Not Available	Available	Available
g. International Shariah Review (ISR)	Available	Available	Available	Available	Available	Available	Available
h. Shariah Risk Management	Available	N/A – general	N/A – general	Available	N/A – general	N/A – general	N/A – general
i. External Shariah Review	Available > 3 years	Not Available	Not Available	Not Available	Not Available	Not Available	Not Available

j. External Shariah Audit	Available	Not Available					
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In terms of *Shariah governance function*, all regulators required the existence of a Shariah review function conducted by SSB in ensuring all activities carried out by IFI are in accordance with Shariah principles, as represented in Table 2.4 above. Regarding Shariah Audit Function that should be conducted by internal Shariah review/audit unit, all regulators required its existence, although in Indonesia this function is embedded in internal audit function as a whole. The other two important key points which are important elements of Shariah governance, namely Shariah Research Function and Shariah Risk Management Function, completed with a specific *model of Shariah governance framework* are required only in Malaysian Standards.

BNM structured these two important functions as tools of monitoring day to day Shariah compliance and the possibility of Shariah non-compliance risk occurrence. Previously, the model of Shariah governance developed by BNM is the most comprehensive framework available for IFI. However, just a few months ago the Sultanate of Oman through their central bank produces a very strict and robust framework from Shariah compliance perspective. It requires all Islamic banks operating in their jurisdiction to perform external Shariah review after 3 years of operation to ensure its compliance to the Islamic principles. It also regulates an obligation for Islamic bank to hire an independent body to perform an external Shariah audit.

Table 2.5 Regulatory Framework for Responsibility & Restriction of Shariah Governance Organs
Sources: Guidelines/Standards of AAOIFI, IFSB, Central Bank of Bahrain, State Bank of Pakistan, Bank Negara Malaysia, and Bank Indonesia

Responsibility & Restriction of Shariah Governance Organs	Oman	Bahrain	Pakistan	Malaysia	Indonesia	AAOIFI	IFSB
a. Limitation on SSC period of appointment	3 years – max 2 periods	Not Available	Not Available	Not Available	1 period equal to BOD period	Not Available	Not Available
b. Restriction on SSC member	Not an employee	Not an employee	Not an employee	Not an employee	Not an employee	Not an employee	Not an employee
c. Number of SSC members	Min 3	Min 3	Min 3	Min 3	Min 3	Min 3	Min 3
d. Diversity of SSC member	1 non-Shariah scholar	Additional expert - AAOIFI	Not Available	1 Shariah Secretariat	Not Available	Additional expert	Additional expert
e. Limitation on Shariah Scholar 's membership	1 bank & max 3 non-competing institutions	Not Available	Not Available	1 bank & 2 non-competing institutions	Max 2 banks & 2 non-competing institution	Not Available	Not Available
f. Training program for SSC	Min annually	Follow AAOIFI	Not Available	Management responsibility	Not Available	Management responsibility	Management responsibility

g. Ground for SSC disqualification	Available	Available	Available	Available	Available	Available	Available
g. Requirement for ISR/ISU	Full time employee	Not Available	Not Available	Full time employee	Not Available	Not Available	Not Available
h. Additional ISR/ISU roles & responsibility	publish paper 1/year	Not Available	Not Available	Not Available	Not Available	Not Available	Not Available
c. Resolution for conflict of Shariah Rulings	Not Available	Not Available	Available	Available	Not Available	Not Available	Not Available

Furthermore, the detail roles and responsibility of *Shariah governance organs* are described through Table 2.5 above. Malaysia and Oman produce the most comprehensive framework for IFI's Shariah governance. They provide requirements to ensure the diversity of SSB members and requirements for internal Shariah reviewer. Moreover, these two countries and Indonesia put a limitation on SSB membership and period of appointment. However, the most advance guidelines produces by Omani government surprisingly requires a strict regulation for SSB and ISR, by asking them to have a limitation of membership and additional responsibility for ISR to produce a paper at least once a year.

Table 2.6 Regulatory Framework for Additional Guidelines
Sources: Guidelines/Standards of AAOIFI, IFSB, Central Bank of Bahrain, State Bank of Pakistan, Bank Negara Malaysia, and Bank Indonesia

Additional Guidelines	Oman	Bahrain	Pakistan	Malaysia	Indonesia	AAOIFI	IFSB
a. Special Guidelines for Audit in IFI	Available -AAOIFI	Available -AAOIFI	Available – AAOIFI & Shariah compliance Instr.	N/A- General	Available	Available	Not Available
b. Special Guidelines for Internal Shariah Audit	Available	Not Available	Not Available	Not Available	Not Available	Not Available	Not Available
c. Guidelines for Risk Management	Available	N/A – General	Available	N/A – General	N/A – General	Not Available	Available
d. Shariah Parameter Reference	Available	Available -AAOIFI	Available	Available	Available	Available	Not Available

In order to complete the governance system some additional guidelines are highly essential in implementing the governance concept of accountability and transparency. These *additional guidelines* related with the governance system are guidelines for audit and risk management in IFI, internal Shariah audit, and Shariah parameter reference, as represented in Table 2.6 above. Since AAOIFI is focusing in accounting, auditing, Shariah, governance and ethical standards, hence risk management guidelines is out of the area of coverage. On the contrary, IFSB will not develop Shariah parameter reference, standard for auditing in IFI and internal Shariah

audit. All of central banks under review process are furnished with auditing, risk management and Shariah parameter guidelines, even though some of them share the same guidelines with conventional guidelines and are not specifically built for IFI. However, the important loophole is the unavailability of internal Shariah audit guidelines. This standard is a very important part of governance and Shariah compliance assurance process for IFI.

In addition, in the theme in Table 2.7 below shows the *implementation factors of governance system*. Only CBB and CBO stated their guidelines as a mandatory type for IFI. All of their guidelines use the word "must" to strengthen its binding power, as the other regulators use the word "should" to represent recommendations to comply with the related guidelines. BNM and SBP added in to their guidelines the strong emphasis of the guidelines implementation; hence it highlighted a strong recommendation of compliance. Furthermore, if the IFI could not comply with the related standards and guidelines, CBB and SBP are required a non-compliance report as a mandatory activities for IFI.

Table 2.7 Implementation Factors
Sources: Guidelines/Standards of AAOIFI, IFSB, Central Bank of Bahrain, State Bank of Pakistan, Bank Negara Malaysia, and Bank Indonesia

Implementation Factors	Oman	Bahrain	Pakistan	Malaysia	Indonesia	AAOIFI	IFSB
a. Binding Power of Governance	Mandatory	Mandatory	Strong Recommendation	Strong Recommendation	Strong Recommendation	Strong Recommendation	Strong Recommendation
b. Non-Compliance Report	NA	Mandatory	Mandatory	NA	NA	NA	NA
c. Accounting Standards	AAOIFI	AAOIFI & IFRS	AAOIFI	MASB – IFRS Convergence	ISAS – IFRS Convergence	Not applicable	Not applicable
d. Promoting adoption of other standard	IFSB, AAOIFI, Basel	IFSB, AAOIFI, Basel	IFSB, AAOIFI, Basel	NA	NA	NA	NA

Moreover, as additional information, it is interesting to look at the accounting standards adopted by each two of central banks in Asia and MENA region that are prominent in developing the Islamic finance industry. SBP and CBB are fully adopted AAOIFI standards, while BI and BNM are developing their own accounting standards in convergence with IFRS. Furthermore, the most interesting feature of this standards comparison is the willingness and effort of three regulators, Oman, Bahrain and Pakistan to encourage and promote adoption standards and guidelines of AAOIFI, IFSB and Basel. This is deemed important, as cross-border collaboration of standards is an important step of harmonization. In the end, each regulatory framework has its own style, appetite, and identity to address the Shariah compliance principles in their regulatory framework.

F. Islamic Banking Industry in the Non Muslim Country

The sharp rise in oil prices since 2003 has resulted in huge liquidity surpluses and a surge in demand for Islamic as well as conventional assets in the countries of the Gulf region. The capacity of the local financial markets has not, however, been able to develop at the same speed....This demand was quickly identified....This has been particularly notable in the UK. (FSA Report 2007)

In the aftermath of the 1998 crisis, the huge liquidity surpluses resulting from the sharp rise in oil prices induced Middle Eastern countries to crave for financial instruments that suited their religious beliefs (DiVanna, et al., 2009; Iqbal & Mirakhor, 2007; Warde, 2010). The earliest reference to an Islamic financial model comes from the Medieval era where the perfect model for Muslims was to keep in line with Islamic teaching; it was also seen as paramount to promote morality in the marketplace (Algaoud & Lewis, 2007; Qureshi, 1946; Siddiqui, 1994). The religious imperatives prompt Muslims to demand financial alternatives and schemes of investment that represent transcendental value. However, there has been a mismatch between Muslim investors' demand and the availability of religiously compliant financial instruments in the market.

...the last few years have seen an increase in the levels of excess liquidity in the Middle East, with a commensurate rise in demand for both conventional and Islamic financial assets.....The UK, with its established history of financial openness, has been a favoured destination for these financial flows. (HM Treasury Report 2008)

The potential of the flow of funds from the 'oil economy' inspired London to become one of the hubs of the financial market with its capacity to offer a supply for the excess demand. The openness of the UK market has enabled the players to create some financial instruments in line with the need to fulfil the religious imperative. The HM Treasury (2008) as reported in the narrative below, confident that the economic benefit is attractive enough for the UK to justify a flexibility to accommodate the newcomer. Some perceive that the facility provided was to simply invite the flow of funds from Muslim investors to the UK. Some others consider this as the government's inability to raise capital from conventional finance that bears 'unforeseen consequences' comprised of both a social and political impact that leads to the implementation of a broader Islamic law and pressures on the existing legal system (Birchall, 2013; Kurti, 2013).

.....The Government believes that everybody in the UK will benefit from the UK becoming a global centre for Islamic finance, through the increased tax receipts, private spending and economic dynamism that flow from the financial services industry.....The Government believes that the growth of Islamic finance in the UK brings clear benefits for the UK economy. (HM Treasury Report 2008 p.17)

The FSA Report (2007) explains that Shariah compliant transactions became established in the UK in the 1980s. The key industry players through the London Metal Exchange started to use similar types of commodity *murabaha* (commodity sales) transactions in significant volumes, to

offer liquidity instruments to Middle Eastern institutions. Subsequently, in the 1990s, several Middle Eastern and South East Asian banks began to offer Islamic retail products on a limited scale, such as home finance. However, the Islamic finance industry retail market at that time was experiencing a slow paced development due to uncompetitive pricing, and a lack of customer protection. The Islamic finance products merely aimed at the wholesale market, and exclusively targeted high-net-worth investors. This is continuously evident in a later process through which two of the authorised Islamic financial institutions in the UK are dedicated as investments banks that were more or less crafted for such types of investors.

....the growth of the industry in the Middle East and South East Asia has influenced the UK market....now products developed in London are being marketed in other countries, for example in the Middle East. (FSA Report, 2007)

After 13 years, the UK became the first country in the European Union (EU) to allow stand-alone Islamic financial institutions to offer only Shariah compliant products. It is now perceived to be the Western hub of Islamic finance with the highest value of Shariah compliant assets of any non-Muslim country (Morales & Shibliq, 2013). In 2000, the UK market started to recognize the existence of Islamic finance. The Bank of England and HM Treasury set up a working group to investigate the potentials and obstacles for retail and wholesale Islamic banks in the UK. This led to the first legislative changes being introduced into the taxation and regulatory system to support the new industry, enabling UK companies to offer Shariah compliant asset finance, mortgages, and ISAs.

The UK's principles based regulatory structure is designed to accommodate a range of financial structures to suit a multitude of clients. This is, after all, a key feature which distinguishes the City of London from some of our less flexible competitors. Following this approach, the Financial Services Authority (FSA) has been willing to discuss with Islamic banks how the products and services they wish to offer can fit within the UK regulatory framework. (Muslim Council Britain Briefing Paper 2009)

The Finance Act 2003 was a starting point to help the industry to remove obstacles from the industry's initial development by preventing multiple payments of Stamp Duty Land tax on Islamic mortgages. This new regulatory policy eased the process for the Islamic finance industry to further develop. As a result, in 2004, the Financial Services Authority (FSA) eventually authorised five Islamic banks to operate in the UK. In addition, Finance Acts in each year from 2005 to 2007 were produced to clarify the tax framework in other Islamic products, including *sukuk*.

....This open approach was taken forward by Sir Howard Davies, when he was Chairman of the FSA.....that he had 'no objection in principle to the idea of an Islamic bank in the UK'.....provided Islamic banks met the FSA's regulatory requirements, the UK had 'a clear economic interest in trying to ensure that the conditions for a flourishing Islamic market are in place in London'. A soundly financed and prudently managed Islamic institution would, he argued, be 'good for Muslim consumers, good for innovation and diversity in our markets and good for London as an international financial centre'. (FSA Report, 2007)

To justify the rationale to support the growth of the Islamic finance industry, the UK's authorities produced some consultation papers and reports (HM Treasury, 2008; Muslim Council Britain, 2009). It is envisaged that commercial logic lay behind the adjustment of the authorities' policies and the regulatory flexibility provided. The UK government could not resist grabbing the economic benefit, as the excess demands from Muslim investors became a new potential for this hub of the Western market.

G. Conclusion

This chapter provides the underlying context, the nature and historical development of Islamic banking Institutions, and the underlying principles and the development of the institution. Shariah has guided IBF to offer ethical investment alternatives that avoid any interest based transactions, and in taking an excessive uncertainty. The comparison between Islamic banks with its conventional counterparts, however, shows (issues) that Islamic banks have been replicating its counterpart's products and services. In addition, the various operational practices in different banks in different countries, the issues on governance and religious compliance in Islamic banks, in relation to Shariah scholars' roles and function have played its own role in the complexity of the interpretation and the implementation of religious compliance principles in every aspects of banking operation.

In the end, the development of standards and regulatory guidance for Islamic banking industry revealed that the existing standards have been unable to capture a reference to resolve the existing issues. The governance guidelines and standards in seven regulatory regimes present as a result of variety of governance guidelines and standards. There is a lack of consensus of governance model that could reduce the level of operational risk of the industry.

Chapter 3 Literature Review

A. Introduction

This chapter explores the review of related literature in line with the scope of this research. It provides an understanding of compliance in a broader research perspective; this is to examine what compliance is in the academic discourse. It shows that individual and institutional moral and normative values based compliance has been the subject of limited academic research. It explores the reflection on the moral and normative issues of compliance in theoretical perspective, to show that the concept of moral and normative duty and compliance has been acknowledged in philosophical scholarly works, and to conclude the need to provide a sensitizing concept to understand the nature and dynamic of religious compliance.

This chapter also presents the development of research in Shariah governance, compliance and audit in Islamic financial institutions. It shows the existing academic discourse on this area, the current research focus on audit of religious compliance principles within the lack of codified benchmark of Shariah compliance definition, and the need to shed a light on understanding Shariah compliance and the dynamic process of its infusion and enactment in Islamic banking operation. In addition, this chapter explores the impact of the lack of academic literature and regulatory guidance to the current practice of Islamic banking industry, to show the absence of clear operational definition of what constitute Shariah compliance, the impact of the lack of clear religious compliance guidance to the current practices, and the critics to the Industry.

B. Compliance in a Broader Research Perspective

When general rules which determine the merit and demerit of actions, come thus to be regarded as the laws of an All-powerful Being, who watches over our conduct, and who in the life to come, will reward the observance, and punish the breach of them; they necessarily acquire new sacredness from this consideration. That our regard to the will of the Deity ought to be the supreme rule of our conduct can be doubted of by nobody who believes his existence. (Adam Smith, 1790, p. 158)

Indeed, the role of religious, normative and moral values is crucial in shaping the concept of compliance, as reflected in Adam Smith's view above. Drawing from the evolution of compliance concepts in prior literatures is useful to provide horizon in constructing religious compliance concept. In terms of research, previous studies have been intrinsically examining compliance behaviour related with the notion of power, control in institutional setting.

Many studies in the context of compliance have been published in academic journals. This research hence analysed compliance related studies published in three well known journals. I selected the representation of research development within organisational level with the focus on compliance. Among top rank journals in accounting and finance, the three journals selected are *Accounting Organizations & Society (AOS)*, *Journal of Business Ethics (JBE)*, and *Accounting Auditing & Accountability Journal (AAAJ)*.

a. Systematic Review of Compliance Concept

Reviewing systematically the concept of compliance in prior literatures this thesis maps and assesses relevant intellectual territory by searching for, appraising and synthesizing findings of primary studies (Denyer, 2009; Dixon-Woods, et al., 2006; Tranfield, Denyer, & Smart, 2003). A systematic review is conducted through the four following steps. *First and foremost*, I searched for articles discussing different perspectives of compliance within complex organisation systems and its environment. This was done through searching keywords 'compliance', 'compliance program', and 'compliance behaviour' in these three journals using integrated electronic database covering Springer, Emerald and EBSCO Host. The period of published papers selected was from 1996 until 2012,

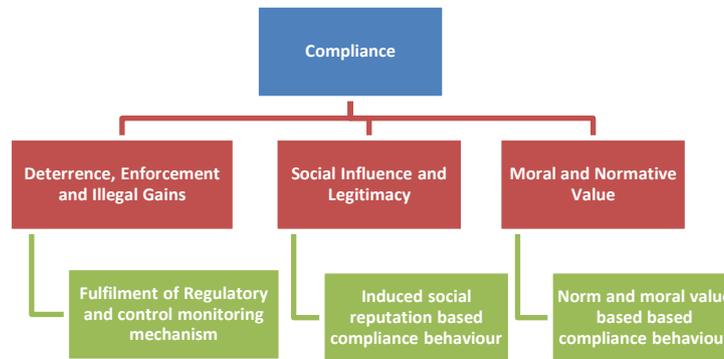
Second, I selected papers for review based on the criteria that there was a considerable length of discussion on compliance in any perspective of interrelationship among regulator/supervisory body, internal and external regulation, and organisation. For the *third step*, we carefully (re)read all selected 71 papers and conducted inductive analysis to determine the main perspectives applied by the authors to the discussion of compliance issues. *Fourth and finally*, we classified all the compliance discussion in all papers into different sources of compliance, which determine the power and control of compliance.

The papers reviewed (summarised in Table 3.1 in appendix no 1) represent perspectives of compliance driven by various motives within complex organisation's structure and interrelated environment. Papers from AOS and JBE each provided 31 papers, and the remaining 8 papers analysed are from AAAJ. The compliance concepts in those papers are discussed in the context of regulation, enforceable regulatory framework, accounting and auditing standards, tax responsibility, corporate social responsibility, ethicality aspect, and also organisation's attempt to maintain their legitimacy.

Sutinen & Kuperan (1999) highlighted intrinsic and extrinsic motivation of compliance behaviour, which includes deterrence, detection of enforcement system, illegal gains and its related sanctions, social influence and legitimacy purpose, and also internal and external moral development and personal values. Etzioni (1961) identified normative power as a determinant of

compliance, which could be in the form of pure normative and social power. Pure normative power is more useful in determining compliance, and may be represented through ritual, symbol, esteem and prestige.

Figure 3.1 Drivers of Compliance Behaviour
Sources: (Etzioni, 1961; Sutinen & Kuperan, 1999)



While, compliance based on social power would be exercised when the organisation can be seen to influence the group’s power. Drawing from Etzioni’s, and Sutinen and Kuperan’s studies, we identify three different motives that could determine the compliance behaviour in an organisation, as represented in Figure 3.1 above. As a result Table 3.2 below presents the analysis of compliance drivers based on the 71 selected papers.

Table 3.1 Sources of compliance in the selected literatures
Sources: (Etzioni, 1961; Sutinen & Kuperan, 1999) modified and analysed by the researcher

	<i>Sources of Compliance</i>	<i>Key Concepts on Compliance</i>	<i>Selected References</i>
1	Deterrence, Enforcement and Illegal Gains	Fulfilment of regulatory and controlled monitoring mechanism	20 papers from AOS, 8 papers from JBE, and 2 paper from AAAJ
2	Social Influence and Legitimacy	Induced social reputation based compliance behaviour	11 papers from AOS, 18 papers from JBE, and 5 from AAAJ
3	Moral and Normative Value	Norms and moral values based compliance behaviour	1 paper from AOS, 5 paper from JBE, and 1 paper from AAAJ

The first group is compliance behaviour with the motives of *deterrence, enforcement and illegal gains*, what then we called *induced regulatory compliance*. This compliance behaviour is represented when an organisation as an economic agent within its socioeconomic environment is controlled through monitoring, surveillance and enforcement of some regulations and policies. The paper reviewed shows that compliance behaviour is mandated by the enforcement of regulations and policies linked to accounting and auditing regulations and standards (Carmona, Donoso, & Walker, 2010; Humphrey, Loft, & Woods, 2009; MacDonald & Richardson, 2004; McCracken, Salterio, & Gibbins, 2008; Mennicken, 2008; Shah, 1996, 1997; Spence & Rinaldi, 2012), taxation (Blanthorne & Kaplan, 2008; Braithwaite; Gracia & Oats, 2012; O'Donnell, Koch, & Boone, 2005), and risk (Arena, Arnaboldi, & Azzone, 2010; Power, 2012). Compliance in the view

of Ferrell et al. (1998) and Mitchell (1998) is enforced where organisations or individuals received illegal gains from non-compliance and are subject to penalties imposed by regulators or policy makers which will result in higher cost than the gains from illegal activities. The shortcoming of this model of compliance is that it is too expensive to implement and monitor.

An alternative perspective emphasises institutional concern about their social reputation. Based on the systematic review, this will produce the behaviour of *reputational based compliance* (Aerts & Cormier, 2009; Darnall, Seol, & Sarkis, 2009; Egels-Zandén, 2007; Egels-Zandén & Wahlqvist, 2007; Francés-Gómez & del Rio, 2008; Houghton, Gabel, & Williams, 2009; Hume, Larkins, & Iyer, 1999; Lund-Thomsen & Nadvi, 2010; Parker, 2000; Sacconi, 2007). Within their daily social exchange and interaction, *social influence* (Alon & Hageman, 2012; Mats Alvesson & Kärreman, 2004; Bobek, Hageman, & Kelliher, 2012; Bobek, Roberts, & Sweeney, 2007; Church, Hannan, & Kuang, 2012; Davis Hammond, 1997; Fogarty, 1996; Frechtling & Boo, 2012; Maciejovsky, Schwarzenberger, & Kirchler, 2012; Majluf & Navarrete, 2011; Michaelson, 2006; Verhezen, 2010) will play a significant role for the organisations as a means of preserving *legitimacy* (Belal & Owen, 2007; Boden & Froud, 1996; Criado-Jiménez, Fernández-Chulián, Larrinaga-González, & Husillos-Carqués, 2008; Dhanani & Connolly, 2012; Fasterling, 2012; Mikes, 2011; Mir & Rahaman, 2005a; Mobus, 2005a; Neu, Warsame, & Pedwell, 1998; Nola, 1998). In this case, informal control among others operates as the driving force of compliance behaviour. Etzioni (1961) argued that the social power behind any form of behaviour including compliance is less useful. It will only work when certain regulatory features and group's power could influence organisations in understanding important sense of distribution of goods and services within a community, the concern of community needs, and put an emphasis on solidarity (Wilson, 1992).

Furthermore, the last source of compliance is *normative and moral value based compliance* behaviour. This form of compliance characterized the institutional behaviour based on a shared moral value and cognitive orientation as an ideology. The shared value may originate from kinship term, religious tenets, or codes within a society. Such shared values induce a feeling of belongingness, loyalty, and compliance with some specific rules (Wilson, 1992). Almost 90 percent of the research analysed focus on induced regulatory and reputational based compliance behaviour. Only 10 percent deal with normative and moral value based compliance behaviour (Alm & Torgler, 2011; Hechter, 2008; McKernan & Kosmala, 2007; Norman, 2011; Trivedi, Shehata, & Lynn, 2003; Tullberg, 2009; G. Watson & Berkley, 2009). Findings of the analysis show that compliance behaviour for the reason of individual and institutional moral and normative values have been the subject of limited academic research.

b. Reflection on the Moral and Normative Issues of Compliance

Yet the moral and normative based compliance have been neglected in the mainstream academic discourse. Considering the duality of compliance concept in IBF context, however, integration of moral and normative issues in shaping IBF’s organizational compliance are deemed important. Thus, further reflection on the literature in this stream of compliance will provide insight to understand the concept of religious compliance.

To start with, we present another systematic review on philosophical scholarly works related moral and normative duty and compliance. This enables us to further explore the disregarded area of compliance. We present Table 3.3 below, the 18th century philosophical discourse to references the work of David Hume, Adam Smith and Immanuel Kant as a starting point. Despite their indirect engagement to compliance discussion, Hume, Smith and Kant’s explanations for why people behave in line with law are explored by several authors (Donnelly, 2007; Dudley & Engelhard, 2011; Stratton-Lake, 2012; Sutinen & Kuperan, 1999). Hume is well known for the notion of passion and morality as explanations of individual behaviour, while Kant considers one’s recognition of moral duty will induce good actions. Similarly, Smith’s observation on human moral sentiments explains the role of religion to provide another restraint of an acceptable form of conducts complement to those which regulate the conduct of other men. It thus enforces a natural sense of duty and “justly places a double confidence in the rectitude of the religious men’s behaviour”(Adam Smith, 1790, p. 117). Drawing from their thinking, it could be argued that moral motivation and moral consciousness may encourage compliance within a broader societal and institutional setting.

Table 3.2 Tracing Moral and Normative Compliance Concept in the Literatures
Sources: Previous literatures, analysed by the author.

Author	Sources of Compliance
Hume (1739)	Morality and Moral motivation. Moral excite passion produce or prevent actions
Adam Smith (1759)	Religious sentiments and natural sense of duty
Kant (1785)	Consciousness of moral law and moral motivation. Recognition of moral duty and moral law behind good actions
Weber (1946)	Personal religious needs and ideal interest. Conformity to legitimate order, charismatic devotion and obedience
Parson (1949)	Actor’s adoption of normative orientation and conformity with norms
Durkheim (1950)	Moral compliance and obligation. Moral values as sacred power and collective sentiments in society
Hirschi (1969)	Individuals conform to or deviate from social norms through four variables: attachment, commitment, involvement, and belief
Kohlberg (1969)	Personal morality and level of moral development
Wilson (1992)	Normative codes and religious tenets as a form of compliance ideology
Sutinen & Kuperan (1992)	Moral obligation (intrinsic) and social influence (extrinsic)

Weber, Parsons, and Durkheim (Weber, Gerth, & Mills, 1946) provide some insights on the concept of compliance, social action and the normative values. These three thinkers hold a common view on the importance of moral values or norms in preserving social order. Weber views legal-rational authority is empowered by a formalised belief in the content of the law (Weber, et al., 1946). In Weber's thinking, compliance is reflected on the concept conformity to legitimate order, charismatic devotion, and obedience. This form of devotion and obedience is coming from personal religious needs and the perceived ideal interest within social order.

Parson (1940, 1949, 1968) argues that normative patterns, which includes common moral sentiments supported patterns and utopian patterns, define what are felt to be, in the given society as proper, legitimate or expected modes of action or of social relationship. The conformity with common moral sentiments is not only a matter of expediency, but of moral duty, which represents actor's value commitments in adopting such normative orientation. Moral obligation is constituted to maintain the integrity of value pattern within a system of social interaction.

Durkheim (1950) emphasises the importance of moral compliance and obligation, which resulted from moral values as sacred power and then becoming a collective sentiment in the society. The heart of Durkheim thinking in 'The Elementary Forms' (Durkheim, 1976) illustrates how religious belief regarded as 'sacred things' interpreted as the 'collective representations' of society will then create 'sacred power' representing a social bond as the unintended consequence of religious practices. The obedience to religious practices creates a social enthusiasm, produced self-restraint and altruistic actions and personal asceticism as a necessary basis of social life as a whole (Durkheim, 2002, pp. 22-23).

Similarly, Hirschi (1969) when explaining that individuals conform to or deviate from social norms dependent upon four variables: attachment, commitment, involvement, and belief. Belief refers to the existence of a common value system within the society, with individuals varying in the depth and magnitude of their belief. This variation reflects the degree of attachment to systems representing the beliefs in question (Hirschi, 1969; Welch, 1998). Moreover, several studies on the role of religion in generating compliance with the law shows that religious belief does has a potent effect on compliance with law (Grasmick et al., 1993; Tittle & Welch, 1983).

By developing cognitive moral development theory, Kohlberg (1969) emphasized cognitive judgment and its relationship with moral action. He argues that personal level of cognitive moral development strongly influences individual's moral and ethical decision. While Wilson (1992) explores the concept of compliance as an ideology represents ethical codes that function in the manner of regulation. It embodies beliefs and evaluation as a generalized notion of

what is morally acceptable, and on both customary and codified regulation that translate what is acceptable into specific guides for action.

According to Wilson (1992), compliance as an ideology might take the form of normative codes or religious tenets. He describes that within an institution a set of moral and ethical norms or standards governs the relationship of structure of power and the responsibility of its members. Based on the shared cognitive orientation as an ideology, this belief will induce the feelings of belongingness, loyalty, and participation to some specific rules.

C. Research in Shariah Governance, Compliance and Audit in Islamic Financial Institutions

In addition to research in compliance from a wider perspective, studies in Islamic finance are emerged in this area which mostly at the exploratory stage, focuses on formal monitoring of religious compliance. IBF have become alerted to legitimise ethical aspect and morality within their operation as the ethical lapse could damage organizational reputation. The development of research in the area of Shariah governance, compliance and audit are discussed in the following sub-sections.

a. Research on Auditing Shariah Compliance

In line with Power argument that the rise of auditing has its roots in political demands for accountability and control, the assurance of religious compliance is subject to formal scrutiny. The initial inquiry taken from governance and control perspective was started by Karim (1990) which investigating the unique feature of Shariah Supervisory Board (SSB) who performs religious audit in Islamic banks. Looking at from the similarities on audit tasks as compared to external auditor, Karim argued that the former is very much influenced by moral value, while the later is more affected by economic factors. As a finding, Karim then criticises SSB's independence as an in-house adviser, and the impact on IBF credibility. That study then opens a new direction of research that concentrates on the uniqueness of governance and audit in IBF contexts, including Banaga et al. (1994), Warde (1998, 2010), Safieddine (2009), and Rammal (2010). Most of their findings revealed the case of close extant of monitoring of Shariah compliance coupled with religious auditor's lack of independence. Criticisms on the practices of moral credential are then putting IBF to face a risk of being challenged on religious ground.

Research conducted by Rahman (2008, 2011) as part of the exposure draft of the Shariah Audit Framework in Malaysian regulatory context has brought a more focus on the need of auditing religious compliance to strengthen IBF credibility. An empirical study conducted by Kasim et al. (2009) examines the expectation gaps of "what ought to be" Shariah auditing and the current practice in Islamic financial institutions (IFI) in Malaysian setting. In the findings, the study

highlighted that what is actually desired does not coincide with the actual practice. Using survey method to 85 respondents, the study shows that within Malaysian regulatory context, Shariah audit function has not seriously taken an impact in IFI despite its potential as a monitoring tool for Shariah compliance. The adverse effect which result in a gap because what is actually desired does not coincide with the actual practice. The results are interesting and useful, but at the same time reflect evidence that the Shariah audit process is still a highly unstructured task and Shariah audit practitioners somehow are unable to respond to the *Maq'asid* (objective of) Shariah agenda despite their apparent willingness to do so.

Shafii et al. (2010) concludes that non-compliance risk faced by the IBF can be mitigated through Shariah compliance audit performed on various aspects of the operations including documentation, reporting and to the extent of the segregation of duties and control procures that involves documentation, system and employees involvement in the operations. As a conclusion Shariah audit will serve as governance mechanism in Islamic finance so as it provides the verification that IBF operates according to Shariah. Another study conducted by Yahya and Mahzan (2012) through interviews in 5 Islamic banks in Malaysia highlighted the need of improvement in understanding among the internal auditor on the implementation of Shariah auditing process, and standardization of Shariah audit framework to provide guidelines to design audit program.

Studies are subsequently focusing on technical audit implementation. The focus on audit and control demands and expectation is a way to insure religious legal standards are being met. However, the industry is trapped within the battle of defining religious parameter. Yet, there remains a relative dearth of empirically based research fundamental point of defining the concept of Shariah compliance as the criteria of audit. Studies are neglecting the conceptual perspective to build up organisational ethical integrity. IBF has been trapped into legal based compliance seeks to build moral commitment to compliance with the religious law. Paine (1994, p. 111) argues that integrity strategy that incorporates an active effort to define organizational ethical compass is more demanding than legal compliance initiative. IBF needs a deeper integrity strategy to entangle the guiding values and pattern of thought and action of the organisation, as much as a broader perspective in that it seeks to enable responsible conduct.

Nevertheless, (Shafii, Salleh, Hanefah, & Jusoff, 2013; Yahya & Mahzan, 2012) both studies have taken a view of religious compliance from a legal perspective. The inquiries focus on the underperformance of formal monitoring of religious compliance. It still misses fundamental research that critically evaluates why it could be the case, and it would be related to the lack of conceptualisation of what constitutes Shariah compliance in the regulatory and institutional level

of Islamic banking industry. The issue of a lack of underlying concept acting as a benchmark on auditing of Shariah compliance in the Islamic banking industry is also under research. The inquiries in this area seem to follow industry's needs to legitimise the practice of Shariah compliance with a lack of critical analysis on the governance issues behind its implementation.

b. Operational Issues of Governance and Shariah Compliance in Islamic Bank

In regards to the Islamic bank industry as the social phenomenon of this research, there are issues in Islamic banks which provide the picture of governance and compliance. Islamic banks as the fairly new and unfamiliar industry for regulators have been operating in a weaker government oversight and non-transparent environment. The collapse of Ihlas Finance House (IFH) of Turkey in 2001 provides an example of the weaknesses in corporate governance practice, which portrays regulatory, and management failures and poor internal controls which entails negative repercussion for soundness and sustainability of an Islamic financial institution (Jang, 2003; Sultan, 2007). Based on the analysis, both authors suggested that Board of Directors of Islamic Banks should have sense of responsibility towards improving corporate governance and sympathetic to promotion of Islamic finance. They should not be a rubber stamp member. They should be knowledgeable on the financial and economic facts, and well informed of the country specific and international regulatory rules and laws that have implications for the bank.

Many governments and regulatory bodies have been continuously exerting efforts to strengthen the industry. Internationally, the Accounting and Auditing Organizations of Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB) have issued a numbers of governance and auditing standards and guidelines. In the year 2000, AAOIFI develop Shariah Standards for the benefit of the governance committee, accountants, financial auditors and all the employees, as well as the customers of the institutions and the supervisory authorities. This is because they provide work guidelines that regulate the steps, activities and procedures required by the Islamic principles for the conduct and supervision of Islamic banking enterprises.

Furthermore, IFSB in 2009 also prepared Shariah Governance System to ensure that there is an effective independent oversight, through issuance and implementation of relevant pronouncements or resolutions that govern its whole operation coupled with internal Shariah compliance review and audit to verify that Islamic principles have been satisfied. Several central banks, such as Bank Negara Malaysia, Central Bank of Pakistan, and Bank Indonesia, have issued governance and auditing guidelines to get the confidence of the users of financial statements in the information contained in them and encourage them to invest and deposit their funds with Islamic financial institutions and to make use of their services. Each of many guidelines provided

have their own coverage and differences based on specific countries or institution scope of enforcement and objectives.

Hence, differences in regulations and guidelines for governance model and its disclosure in many countries, make it difficult for Islamic banks to have a uniform benchmark for their practices. KPMG Report (2006) pointed out the lack of a unified Islamic governance model in Islamic Financial Institutions, which then has an effect on the measurement and monitoring process on their compliance with Islamic principles. The lack of consensus of governance model in this industry has added a level of their operational risk. In the year of 2007, KPMG showed that many conventional banks are converting to Islamic finance and opening Islamic banking windows, and they are not going after the concept itself, but are following the flow of money.

The KPMG Report (2007) also emphasised the need to adopt a unified governance framework given that the rapid proliferation of Islamic finance industry has not been matched by development in the Islamic finance regulatory and supervisory architecture and infrastructure. Limited research on governance in Islamic financial institutions also provide the same avenue, Karim (2001) discussed the variations in Islamic banks regulations and its impact on accounting information provided. He raised the issue of what collaborative relationship could productively be established between specialized regulatory bodies in order to achieve harmonization of related regulations. Shanmugham and Perumal (2005) compared governance models in Malaysia, and Middle East and North African Region (Bahrain, Bangladesh, and Saudi Arabia), and described that those models were not sophisticated enough to meet every changing need of Islamic business dealings.

Furthermore, Ebrahim (2005) and Alhabshi (2005) using Malaysian settings concluded the need to standardize the products and operation of Islamic banks through promoting corporate governance practices. Within the context of agency structure in Islamic banks, Safieddine (2009), and Archer and Karim (2009) highlight conflicts between some agency mitigating mechanisms and Shariah law. He suggests an alternative model of governance practices that addresses the conventional and unique agency issues which appears to substitute achieve the dual purpose of safeguarding the interests of Investment Account Holders and preserving the principles of Shariah.

Hence, the literature concludes that a comprehensive Islamic corporate governance framework is required to encourage transparency and disclosure in decision making which is of paramount importance to investment account-holders against conflicts of interest because their funds are normally pooled together with those of shareholders. The governance structures of Islamic financial institutions are distinguished from conventional governance structures by the

addition of a Shariah advisory body. Playing its roles as in-house religious advisers who make up the Shariah supervisory or advisory board, their responsibility is to ensure that the institution's business practices and products conform to Islamic law, and to mitigate the institution's exposure to fiduciary and reputational risks related to Islamic standards of compliance.

c. Issues of Shariah Boards Performance

The Shariah Supervisory Boards (SSB) and audit activities are the key principles of corporate governance at IBF that ensure the constant surveillance and check-and-balance over their operations (Alwi, 2007). Governance Standards of AAOIFI (1999) and IFSB (2008) state that SSB is responsible to perform *ex ante* and *ex post* audit which enables it to justify to what extent Islamic banks' operations comply with Shariah principles. Central Bank of Indonesia governance guidelines for Islamic Banks (2010) emphasised and tried to define the role of SSB that does not differ with those of external auditors. SSB in each Islamic bank are required to monitor and confirm that the bank's transactions in structuring and developing product, as well as their daily operations are in conformity with the Islamic principles (Shariah). They required to do sampling and audit, reporting activities that could support their findings.

However, several findings exhibit the issues related to SSB performance. IBF have been suffering from a severe shortage of experienced Shariah scholars. According to Karim (1993) ideally both external auditor and Shariah adviser should be from one organizational body since Islam does not recognise any separation between business and religion. Nevertheless, due to lack of human resources this ideal situation has yet to be practised. Banaga (1994) also outlined from his case study of City Islamic Bank, that some misunderstanding and conflict between SSB and management have appeared, which caused a tense atmosphere, and then eventually resulted in a number of Shariah violations. The conditions affected the degree of monitoring which is carried out by SSB, as the role of external auditor has been extended to cover the Shariah compliance.

Rahim et al. (2002), Syafei (2002), and Hassan (2010) were surveying Islamic banks in Malaysia and Indonesia in the roles, functions and competency of SSB in Islamic banks. Those studies pointed out the need to enhance the responsibility, independence and the importance of continuous training and courses to enhance the competency of SSB in the middle of recent controversies surrounding their performance. SSB are constantly criticised for being lenient, hasty and incomprehensive in certifying new products because of lack of depth in the field of accounting and finance. In regards to those problems, Ghoul (2008) conducted a case study in Dubai Islamic Bank and Shariah Capital Company in USA, to examine the impact of scholar-related issues on corporate governance in IBF, and in the result of his research suggested developing an internal Shariah Audit Unit. This unit shall conduct internal Shariah audit as a part of internal

control system, as it would lighten the load of SSB, and standardization of Shariah interpretation to harmonize the process of Shariah compliance assurance in IBF.

d. The Issues with Audit and Shariah Compliance Assurance

Based on the practical issues of previous parts of the discussion, several attempts have been examining the problems. Simpson and Willings (1996) emphasised that one of the relevance of the Islamic banking industry's infancy highlighted by the continued lack of an internationally accepted framework of uniform and comprehensive accounting standards or auditing guidelines, and Shariah compliance assurance. He argued that the role of external auditors in the Islamic banks is seen to be complex due largely to the lack of experience of most external auditors on the Shariah principles. The establishment of rules and regulations would enhance the effectiveness of the banks and ensure its compliance to the Islamic principles.

Hameed et al. (2005), Ghoul and Karam (2007), and Ghoul (2011) suggested that IBF should have regular independent internal Shariah audits, to strengthen their confidence, as people are now experiencing a movement along a continuum from a society that trusts everything and audits nothing to a society that trusts nothing and audits everything. Sultan (Sultan, 2007) described that the concept of auditing should be extended to the development of a useful and comprehensive audit framework to ensure effectiveness of the goals of Shariah compliance in IFI activities relating to the system, products, employees, environment and the society. According to Rahman (2008), audit for Islamic financial institution's compliance toward Islamic principles, called Shariah audit, still needs an academic attempt to provide a comprehensive theoretical and practical framework.

Shariah auditing has a key importance, as there is a growing awareness among Islamic institutions that every institution should contribute towards achieving the objectives of the Islamic law or the *Maq'asid Ash-Shariah* (Hameed, et al., 2005). Therefore, there is a need to develop a useful Shariah audit framework to ensure effectiveness of the goals of Shariah compliance in IBF, which in turn can contribute positively to the *Ummah* (society) at large. Harahap (2003) stressed the importance of formulating a philosophical foundation of the auditing theory from Islamic perspective as he elaborated that the absence of a philosophical foundation would lead to the variation and lack of focus in the development of Islamic auditing as a discipline and in practice.

The need for consistency in pronouncements between the various Shariah Supervisory Committees (SSC) was highlighted by Grais and Pallegriani (2006), and Bhambra (2007), who in turn explained that Shariah non-compliance risk is clearly a major challenge, since Shariah is the cornerstone of Islamic financial products and services. If the customers find that the products that

they have in their portfolio are not Shariah compliant, this would seriously undermine the confidence in the Islamic financial services industry as a whole. Kasim et al., (2010; 2009) and Rahman (Rahman, 2008) were elaborated the need and responsibility of research to identify and implement a comprehensive and integrated Shariah auditing framework that will detail out policy guidance to conduct properly both the internal and the external Shariah audit, in order to cater for the ever-increasing number of IBF.

Limited studies in Shariah audit and compliance assurance practices provide a foundation for a highly required contribution in IBF industry. Grais and Pallegriani (2006) identify the issues and challenges of Shariah compliance process in the IBF on corporate governance. Their study focused on the limitations in relying to the Shariah compliance assurance to the internal party (i.e., Shariah Committee), and proposed the need of an effective framework to monitor and assess Shariah compliance. This finding is similar to the study conducted by Abdul Manan (2006), even though auditors are responsible for auditing the financial statement. External auditors should give reasonable assurance that the financial statement is free from material misstatement, but somehow they did not assess or audit whether the transaction made by Shariah listed company is free from unlawful transaction. Abdul Manan (2006) also proposed in his study that there should be a proper framework for the external auditor to audit the IBF.

Hameed (2005; 2014) contributes to the development of Shariah audit literature by exploring the perceptions of Accounting Academicians, Audit Practitioners and Shariah Scholars on the practice of Shariah Audit for Islamic Financial Institutions that highlights the importance of developing a proper governance of Shariah compliance issues. In addition to the previous research, Adawiah (2007) proposed a framework of Shariah Compliance Governance, which comprises some aspects and stages of process. The result shows that Shariah compliance in Malaysia are looking at only aspects of inception and conceptualisation of an Islamic product, structuring the rules and principles as according to Shariah, and legal documentation procedures. The audit review stage, the process is still not yet formulized at the regulatory level. Even though some banks might impose it at the internal department level such as Internal Audit department, but there is none of the independent party being appointed to audit the financial report of the Islamic financial institutions.

According to Adawiyah (2007), Shariah advisors shall also conduct and arrange Shariah training programs for the Islamic Banking staff especially the internal audit department to ensure the accuracy of financial reporting for Islamic instruments. Significantly, a strong Shariah infrastructure is essential to ensure that Islamic financial instruments and strategies are Shariah compliant. The other study, which is more comprehensive in identifying the issues and challenges

of Shariah audit, is done by Raman (2008). He argued that Shariah audit is needed to complement the current governance mechanism of Islamic financial services industry. Rahman (2008) also discussed in his paper some challenges that are considered as pre-requisites to undertake effective Shariah audit.

In regards to independency, Hudaib and Haniffa (2009) conducted research using discourse analysis. The result demonstrates that auditors of Islamic banks construct the meanings of independence in appearance and in fact through their social interactions at three levels: micro (personal self-reflexivity through ethical reasoning and reputation of individual auditor); meso (organisational culture through a range of commercial activities and image management) and macro (through political, de jure, and socio-economic structure). In the context of Saudi Arabia, the following need to be addressed: freedom of expression, adoption of Islamic ethical values, reflection of societal needs, tackling corruption, having competent judges and having a more independent and influential professional body (Hudaib & Haniffa, 2009).

Afterwards, Rammal & Parker (2010) conducted longitudinal case study of the Pakistani Islamic banking sector to investigate the issues of selection and training of Shariah advisors in Islamic financial institutions. The study reveals a limited pool of Shariah advisors who may be serving multiple Islamic financial institutions in contravention of government banking regulations, and creating conflict of interest situations. The study also discusses how the dual role of internal and external religious auditor performed by the Shariah advisors adds to the potential for conflict of interest in Islamic banks.

Besar et al. and (2009) and Wardhany and Arshad (2012) criticises the role of Shariah Board, the process of Shariah review, and the lack of transparency in disclosing Shariah compliance implementation in Malaysia, Indonesia and Brunei Darussalam. Both studies are based on published information from Islamic banks and local regulators, which in a sense very general in the analyses. Shafii et al. (2013) also presents similar finding that explore a lack of independence and competency of Shariah auditors. This research endorses human capital development in Islamic finance industry, and indicates a need to improve Shariah auditors' knowledge and qualification on Shariah and accounting. In the end, the research findings from the abovementioned studies have not really touched the main issues in the dynamic Shariah compliance definition, and implementation. The research inquirers who mostly conducted research based on publicly available data, missed to capture the complexity in balancing religious and profit objective has been increased due to human reflexivity, regulatory pressures and business demands.

D. Critics to the Religious Compliance Practices in Islamic Banking Industry

In a later development stage, scholars (DiVanna, et al., 2009; Hayat, et al., 2013; Maurer, 2003, 2005, 2010, 2012; Pitluck, 2012; Unal, 2011; Warde, 2010) who have different backgrounds compared Islamic finance research presenting their critique to IBF and Islamic banks in particular as a different form of investment alternative. They regard Islamic banks practices as ambiguous in much of their translation of the divine law (Shariah). It seems to be in conflict with societal expectations of IFI ethicality and philanthropic motivation (Maurer, 2012; Pitluck, 2012). Maurer (2012, p. 421) criticises IFI ethical financial and investment alternatives when he argues that it is 'patently ridiculous [to] infus[e] morality into money and finance'.

Maurer (2003) criticises the powerful and emotionally unsettling uncanniness in Islamic banking's ability to negotiate and compromise between alternative religious and dominant values in a strange blend of a capitalist and moral economy. Maurer (2003, 2005, 2012) explores a reflection of the way the uncanny works in concert with critical analyses of capitalism, when a transfer of revenue from non-Shariah compliant activities to a charitable fund becomes a purification method. The IFI reveals the transcendental in the failure of equivalence materialised in their social activity, where its actors perform as the play-within-a play of the capitalism game, in making change, providing alternatives or failing to do so, in giving *zakah* or seeking to avoid it (Maurer, 2003).

Scholarly works have identified the IBF's heavy reliant on the views of Shariah scholars in the seal of approval of compliance (Dranove & Jin, 2010; Hayat, et al., 2013; Lizzeri, 1999). In the course of interpretation most of the theological exegeses are based on personal judgment and bear a risk of certifier bias. The scholars' tacit knowlegde, independence, competence and effectiveness in scrutinising complex financial instruments become the main factors and challenges in interpreting and deciding an approval of contracts and financial products (El-Gamal, 2006, 2007; Hayat, et al., 2013; Rammal & Parker, 2010; Shanmugam & Zahari, 2009; Unal, 2011).

E. Conclusion

The discussion in this chapter has shown that there is an absence of a clear operational definition of what constitutes Shariah compliance. The literature has illustrated the impact of the lack of clear religious compliance guidance for banking operations and the uncertainty in the nature of religious (Shariah) infusion. The existing scholarly works also shows discrepancies, ambiguities and paradoxes in Shariah compliance interpretation, implementation and monitoring that are emerging in this understudied yet increasingly prevalent feature of the IFI governance

system. The review of the current literature warrants the objective of this study to empirically investigate how Islamic banks and Islamic banking industry dynamically redefine the sacred realms into the imminent material empirical character of contemporary finance.

Chapter 4 Theoretical Framework: A Sensitising Concept of Religious Compliance

A. Introduction

The discussion in this chapter is an extension of the literature review chapter which has shown how there is an absence of a clear operational definition of what constitutes Shariah compliance, and has illustrated the impact of the lack of clear religious compliance guidance for banking operations. For this reason, the central goals of this chapter are to draw attention to the religious (Shariah) compliance concept as an understudied yet increasingly prevalent feature in IBF audit and governance systems, and to offer a theoretical account of the boundaries of compliance in the sacred realms and how IBF dynamically redefines it in the material empirical context of contemporary finance. This chapter presents the concept of compliance within the context of Islamic law, which mixes the religious and societal concept of compliance, and sets out to contribute to the development of an understanding of the nature of Shariah compliance and analyse whether or not there is a way to resolve the lack of consensus and consistency in the criteria of compliance. A parallel is drawn to Giddens' consciousness concept in order to explain the dynamics of the concept of compliance from both a religious and socioeconomic perspective.

The structure of this chapter consists of several parts. Firstly, the need for a formal tool to analyse religious compliance in the IBF context is explored in order to illustrate that such a tool is needed to understand and analyse Shariah compliance at societal, institutional and individual levels. Secondly, the duality of compliance from the religious perspective is examined in order to show the duality of compliance from the perspective of Islam and other religions and to conclude the need for a framework to be set up to provide a sensitizing concept which aids understanding of the nature and dynamics of religious compliance. Next, the basis for the setting up of a framework for developing a sensitizing concept to understand Shariah compliance is presented and elaborated on. Finally, a perspective on the theoretical and practical implications of the research is given and the particular focus of this research study conveyed.

B. The Need for a Formal Tool to Analyse Religious Compliance

The two previous chapters illustrated how there was an absence of a coherent concept of Shariah compliance across the Islamic banking industry. Therefore, the search for a sensitizing concept of religious compliance is deemed important for Islamic banking institutions. The objective of this research was thus to examine the Islamic banking industry's implementation of the religious compliance concept as well as explore the issues of infusion and enactment of

religious compliance principles within their operation. In line with the research objective, a clearly realised and articulated concept and a tool for understanding religious compliance is very much needed for this research.

From a research methodology perspective, Bryman (2012) emphasises the importance of concepts as part of the landscape of qualitative research. In addition, from the Islamic finance industry perspective, the absence of a codified concept brings another layer of complexity to its operational level. In response to the lack of a definite concept of religious compliance, this chapter offers a sensitizing concept of Shariah compliance to 'provide a general sense of reference and guidance in approaching empirical instances' .

C. Religion and the Duality of Compliance

It is in this manner that religion enforces a natural sense of duty: and hence it is, that mankind are generally disposed to place great confidence in the probity of those who seem deeply impressed with religious sentiments. Such persons, they act under an additional tie, besides those which regulate the conduct of other men. (Adam Smith, 1790, p. 158)

Adam Smith (1790, pp. 151-152) explores the nature of men who have religious sentiments, where their actions are observed by a God who is an all-powerful being. With a natural sense of duty, human conduct is regulated by religious law which, in return, promises certain rewards and punishments guided by sacred rules. Religious law provides an additional tie besides human rules and regulations. It asks the religious man to fulfil the natural duty of religion in terms of an obligation to the morality of the following two precepts - to love God with all his heart and to love human beings as much as he loves himself.

Adam Smith's (1790, pp. 212 - 216) assertion concerning the relationship of human beings and God and their fellow men, reflects the shape of human motives in the practice of virtue guided by the Law of the Infinite Power and the rules of mankind. For religious man, the principle of conduct governing their life is based on these two directives. In the light of understanding religious compliance in the IBF context, the concept of compliance from a religious perspective is explored. It is thus important to draw upon the fundamental roots of Islamic beliefs and values that uphold IBF's institutional arrangement in implementing Shariah compliance. In addition, other religions' understanding of compliance is investigated in an effort to shed light on the concept of religious compliance in the IBF institutional environment.

a. The Nature of Islam

Islam, as a religion, is seen as a blessing for humankind that is made manifest in The Qur'an, the book of guidance for all people through God's last Messenger, Muhammad. Diwany et

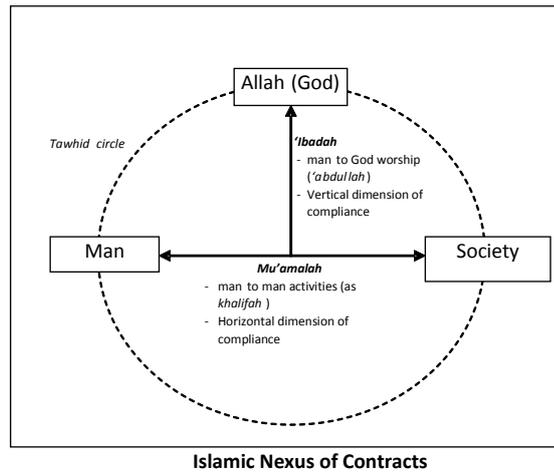
al. (2010) have described The Qur'an as the source of Divine Knowledge and an illustration of the lifestyle, daily religious practices, acts and behaviours of the Prophet Muhammad (*Sunnah*) - the Qur'an and *Sunnah* have thus become the source of religious codes. Islam provides guidance through the Qur'an and *Sunnah*, which are divided into three foundations within their religious codes - namely, the Code of Faith (*'Aqidah*), Code of Practice (Shariah), and Code of Ethics (*Akhlaq*). These three elements of religious codes provide guidance for life: the Code of Faith (*'Aqidah*) governs the principles of faith and belief in Islam; the Code of Ethics (*Akhlaq*) defines the Islamic ethical and moral code at a personal level. The Code of Practice (Shariah), which literally translates as 'path to a fount', is treated as being synonymous with the Law (*Ahkam*) and governs all forms of practical action (i.e., ethics and the compliance approach to faith are directly connected). It includes both the law that governs man's worship of God, which pertains to devotional matters (*'ibadah*), and the law that relates to man's acts in terms of political, economic and social spheres of behaviour (*mu`amalat*). Shariah, as a law, is considered enforceable in both of these areas. The ethical issues in IBF discussed in this chapter fall within the Code of Practice (Shariah).

According to Al Ghazali (F. Karim, 1993), Shariah as a means of law seeks to improve the welfare of individuals in society, and compliance with this law will benefit people, not only in this world but also in the hereafter. The 'life hereafter' is part of the cycle of life, within which all humankind will be responsible for their actions, go through the final judgement, and receive reward or punishment accordingly. The significance of this axiom therefore requires compliance with the rules of conduct, and for one to do a continuous check and re-evaluation of one's life system in order to earn the reward of the hereafter. Umar ibn al-Khattab, one of the Prophet's companions, in one of his famous sayings said: 'Judge yourselves before you are judged, evaluate yourselves before you are evaluated and be ready for the greatest investigation (the Day of Judgement)'. Hence, individuals need to check, evaluate, and investigate their own lifestyle and level of compliance with Shariah, in preparation for the real 'ultimate judgement of compliance'.

b. The Concept of Duality of Compliance in Islam

In Islam, the individual agrees to observe the rules of Shariah in both their private and public affairs (Iqbal & Mirakhor, 2007). The acceptance of Islam represents a contract between the individual and the Creator. Based on this contract, the model of Man in the Islamic perspective has what is known as a *duality of functions*. In the first function, the relationship between Man and God (*Allah*) is that of "the servant and the served" (*abdullah*). Personal behaviour should be in accordance with the commands of God. Compliance to the Highest Authority ought to be evidenced by behaviour in society.

Figure 4.1 Duality of Compliance
 Source Diwany et al., 2010, Iqbal and Mirakhor, 2007



In the second function, Man is designated as the vicegerent (*khalifah*) of God on earth. *Khalifah* means someone who takes the place of another in his absence or is an agent of the absolute owner (Asvat, 2011, p. 18). Humans are seen as unique and privileged beings who have received the potential to develop God-like qualities. In the concept of trust (*amanah*), the aim of God is to initiate the rule of *khalifah* on earth to preserve social order and assure the prosperity of His creations. The Islamic nexus of contracts in the Figure 1 above shows the key concept of *duality of compliance* links the relationship between God as the Creator, human beings, and the wider society, within the duality of man's functions. In Man and God's relationship as *abdullah*, personal devotion to the Creator is required, and is reflected in worship participation.

The concept of duality of compliance is reflected in Figure 1 above. The honouring of God (*ibadah*) as ritual and devotional activity which reflects the strength of religious belief is shown by the *vertical dimension of compliance* line. Scholars suggest that the strength of personal religious and ideological compliance will influence personal compliance with societal rules and regulations (Fukuyama, 2010; Iqbal & Mirakhor, 2007; Yagil & Rattner, 2002). In this case, religious law provides structure and significations that define individual roles and activities, and thus one would be expected to eventually produce compliance behaviour. The strength of the vertical dimension of compliance is expected to persuade individuals to have an expectation of morality to perform within the line of the *horizontal dimension of compliance*, which is reflected by compliance to the rules and regulations at the societal level. A reflection of the role of *khalifah* is when religiously based compliance ideology may infuse actors with an aura of justice and potentially mobilize actors to comply with institutional norms and channel their behaviour in the direction of fulfilling institutional goals (Wilson, 1992).

c. Duality of Compliance in Other Religions

From the perspective of Christianity, Pryor Jr. (2003, 2008) explains that it becomes a moral duty for a man to obey both the religious law and any lawful authority. In Judaism, sheer compliance with the law is the vehicle through which man fulfils his life's objectives, actualises himself, and exercises his responsibility to the Creator (Bulka, 1973). In a broader perspective, Fukuyama (2010) explains that in society, the rule of law first originated from, and was dominated by, a transcendental religion. The first laws that rulers had to respect were religious ones. These included shared rules of justice which were all recognized in their respective societies and derived from the Hebrew Bible and Talmud, the Roman Twelve Tables, the early Church decretals and canons, the Sunnah and hadith in Islam, and the Vedas and shastras in Hinduism. In each society and influenced by various religions, rulers explicitly recognized a duty to live under the religiously defined law (Fukuyama, 2010).

Pryor Jr. (2008) suggested that in the Christian perspective, the dual dimension of compliance is clearly explained. The New Testament illuminates the Christian duty to both obey government and its law and also be obedient to God. Saint Matthew's Gospel explicates Jesus' provocative lesson about the moral duty to obey government: "Then render to Caesar the things that are Caesar's; and to God the things that are God's."³ In the same vein, the Apostle Paul, in his Epistle to the Romans, taught that "Every person is to be in subjection to the governing authorities. For there is no authority except from God, and those which exist are established by God."⁴ Additionally, Peter, in his first Epistle, wrote: 'Submit yourselves for the Lord's sake to every human institution, whether it to be the king as supreme or to governors as sent by him for the punishment of evildoers and the approval for those who do good.'⁵

This has parallels with Max Weber's view that legal-rational authority is empowered by a formalised belief in the content of the law. Weber highlighted that obedience is not given to a specific individual leader, but to a set of uniform principles (Coser, 1971; Williams, 2003). Wilson (1992) regards beliefs as compliance ideology that may be in the form of kinship terms, religious tenets, societal codes, or as a comprehensive ideology for a multifaceted secular state. Belief refers to the existence of a common values system within a society. With this variation, which reflects the degree of attachment to systems representing the beliefs in question (Hirschi, 1969; Welch, 1998), individuals vary in the depth and magnitude of their belief.

³ Matthew 22:21 (New American Bible) November 11, 2002 United States Conference of Catholic Bishops

⁴ Romans 13:1 (New American Bible) November 11, 2002 United States Conference of Catholic Bishops

⁵ 1 Peter 2:13-14 (New American Bible) November 11, 2002 United States Conference of Catholic Bishops

Moreover, several studies on the role of religion in generating compliance with the law (Grasmick et al., 1993; Tittle & Welch, 1983) show that religious belief may have potent effects on compliance with the law. In the ideal form of IBF, Islamic law (Shariah) as virtual rules provides control of exemplary conduct to ensure that the additional tie of religious ethics and morality is embedded into institutional governance systems. Indeed, it is interesting to explore how religious tenets give values meaning in an organisational context when 'ought' reflected in the vertical dimension of compliance is intermingled with 'is' within the horizontal dimension of compliance, and how this creates dynamic in the practice of IBF operation.

D. Setting up a Framework for a Sensitising Concept: Using Giddens' Consciousness Concept

In the absence of a coherent concept of Shariah compliance, the search for a sensitizing concept of religious compliance is important. The sensitizing concept developed here utilises the nature of the compliance concept from an Islamic perspective and in an IBF context, and Giddens' boundaries of consciousness (Giddens, 1986). The normative rules of Islamic law create a dual sense of compliance in both the spiritual and societal dimensions. Religious order as a medium to define conduct which is in accord with the ideal letter of the law, whilst simultaneously requiring actors to organise self-reflexive phenomenon, is described by Giddens as follows:

Human social activities like some self-reproducing items in nature are recursive. That is to say, they are not brought into being by social actors but continually recreated by them via the very means whereby they express themselves as actors. In and through their activities agents reproduce the conditions that make these activities possible. (Giddens, 1986, p. 2)

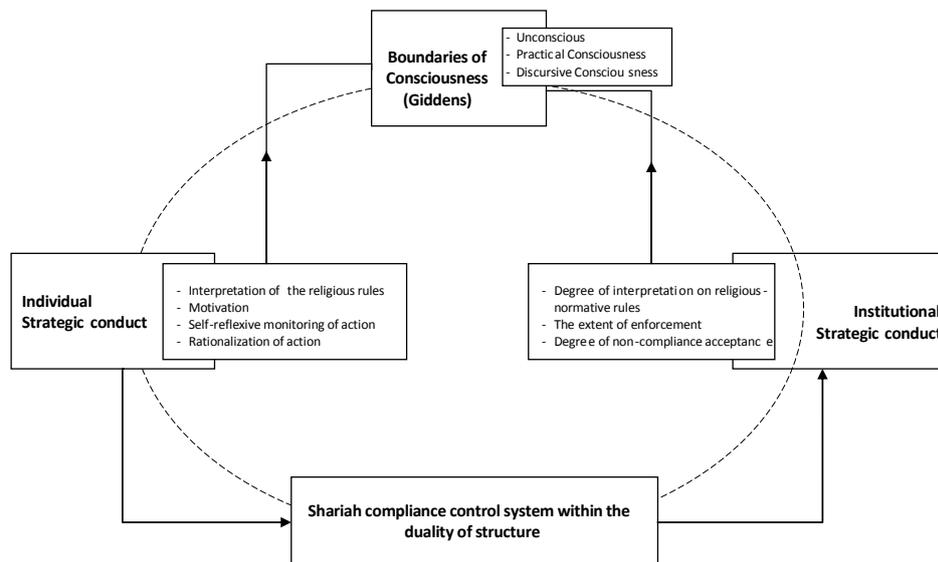
Linking back to IBF, normative rules within Shariah are intended to stabilize the structure of compliance behaviour. However, for many reasons regulators have left religious compliance under IBF's institutional discretion. Thus, the level of enforcement of Shariah compliance is endogenous. In a sense, IBF's reflexivity in compliance behaviour lies within a continuum of an expected cost linked to institutional legitimacy and pressures, and the extent of the accepted level of non-compliance. Giddens (1986, p. 3) asserts that 'human action occurs as a *durée*, a continues flow of conduct, as does cognition.' IBF compliance action is composed of an aggregate of actors and institutional intentions, reasons and motives.

Thus, Shariah compliance monitoring is a product of processes by which social actors together negotiate the meaning of action and situations in translating relevant Shariah principles (Crotty, 1998, p. 11). The interpretation and infusion of theological principles into a commercial context are rooted in a process of *ijtihad*, which refers to individual interpretation of the Qur'an

and *Sunnah* (Prophet Muhammad behaviours and life stories) as the primary sources of law based on acceptable hermeneutic techniques (Diwany, 2010; Iqbal & Mirakhor, 2007; Maurer, 2005).

Ijtihad is exercised through the consensus of the scholarly Muslim community (*ijma*), reasoning by analogy (*qiyas*), judicial preference (*istihsan*), public interest (*maslaha*), and custom (*urf*). *Ijma* is the most acceptable reference in Islamic jurisprudence. The interpretation of Islamic law is a form of an entanglement of both individual and institutional perspectives in introducing rulings for new cases. In order to arrive at a consensus (*ijma*), an individual scholar's interpretations (*ijtihad*) are brought to a group of scholars for in-depth discussion and debate on the authenticity of texts, their meaning and their implications, in order to achieve an agreement of a certain institutionally based Shariah opinion (*fatwa*).

Figure 4.2 Dual Analysis Using Giddens' Boundaries of Consciousness
Sources: (Giddens, 1986; Mahoney & Thelen, 2010)



In the IBF context, Islamic law (Shariah), as an endogenous rule, underlies its operation and has a similar process of interpretation, as represented in Figure 4.2 above. IBF relies on Shariah scholars to interpret sacred rules and infuse them into modern financial instruments. To legitimately offer a financial alternative, IBF needs religious rule pronouncements from the board of scholars, which are composed of individual scholars' interpretations of Shariah. In many cases, the most prominent scholar on the board drives the nature of religious compliance decisions (Unal, 2011). In this case, the individual in-house scholar defines the institutional strategic conduct as it relates to religious compliance principles. Thus, it is important to take into account this dual strategic conduct in proposing a sensitizing concept for IBF's religious compliance.

It is difficult to separate IBF's religious compliance from the dynamics of shareholders' motivation, regulatory control, and other external pressures (DiVanna, et al., 2009; Warde, 2010).

Mahoney and Thelen (2010) regard compliance as a dynamic which continuously evolves in response to complex real world situations. To interpret sacred rules and embed them in modern financial instruments through reliance on Shariah scholars' tacit knowledge is an inherently complex and exigent process. IBF might engage in new rules creation or creative extensions of existing rules in the banking environment.

Islamic law itself is often only implicit and this characteristic follows through into its translation into IBF institutional rules. The result is interpretation which may shift over time. The ambiguous religious rules allow for more space to construct meanings of individual and organizational compliance which correspond to environmental demands and managerial interests (Edelman, 1992; Knight, 1992; Mahoney & Thelen, 2010). This then creates ambiguity of institutional rules which opens the degree of non-compliance acceptance.

Due to lack of consensus on the religious rules, rules ambiguity in IBF is evident at three levels: regulatory, institutional, and actor; this will be addressed in the proposed sensitizing concept. In line with Mahoney and Thelen (2010), IBF interpretation of Shariah compliance depends on the politically contested nature of institutional rules, the degree of openness in interpretation, and the extent of rules implementation. Considering the nature of the dual dimension of compliance in the IBF context, and the reflexive process of IBF monitoring of actions, similar to Giddens' view, the context of religious compliance is dynamic and dependent on the boundaries of social agents' and institutional consciousness.

E. Giddens Consciousness Concept

Giddens (1986, p. 3) describes consciousness as human' sensibility to 'register a range of surrounding stimuli'. Human is a knowledgeable and reflexive being, which continuously 'lose and regain consciousnesses. It refers to human's reflexive monitoring of his own conducts, or continuously monitored by others. Giddens (1986, p. 3) describes his view that 'human action occurs as a *durée*, a continuous flow of conduct, as does cognition', consciousness is an enduring and continuous conducts. It relates to human's reflexivity, due to dynamic in their intention, motives, and reasons.

Giddens explains consciousness as ranging from a discursive to a practical and up to an unconscious level. Giddens explores the level of consciousness in actors' reflexive monitoring of their own conduct and that of others. At the discursive consciousness level, actors signify a capacity to 'give reason' and 'rationalize' their conduct, whilst at a practical consciousness level, 'agents' stocks of unarticulated knowledge' enrich them to orient certain rules based activities, and to interpret the acts of others (Giddens, 1986; Turner, 1986). Additionally, unconscious at the

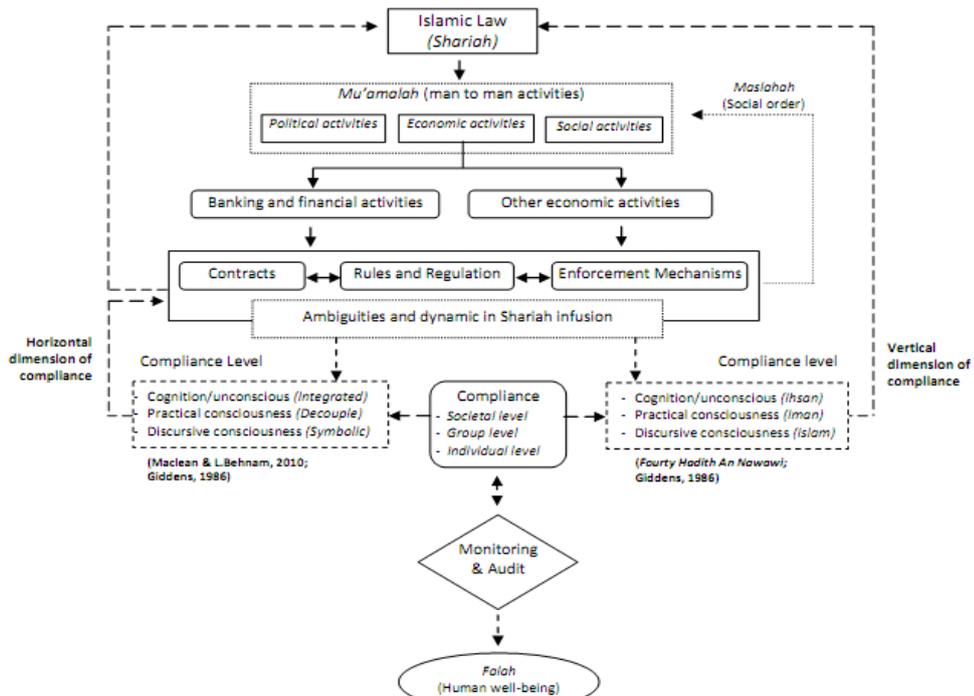
highest level refers to actors being able 'to register a range of surrounding stimuli' and being sensible enough to 'give a coherent account of their activity and the reasons for them'(Giddens, 1986, p. 45).

Giddens (1986, p. 7) argues that the division between discursive and practical consciousness can be altered by 'many aspects of the agent's socialization and learning experiences'. The difference in these two consciousnesses lies in 'what can be said and what is characteristically simply done'. In the context of IBF, enactment of religious rules might be symbolic to some extent or decoupled in a more formal monitoring. At the highest level, the unconsciousness level of compliance, IBF represents an enactment of Islamic law as virtual rules in the sense of what Giddens regards as an inherent memory.

F. A Sensitizing Concept of Religious Compliance

The Islamic nexus of contracts suggests that the Divine Law directly affects the relationship between the Creator, Man and Society, and provides guidance for social, political, economic, and financial systems (Iqbal & Mirakhor, 2007). Asutay (2007, 2012) argues that IBF's ethical norms and values derived from Islamic ontology are fully integrated with its economic motives, to create productive and ethical economic activities.

Figure 4.3 A Sensitising Concept of Religious Compliance
Sources: (Diwany, 2010; Giddens, 1986; Iqbal & Mirakhor, 2007)



This reflects the fact that the concept of the dual dimensions of compliance, economic activities and institutions cannot be separated from the rules of the Divine Law (Shariah). In Figure 4 above, finance and banking activities are classed as economic activities and hence fall under Shariah law. Figure 4 also shows that the law embraces both individual and institutional spheres as religious norms create both rights and obligations associated with compliance to the Islamic principles.

a. Religious Law within the Institutional Dynamic

Religious law provides ‘a unified view of the life attained by a consciously integrated meaningful attitude toward life’ (Weber, Roth, & Wittich, 1978, p. 450). IBF’s economic activities offer banking and financial services developed out of a religious imperative to provide alternative financial services in keeping with the principles and teaching of Islam (Chapra & Ahmed, 2002; Iqbal & Mirakhor, 2007). In line with the duality concept of compliance, Islamic law (Shariah) provides guidance for human interrelationship activities, in addition to its main facet on activities linked to faith in, and submission to, God.

The contracts, rules, regulations, and procedures ought to represent IBF submission to the Divine Law, which in turn creates an expectation for IBF to promote social welfare (*maslahah*) in society. In a more institutionalized form, however, IFI investment alternatives seem ambiguous in much of their translation of the Divine Law (Shariah) as well as seeming to be in conflict with society’s expectations IBF’s ethicality and philanthropic motivation (Maurer, 2012; Pitluck, 2012). In practice, the sacred rules are not static, and are interpreted in ways that reflect divergent individual, institutional, and regulatory interests and demands.

Kuran (1986) criticizes the effectiveness of Islamic norms because of the ambiguities of interpretation. Knight (1992) suggests that the formalization of rules will resolve the conflict linked to ambiguity of rules. In contrast, Mahoney and Thelen (2010, p. 11) found ambiguity as a more permanent feature as a result of actors’ conflicting interests, and the degree of interpretation and implementation at the institutional level.

b. IBF’s Religious Rules: Ambiguities Drifted Down

The religious imperative creates the need for IBF’s existence, and thus Shariah serves as IBF’s implicit rules. Despite the importance of religious legitimacy for IBF, this suggests that religious rules are endogenous and lack binding power. IBF can legitimise their position and ambiguities could potentially be reduced if more formalised, explicit rules are introduced. In this case, regulators, both at international and national levels, play an important role in assisting the Islamic banking industry to interpret the religious compliance principles. It might promote IBF

coherent conduct to unconsciously enact the religious rules in its operational activities. However, regulatory appetite and the related infrastructure linked to Shariah implementation seems to be wide ranging, even in predominantly Muslim countries, as evidenced in Table 4.1 below.

Table 4.1 Divergent Shariah Regulatory Framework
Sources: Guidelines/Standards of AAOIFI, IFSB, Central Bank of Bahrain, State Bank of Pakistan, Bank Negara Malaysia, and Bank Indonesia

	Oman	Bahrain	Pakistan	Malaysia	Indonesia
<i>Shariah</i> Supervisory Board (SSB)	Bank level	Bank level	Two tier	Two tier	Two tier
Binding Power of International standards (AAOIFI)	Mandatory	Mandatory	None	None	None
Comply with or Explain Report on overall regulatory requirement	None	Mandatory	Mandatory	None	None
Specific shariah compliance report	None	None	Mandatory	Mandatory	Mandatory
Legal sanction for non-Shariah compliance	None	None	None	Legal fine & imprisonment	None
Rectification plan of Shariah non-compliance events	None	None	None	Within a month	None

In some countries with larger numbers of IBF institutions, which includes Pakistan, Malaysia, and Indonesia, the regulatory infrastructure is more mature compared to other Islamic countries shown in Table 4.1 above. As the regulatory rules are more formalized in these countries, specific Shariah compliance reports are deemed mandatory. These three countries have a two tier Shariah governance framework (Muneeza & Hassan, 2013). The religious authorities linked to IBF are available at both national and bank level, reflecting the role and independence of Shariah scholars. The national board sets general religious guidance for the Islamic banking industry, whilst the in-house board of scholars produces religious pronouncements at the operational level.

This is not a novel criticism; concerns about financial institutions' Sharia compliance being determined and audited by scholars that they choose have been voiced for years. However, it has not generally received quite this level of direct attention... which is a difficult change to make for an industry that has for many years relied on a relatively hands-off approach to regulating Sharia governance...(Interview with Kuwait's Central Bank's Governor - Mohammad al-Hashel - Thomson Reuters - reported by Goud, 2014)

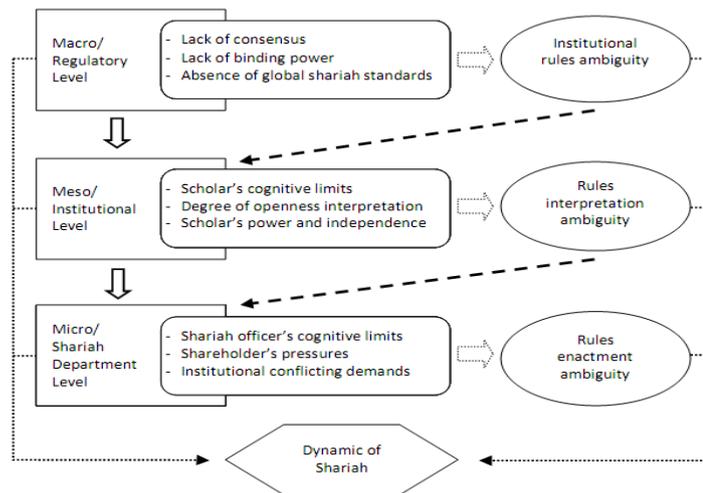
The above quote represents self regulatory approach and the lack of codification of the sacred rules due to the absence of globally accepted religious rules. There is no clear enforcement of the existing standards and guidelines. Such a characteristic of IBF's regulation adds to the complexity, and creates *institutional rules ambiguity*. The needs of an IBF institution to legitimise its credibility and integrity as an ethical and religious based financial services provider might differ with another similar institution due to the extent of the enforcement mechanism.

Rather than sticking to our traditional principles, so many participants in this industry see Shariah as an obstacle to be overcome, as something for which a workaround is needed.

Where's the intellectual substance in that? (Interview with Ethical Finance Practitioner - Tarek El Diwany - Financial Times - reported by Wigglesworth, 2014)

The ambiguities in IBF are evident and unresolved even at the regulatory level, and have subsequently drifted down into the institutional and actors' levels, as represented in Figure 4.4 below. Accordingly, the unresolved ambiguity coupled with low exogenous pressure creates a grey area. It leaves some room between the rules and IBF institutional understanding and interpretation, and a gap between rules and enforcement which has drifted down into the institutional and actors' levels. At the institutional level, the gap allows for different interpretations, which Mahoney and Thelen (2010) regard as *conversion*, where IBF has an opportunity for discretion in enforcement, in line with Diwany's criticism above.

Figure 4.4 Ambiguities and Dynamics of Shariah Infusion in IBF
Sources: DiVanna et al. (2009); Hayat et al. (2013); Mahoney and Thelen (2010); Warde (2010)



The economic and social interactions between IBF and investment account holders are reshaped through transactions that are facilitated by explicit and implicit contracts within a specific institutional setting with specific objectives (Iqbal & Mirakhor, 2007). To achieve a specified objective, SSB's pronouncements have served as interpretations of the religious rules at the institutional level, which regulate IBF financial instruments and contracts.

IBF religious interpretations and approval of contracts and financial products are heavily reliant on scholars' cognitive limits, competence and effectiveness in scrutinizing complex financial instruments (El-Gamal, 2006, 2007; Hayat, et al., 2013; Unal, 2011). Besides, the effectiveness of the Shariah board's governance is somehow questionable, since some of the highly ranked scholars tend to concentrate on several boards, at both the regulatory and institutional level, at the same time. Thus, there is a divergent degree of openness of

interpretation intermingled with the extent of SSB power, which tends to create the *rules interpretation ambiguity* at the IBF level.

This fatwa pluralism can create ambiguity in decisions on the consistency of a transaction in terms of its compliance with Shariah law. Furthermore, how the scholars operate, how they are chosen by the institutions they work for and how sympathetic they are to these institutions are open questions. (Kan, 2012)

Unal (2011) and Hayat et al. (2013) criticize the closed circle of the top 20 scholars who dominate half of the industry, which in turn places a big question mark on the scholars' quality and effectiveness in terms of compliance assessment. Hayat (2013) emphasises how the process of compliance certification has a high transaction cost. From the operational perspective, compliance approval should be performed on a day-to-day basis. Therefore, in all countries listed in Table 4.1 above, regulators require banks to employ a Shariah Compliance Officer (SCO) in their governance structure, as an independent, extended structure of the SSB. In practice, however, most assessment tends to be undertaken by this officer at the individual actor level, with the SSB left to make final approval. In this case, the rules interpretation ambiguity at the IBF level then drifts into the actor's level.

The SCO is essentially employed for the function of daily review of religious compliance. He also essentially replaces SSB roles in the main process of religious compliance certification on the bank's products. From a wider perspective, the SCO function as a certifier of religious compliance is a form of cost reductions for IBF. In most Islamic banks, the SCO has another two functions in product development and has a role as an internal member of the SSB. This then creates room for criticism of his independence, competence and the effectiveness of the Shariah governance structure. In this case, someone who develops the products will, accordingly, be responsible for reviewing and reporting the products' compliance. Moreover, in most cases, the SCO's commitment to enact the Shariah requirement meets the conflicting institutional demands. The SCO therefore includes consideration of the shareholders' economic agenda and efficiency criteria. The SCO's role as a frontier line of independence reviewer clashes with his function in the IBF managerial structure, and results in the *rules enactment ambiguity*.

The infusion of Islamic law in the IBF environment is ambiguous and drifts into the institutional and actor levels. The institutional rules ambiguity, rules interpretation and enactment ambiguities create room for agency and creativity. With the inexistence of codified rules, coupled with conflicting demands, inconsistencies of Shariah compliance implementation become evident. Actors and institutions exploit the endogenous rules in line with the degree of openness in interpretation of the rules; this, in turn, then shapes the compliance according to their preferred direction.

c. Religious Compliance Level: A Product of IBF's Dynamic Process

From an Islamic perspective, the achievement of IBF ideally takes the form of social order through the fulfilment of the Divine Law within their banking operation. It is envisaged that it seems impossible to resolve the inconsistency of Shariah compliance definition, interpretation and implementation. Religious compliance behaviour subsequently is a dynamic process in the middle of rationalization of power and authority allocation. IBF needs to demonstrate the extent of compliance in order to legitimize religious compliance fulfilment. Drawing a parallel to Giddens' consciousness concept, the compliance levels, both in the religious and the societal dimension is a product of the dynamic process of socially constructed reflexive conduct, as represented in Figure 4.3 (p.72).

The three levels of compliance elucidated how the dynamic process of compliance enactment in both religious and societal level. The religious levels of compliance (*iman, Islam, and ihsan*) represent the individual efforts to accept and behave within the boundaries of compliance in religious perspective. At the societal level, the three levels of compliance (symbolic, integrated, and decoupled compliance) featuring the dynamic behaviour of organisation, including IBF, to and work within and redefine the sacred realms into the material empirical context of contemporary finance.

In line with Giddens' (1986, p. 3) as does cognition, human behaviour is dynamically changes due to the changes of his motives, reasons, and intentions. In the end, the consciousness level is similar to human sensibility to create a dynamic of continuous compliance behaviour. Resembling Giddens' consciousness levels, the compliance levels in religious and societal perspective is a product of the religious and societal rules enactment process. In the case of IBF, the institutional objectives, business demands, and shareholders motives and intentions played an important factor in the reflexive Shariah compliance enactment process. The dynamic attitude of Shariah compliance in IBF is represented as the different range of IBF's practices to maintain its products and services, and its operational activities to conform to the religious principles. As consequence, the level of compliance to Islamic law is dynamic depending upon those impacted factors.

By borrowing the notion of 'consciousness level' explained by Giddens (1986), the three levels of compliance explained in Figure 4.3 were reproduced to show both compliance in the *religiously vertical* and the *socially horizontal dimension*. Table 4.3 below shows how this level of compliance or obedience to law is devoted to acceptance of the discourse of the rules of order. Giddens defines the lowest level of compliance as *discursive consciousness*, which refers to 'articulateness' in accepting certain standards of conduct in light of a coherent reason. This is

parallel to the level of *Islam* in the Islamic perspective. *Islam* or *taslim* in the Islamic perspective means ‘to surrender’ or ‘to be saved’.

Table 4.2 Compliance Level Parallel to Giddens’ Consciousness Concept

Dimension	Giddens	Socioeconomic / Institutional	Religious / Individual
Compliance Level	Discursive consciousness	Symbolic compliance	Symbolic compliance (<i>Islam</i>): accepting the Divine Law
	Practical Consciousness	Decoupled	Decoupling (<i>iman</i>): Practically implementing the Divine Law
	Unconscious	Integrated Compliance	Integrated Compliance (<i>ihsan</i>): unconsciously complied to the Divine Law

The second level is *practical consciousness*, which Giddens regards as the reflexive monitoring of human conduct. This level is parallel to *iman* in the religious context and represents compliance at a higher level than acceptance, since it is followed by practicing or implementing the rules of conduct. In a sense, *Iman* in each human being is reflexive, as it could be strengthened in a certain condition or decreased in different circumstances. The degree of *Iman* is forever fluctuating, and is represented by any good or bad deed performed by human beings at different point of times.

Furthermore, the highest level of compliance is *cognition* or *ihsan*, which means unconsciously complying with the Divine Law, as compliance is embedded in the power of faith. Giddens (1986, p. 44) describes cognition as thus: ‘...to register a range of surrounding stimuli and there is nothing reflexive about consciousness understood in this way. It means that at this level people will comply with the religious guidance without reserve, and act as if seen by God in all aspects of life’.

In the *socially horizontal dimension*, compliance programs represent collective actions to help economic institutions to gain or maintain legitimacy and deter misconduct (Maclean & L.Behnam, 2010). Referring to Giddens’ notion of consciousness, at the *discursive consciousness level*, compliance will be translated into *symbolic compliance programs*. At this level, a compliance program can be formally announced and, without actually being implemented, is designed to help the organizations maintain or gain legitimacy from external audiences (Maclean & L.Behnam, 2010).

Moving to the next level, a *decoupled compliance program* is represented by the notion of *practical consciousness*. At this level, economic institutions try to gain legitimacy from the external environment by creating visible, largely symbolic, compliance programs that signal fulfilment of legal requirements while simultaneously decoupling those structures from core processes (Maclean & L.Behnam, 2010). At the highest level, an *integrated compliance program* is

designed to be a means of institutions' *cognition* of compliance. At this level, compliance programs aim at creating integration of crucial elements of the compliance program into the day-to-day, central, task-related processes of the organization.

Hence, in the *horizontal dimension of compliance*, the power of compliance could be enforced through a *societal or juridical level*, where authoritative law and regulation establish principles of action. This may be difficult, however, because compliance may only be enforced at the *group or individual organisational level*. In the context of Islamic financial institutions (IFI), compliance to Islamic Law (Shariah) is the cornerstone of their operations. Reinhart (1983, p. 199) maintains that Islamic law stands as a significant example of moral and legal theory of human behaviour in which initial moral insight is systematically and self-consciously transformed into enforceable guidelines and attractive ideals for all human life. In the practical context of IBF, however, moral rules are difficult to define.

Relying on 'permissibility' as the basic principle for commercial transaction makes it much more complicated to observe the moral rules. IBF signifies that all contracts and transactions are regarded as permissible unless there is a clear injunction of prohibition (Kamali, 2008), which is highly related to all legal formal requirements. Societal expectation upon IBF to comply with certain moral and ethical norms and desire to be philanthropic is left to IBF discretion.

d. Monitoring and Audit of Religious Compliance

Shariah law has the ultimate objective of bringing about human well-being, as represented in the last part of Figure 4.3 (p72). Linking back to IBF as an economic institution with their banking and financial activities based on the Divine law, hence fostering society's well-being, eventually becomes part of their institutional objective. In this case, the role of the audit of compliance to the religious law from the institutional perspective is merely a tool for checking the fulfilment of all legal requirements. From a wider perspective, an audit of religious compliance in IBF serves as a balancing mechanism in checking and monitoring the dynamic compliance implementation.

Such an assurance program, if properly in place, would be a compliance defence system, and would bring about reference to a rectification program to stabilize the dynamic of compliance attitude, which in the end guides IBF to be congruent with its ideals. However, criticism of IBF's Shariah governance effectiveness, the ambiguities in the interpretation of religious principles, and a lack of monitoring of Shariah compliance is escalating. It encourages scholars to refer back to the successful history of the *Hisbah* institution of the medieval Islamic state (Kasim, et al., 2009; Muneeza & Hassan, 2013; Rahman, 2008, 2011). The *Muhtasib* (the auditor of a *Hisbah*

institution) performed dual checking within the two dimensions of compliance in the Islamic perspective.

The duty of a *Muhtasib* is to perform an audit and engage in supervision of the religious, economic, and social affairs of Muslim life. *Hisbah* literally means accountability or reward (Dogawara, 2011). The *Hisbah* institution plays an important role in maintaining proper conduct, and consistency with Islamic law, in social, economic, and political spheres. Within the *Hisbah* institution, a *Muhtasib* or a person appointed to oversee compliance at both the religious and social level has the function of supervising activities and transactions from three angles (Kahf, 2000). These will include religious and ethical control, economic and market stability control, and also control of environmental and social balance.

The focus on audit and control demands and expectations is a way to ensure religious legal standards are being met in the IBF environment. However, with a lack of consensus on Shariah compliance criteria, the industry is trapped within the battle of defining religious parameters. IBF has been trapped into legally based compliance whilst seeking to build moral commitment to compliance with the religious law. This is represented through the differences of interpretation of Shariah and even fatwa in different jurisdictions and Islamic financial institutions. As a consequence, the topic of auditing religious compliance in IBF is flourishing within existing academic work due to the industry focus on legitimating legal compliance to the religious order (Banaga, 1994; Kasim, 2010; Kasim, et al., 2009; Najeeb & Ibrahim, 2013; Rahman, 2008, 2011; Yahya & Mahzan, 2012). IBF has become alerted to legitimising the ethical aspect and morality within their operation since an ethical lapse could damage organizational reputation. In line with Power's (1999) argument that the rise of auditing has its roots in political demands for accountability and control, the assurance of religious compliance is subject to formal scrutiny.

G. Conclusion

This chapter aimed to draw attention to the nature of Shariah compliance by offering a sensitizing concept of religious compliance for Islamic financial institutions. The concept blends theoretical development of compliance from a western perspective with the concept of compliance in an Islamic context. The nature of Islam has three elements, including promotion of human well-being, belief in the oneness of God, and faith in the 'life hereafter'. These concepts require all of humankind to be responsible for their actions, in that one has to comply with the rules of conduct, and continuously check and re-evaluate one's life system in order to earn the reward of the hereafter.

Having these three elements shapes the compliance concept from an Islamic perspective. Compliance to Islamic law is an important feature of the Islamic finance industry, which is now facing the risk of non-compliance and ethical scepticism that could endanger its reputation. The religious compliance principle of IBF seems ambiguous. The proposed framework started with the model of Man from an Islamic perspective that has a duality of functions in the form of 'Server or Worshipper' (*abdullah*) and the 'Vicegerent' (*khalifah*). The dual devotional and social functions induced the dual concept of vertical and horizontal compliance. Besides the devotional and religious compliance for both the individual and institutional level, economic institutions also develop compliance programs that reflect the horizontal dimension of compliance.

In the process of infusing Shariah compliance in IBF, however, inconsistency of Shariah interpretation has drifted into the regulatory level. As a result, the industry suffers a lack of consensus and accepted standards of what constitutes Shariah compliance. It creates ambiguities at regulatory, institutional, and individual levels. The rules interpretation ambiguity has drifted down from regulatory to individual level, and has resulted in rules interpretation and rules enactment ambiguities. Eventually, as a result of rules ambiguities in the IBF context, the framework shows that it provides the opportunity for agency, rules diversion, and divergent levels of compliance at the individual, group, and societal level.

Drawing from Giddens' consciousness concept, IBF compliance could be discursive, practical or become a part of individual or organisational cognition. Moreover, in a sense the degree of religious compliance itself is dynamic, resulting from the entanglement of various factors. Reflecting on the ambiguities and dynamics of compliance, it is envisaged that the inconsistency and lack of consensus of what constitutes Shariah compliance will remain unresolved. A growing discourse of Shariah auditing to ensure IBF's religious compliance is somehow questionable due to lack of widely accepted criteria. It could be redefined to balance the compliance dynamics as a warning system to bring the institution back to congruence with its ideals.

In the end, besides all the normative religious and institutional rules, Islamic financial institutions and their key actors present a feature of end process of religious compliance infusion and enactment, either to comprehensively comply with Islamic ethical and moral values or present symbolic and decoupling programs of compliance. In another perspective, Giddens concludes that even though all normative and interpretive rules are available, in the end actors, with their power, knowledge and reflexivity, will govern their compliance behaviour.

This chapter concludes that the sensitizing concept explores the nature of religious and societal compliance in Islamic perspective. Using Giddens' consciousness concepts, the

discrepancies, ambiguities and paradoxes that emerge in the process of implementing Shariah compliance is also revealed. The sensitizing concept also illuminated how the level of compliance in IBF with its operational complexity is a product of the enactment process. In the end, due to competing motives, business models and demands, and actors' reflexive intentions, it is unlikely for IBF to resolve the lack of consensus and consistency in the criteria of compliance.

To sum up, using Giddens' consciousness concept the proposed concept represents the dynamic of the level of individual and institutional compliance. The sensitizing concept in the end provides a tool to understand the dynamic of Shariah compliance enactment in IBF institutions. Linking back to the research objective outlined in Chapter I, this research avoids putting a focus on examining the level of compliance as a product of the enactment process, as it will miss a comprehensive picture of the discrepancies, ambiguities and paradoxes that are emerging in the process. Instead, based on the sensitizing concept of religious compliance, the focal point of this research is to explore and investigate the process of religious compliance translation, infusion, implementation, and enactment in the Islamic banking industry.

Chapter 5 Theoretical Framework: Theoretical Lens for the Research

A. Introduction

As discussed in previous chapters, the Islamic banking sector is characterised by divergent operational practices in different banks and in different countries. Heavy reliance on in-house scholars for the interpretation and implementation of religious compliance principles in every aspect of banking operations, combined with a lack of clarity within the existing regulatory frameworks and standards on Shariah compliance for Islamic banks has created huge complexity. Indeed, both the academic literature and regulatory guidance have shown the absence of a clear operational definition of what constitutes Shariah compliance and this lack of clear religious guidance has had a substantial impact on current banking practices.

As summarised in the conclusion to Chapter IV (p.82), the central purpose of this research is to explore and investigate the process of religious compliance translation, infusion, implementation and enactment in the Islamic banking industry. This theoretical chapter identifies theories that can serve as the theoretical perspective for this study, becoming tools to interpret and support the empirical data that represents the phenomena in the field (Ahrens & Chapman, 2006; Ragin, 1992). Having identified the theoretical lens for this study, this is then used to explain those phenomenon whilst carefully considering the main themes in the data (Ragin, 1992, p. 220).

The structure of the discussion in this chapter is presented in several parts. Firstly, I explore religious compliance in Islamic banking institutions that involves both individual and institutional strategic conduct and how it is grounded in sociology of practice theories. Secondly, I present the link between religious compliance and institutional work as a theoretical lens. Thirdly, individual responses to the ambiguity and the adjustment of the existing boundary of acceptable practice are explored. Next, the sensemaking perspective (S. Kaplan & Orlikowski, 2013; Lockett, Currie, Finn, Martin, & Waring, 2013; Maitlis & Christianson, 2014; Maitlis & Lawrence, 2007; Monin, Noorderhaven, Vaara, & Kroon, 2012; Schultz & Wehmeier, 2010; Vaara & Monin, 2010; Weick, 1995) that emerged from the ambiguity of rules interpretation is discussed. Finally, I conclude with the perspective of combining both institutional work and sensemaking to explain and describe how Shariah principles are infused in Islamic banking institutions.

B. Religious Compliance and Individual and Institutional Strategic Conduct: Grounded in the Sociology of Practice

In its standard, Accounting and Auditing Organizations for Islamic Financial Institutions (AAOIFI) defines Islamic financial institutions as entities that ‘comply, in form and in substance, with the principles and rules of the Islamic Shariah in their financial and other dealings’ (AAOIFI, 2010 SFA No.1 p.5). In line with AAOIFI, the central banks of some Muslim countries provide a similar definition to the AAOIFI standard, which previously has been discussed in Chapter 2, and was illustrated in Table 2.2. (p.34). Thus, the religious law is an underlying rule and value that needs to be infused in Islamic banks. The infusion and translation of Shariah in the bank is fundamental to ensuring that all banking products and services are permissible according to Islam (Hayat, et al., 2013). In addition, as banking institutions are bound by strict regulations at the national and international level, Islamic banks operate within two quite different but highly institutionalized environments.

In the process of institutionalizing religious law, Islamic banks rely heavily on the in-house scholar’s interpretation of each element of the operation. The implementation of Islamic law in the operation of a bank also depends on the internal Shariah officer within the bank. Therefore, in regard to the infusion of Islamic law, there is an entanglement of individual and institutional strategic decision making and business conduct. In regard to the central objective of this research, a theoretical lens which takes into account individual and institutional conduct is thus necessitated.

Voronov and Vince (2012) assert that the sociology of practice (e.g. Bourdieu, (1977) Giddens, (1986) provides a ground for any theoretical lens to portray and examine the purposive action of individuals and organizations. Along the same lines, Lawrence, Suddaby and Leca (2009) state that both theories underscore and contribute substantially to institutional research by conceptualizing the interrelationships between actors and their institutional environments. Bourdieu’s concept of habitus ‘links macro-processes occurring at the field level with micro-level processes occurring at the individual level’ (Battilana & D’unno, 2009, p. 44). According to Bourdieu, habitus is acquired through a relationship to a certain field, and as a result social structures are embedded in an active agent’s mind and body, in which their acting is socially constituted in their own field (Battilana & D’unno, 2009). More specifically, Bourdieu’s concept of ‘the orchestration of habitus’ explains ‘the production of a common sense world endowed with the objectivity secured by consensus on the meaning (sense) of practices and the world’ (Bourdieu, 1977, p. 80).

Citing *Revue des Etudes Islamiques* (1927, part 1, pp. 47-94), he argues that the *qanun*⁶ in the Islamic perspective plays 'as a set of provisions in the form of rules, based on conventions and contractual agreements' (Bourdieu, 1977, p. 200). In reality, rules interpretation is a product of the bringing together of the agent/translator's experience, and the continuous reinforcement of similar or identical experiences of the individual and collective. Similar to Durkheim's concept of 'collective representation' (Durkheim, 2002, pp. 22-23) and Miller's 'conscience collective' (Miller, 2002, p. 35), Bourdieu concludes that any rules based decision 'can be applied only with the consent of the "convicted" party' (Bourdieu, 1977, p. 200). In this case, rules interpretations at individual level are subject to a collective sense of right or wrong emerging from within a social context. In this research the context is the Islamic banking sector, discussed in Chapter 2, where religious scholars play a similar role of interpreter and mediator of rules, and it is clear that religious law interpretation varies in different countries. In regard to the objectives of this research, however, this theory that focuses on structure, agency and individually reconciled conduct is limited as a tool for portraying the process of Shariah infusion within Islamic bank operation.

From a more comprehensive perspective, Giddens (1986), through structuration theory, examines institutions as reproduced features of social systems constructed by an aggregate of actors and institutional intentions, reasons and motives. Giddens emphasises concentration on 'contextually situated activities of a group of actors' (Giddens, 1986, p. 288) where institutional reproduction lies in human action that 'occurs as a *durée*, a continues flow of conduct, as does cognition' (1986, p. 3). His concept of duality of structure (where structure is treated as a product of, and a constraint on, human action) shows that, through human agency and reflexive conduct, rules are recreated and institutions formed, reproduced and modified through the interplay of actions and structures.

Battilana and D'ahunno (2009, p. 43) explain that structuration is a process-oriented theory which can be beneficial in conceptualizing the interrelationships between actors and their institutional environments. Criticism from inquirers has been directed at the views of both Bourdieu and Giddens for their excessive subjectivism, ambiguity, and inability to transcend the agency versus structure dichotomy. In academic scholarship, however, structuration theory (Giddens, 1986) has been used as a sensitizing device for the purposes of understanding and interpreting research problems in studies that want to portray the continuity or transformation of structures, and the reproduction of systems (Moore, 2011).

⁶ Qanun: Laws promulgated by Muslim sovereigns

Several studies have demonstrated its potential as a sensitising device to help understand the entanglement of organizational discourse and the structures of signification, legitimation and domination of rules (Scapens & Macintosh, 1996) (Jack & Kholeif, 2008; Kilfoyle & Richardson, 2011; Macintosh & Scapens, 1990). For this research, structuration theory, and its consciousness concept in particular, serve as sensitising devices to understand and to establish a concept of religious compliance. In addition, viewed through Giddens' framework, Shariah compliance is enacted as social norms and values are constituted and reconstituted as social structures by the actors as social agents within Islamic banks. To sum up, both Bourdieu (1977) and Giddens (1986) are mediating structure and agency, which regards habitus, institution and system 'as situated practice' with knowledgeable agents that have a potential to reconstitute or even transform the institution (Urry, 1982).

However, structuration theory would not be a suitable tool to portray a process, in this case, the process of religious compliance infusion. In this case, a theoretical perspective that can convey the process of institutionalization of religious compliance principles is inevitably important. Institutional theory, especially 'institutional work' became the most suitable lens to portray the process of individual and organizational strategic conducts to formalise, maintain, and transform religious compliance rules.

C. Religious Compliance and Institutional Work

It was noted in Chapter 2 that the in-house scholars have become the central point of authority for religious infusion in Islamic banks. In regard to religious compliance, the 'in-house scholars' translation of rules forms the basis for institutional rules. Thus, institutional work is closely related to the exploration of the entangled strategic conduct of individuals and institutions and how individual agents are constrained by institutions whilst, at the same time, creatively directing and transforming them (Lawrence, et al., 2009; Voronov & Vince, 2012). To further understand this theory, it is important to explore the ground and the nature of institutional work, and how it is deemed useful to fulfil the objectives of this research.

To understand Islamic banks as an institution, and religious compliance institutional processes, it is deemed necessary to explore institutional theory as an analytical lens. The need to understand organizational institutionalism, which refers to how and why individuals and organizations behave in certain ways, and the consequences of such behaviour, has been attracting scholastic endeavour for many years. Contributing to these overarching questions on organizational theory, Hall and Taylor (1996) classify three schools of thought in institutional

analysis, which explores institutional conduct and institutionalisation through the rational choice perspective, the historical and comparative approach, and the sociological viewpoint.

The rational choice perspective regards institutions as based on behavioural and instrumental assumptions that are heavily dependent upon a calculative approach. The historical approach was developed as a 'response to the group theories of politics and structural-functionalism prominent in political science during the 1960s and 1970s' (Hall & Taylor, 1996, pp. 5-6), whilst the sociological or cultural approach concentrates more on institutional and individual actions. These classifications of institutional analysis, however, do not provide an explanation of organizational behaviour. Greenwood et al. (2008) remark that Hall and Taylor's classification is now no longer fit for the development of academic inquiries.

In the late 1970s, at least three enduring perspectives on organizational theory were introduced. These included resource dependent theory, ecology theory, and the new perspective of institutional theory, which later became known as new institutionalism (Greenwood, et al., 2008). This new strand of institutional theory was initiated by Meyer and Rowan (1977) and Zucker (1977). This theory largely portrays 'organisation[s] as agentic actors' responding to complex networks and the emergence and transmission of rationalized myths (DiMaggio & Powell, 1983; Meyer & Rowan, 1977; Scott, 1983). Historically, the institutional perspective has involved continuous discussion around understanding of symbol and language, myth and ceremony, decoupling, the interplay of social cognitive processes, the relationship between individuals, group and environment (in which they potentially shape each other's environments), collective behaviour and belief (Lawrence, et al., 2009).

In general, most institutional endeavours have focused on the sectoral, field, and global level (Powell & Colyvas, 2008, p. 276), and have focused on an organization's structure and the effects, with limited discussion of agency (Thornton, Ocasio, & Lounsbury, 2012, p. 76). Powell and Colyvas (2008, p. 276) state that institutions are sustained, altered, and extinguished by individuals who play an important role in enacting, interpreting and translating a concrete social situations. Institutional inquiries have thus overlooked the importance of actors' involvement in purposive and manipulative action (Lawrence, Leca, & Zilber, 2013; Thornton, et al., 2012) and forms of work in the organizational operations (Barley, 1996; Barley & Kunda, 2001; Thornton, et al., 2012).

With Barley's (1996) focus on the role of technicians as an important part of the workforce, and Barley and Kunda's (2001) focus on the concept of work in bureaucratic organizations, the idea of reintegrating studies of work with organizational theory emerged. This included Kreiner, Hollensbe and Sheep's (2009) exploration of work-home boundary negotiation,

and studies of institutional work (Lawrence, et al., 2013; Lawrence, et al., 2009; Lok & De Rond, 2012; Mair & Marti, 2009; Zietsma & Lawrence, 2010), identity work (Ibarra & Barbulescu, 2010; Koerner, 2013; Leung, Zietsma, & Peredo, 2013, 2014; T. J. Watson, 2008), and values work (Gehman, Trevino, & Garud, 2013). In addition, the increasing importance of 'turn to work', the attention to organisational work processes, (Lawrence, et al., 2013; Phillips & Lawrence, 2012) shows a shift in researcher attention. It was an unexplored research area that is now considered important, as it explores the institutionalisation processes and the involvement of the micro actors in creating, maintaining, and disrupting institutions.

Institutional work as part of the new wave of scholarship led to scholarship on 'work' within organizations gaining academic acceptance when Lawrence et al. (2009) examined the role of actors' actions, intentions and rationality in enabling conditions for agency. Voronov and Vince (2012) describe how institutional work aims to reconcile two disparate traditions in institutional theory. It establishes a bridge between the emphasis on the pressures applied by institutions to individuals and organizations, which results in conformity and compliance, and the focus on the ways institutional entrepreneurs transform institutions. Focusing on practical and purposive actions within the creation, maintenance, and disruption of institutions, Suddaby et al. (2009) introduce institutional work to provide a bridge and extend the academic work on institutional entrepreneurship, institutional change, and deinstitutionalization.

Aiming at shifting the focus to the practical work of actors in relation to institutions, institutional work has been portrayed as filling the gap in the micro foundation of institutional theory. It relates to 'the relatively invisible micro-processes of intentional actions that individuals engage in to further their own interests' and it becomes institutional work when 'they simultaneously contribute, often in unanticipated ways, to advance institutional projects' (Boxenbaum & Pedersen, 2009, p. 179). In further research endeavours, scholars have not been successful in developing the micro foundation itself. Relatively few studies have looked at individual action in more detail and then linked it with institutional conduct. Most researchers that set an objective to explore the micro foundation have not provided any substantial contribution (Battilana & D'ahunno, 2009; Boxenbaum & Pedersen, 2009; Powell & Colyvas, 2008). Thus, there is a gap in the academic discussion in exploring and presenting the micro-processes within the analysis of institutional work.

In order to fill this gap and develop the micro foundation, academic work has proposed a juxtaposition of institutional theory with other theoretical perspectives. Powell and Colyvas (2008) highlight the potential of a sensemaking perspective (Weick, 1995), an ethnomethodology approach, and a focus on interaction rituals. More specifically, sensemaking is 'a mechanism by

which institutional logic is transformed' (Thornton, et al., 2012, p. 96). In a similar perspective, Suddaby (2013) explores the use of sensemaking and strategy as practice theory to strengthen the discussion at a micro level. The sensemaking perspective allows this research to focus on the micro/individual strategic religious decision making that has been missing from the endeavour on institutional theory and institutional work.

D. Ambiguous Rules and the Boundaries of Religious Compliance

Reflecting on the objectives of this research, the infusion of religious law in Islamic banking operations relies heavily on scholars' judgments and interpretations. In addition, the lack of consensus on what constitutes Shariah compliance creates ambiguity in terms of the boundaries of the rules and their interpretation. The religious compliance principles have guided Islamic banks to avoid interest (*riba*), gambling, and excessive uncertainty. In practice, however, Islamic banks face the challenge of not having an operational definition of religious boundaries that satisfy both national and international standards for the Islamic finance industry, as discussed in Chapter 2. Thus, the interpretation of religious compliance and its boundaries are left to institutional discretion.

According to Mahoney and Thelen (2010, p. 10), compliance is a variable of both stability and change. Compliance to certain rules is a way to stabilize expectation and the strategic behaviour of actors within an organizational environment. On the other hand, Mahoney and Thelen (2010) observe that the need to enforce compliance rules in institutions carries a potential for change for several reasons. Firstly, compliance may become inherently complicated, as rules can never be precise enough to address all organizational complexity in real-world situations and so actors become engaged in the creative extension of rules to match the new reality.

Secondly, actors with different interests, cognitive limits, power, authority and levels of creativity and reflexivity see rules as being ambiguous. The ambiguity is a more permanent feature even when rules are codified. Thirdly, rules are often only implicit, with shared understanding of rules potentially existing to different degrees of openness in interpretation, and potentially shifting over time. As a consequence, the rules might be undermined and violated, as actors tend to favour exploiting the letter over the spirit of the rules. Fourthly, the fact that rules have to be applied by the actors and not the designers of the rules opens up a space for modification and change in their implementation and enactment for both practical and analytical reasons.

The dynamic of potential change is subject to two factors: 'the politically contested nature of institutional rules', and 'the degree of openness of interpretation and implementation of these

rules' (Mahoney & Thelen, 2010, p. 10). These two factors at different levels of variation represent ambiguity and uncertainty in the contested nature and interpretation of rules. The ambiguity of rules provides scope for actor agency and creativity to bend them in a preferred direction. The complexity and paradox that exists in organizations allows for multiple explanations to be plausible (James G March & Olsen, 1976; Martin, 1992). March (1994) and Weick (1995) describe the ambiguity further in the following definition:

Ambiguity refers to a lack of clarity or consistency in reality, causality or intentionality. Ambiguous situations are situations that cannot be coded precisely into mutually exhaustive and exclusive categories. Ambiguous purposes are intentions that cannot be specified clearly. Ambiguous identities are identities whose rules or occasion for application are imprecise or contradictory. Ambiguous outcomes are outcomes whose characteristics or implications are fuzzy. (March (1994) in Weick, 1995)

In the context of the caesarean surgery section in hospitals, Goodrick and Salancik (1996) argue that uncertainty provides discretion, and reaches its peak when institutional standards/rules are most uncertain. Similarly, Mahoney and Thelen (2010, p. 20) explain that the complexity of rules, the kinds of behaviour regulated by the rules, and the extent of resources mobilized by the rules become sources of variation of scope of discretion. In addition, differences of levels of discretion in interpretation and enforcement might create two outcomes: '*conversion*' when 'rules are ambiguous enough to permit different/contrasting interpretation', and '*drift*' when a gap opens up between rules and enforcement (Mahoney & Thelen, 2010, p. 21).

In an ambiguous organizational environment, actors may reflexively create, employ and transform rules and adjust their boundaries through rule conversion, rule breaking, exploitation of conflict and contradiction among overlapping or nested sets of rules, and rules combination (Mahoney & Thelen, 2010; Sheingate, 2010, p. 183). *Rule conversion* works through concentration on the letter and, in essence, violation of the spirit of a rule. In an environment that has a gap between rules and enforcement, actors might possibly engage in *rule breaking* through minor but unenforceable violations of rules. Within an environment of high rules complexity, actors may also combine rules to establish new rules/procedures to enable them to achieve their goals.

Eventually, actors in judgment and decision making processes do not just work on rules, but often work through rules. From a system thinking perspective, Ulrich (1983) explores the modification of boundaries in judgmental processes, in which facts and values are negotiated reflexively. A boundary might be expanded (*boundary expansion*) to extend the restrictive limits. In a context with ambiguous frames of reference, actors may engage in *boundary shifting* to enable them to see problems from different points of view. In a higher level of ambiguity, judgment processes may involve the practice of boundary transgression, when actors work with

multiple frames of reference, and do not allow themselves to become attached to a single frame of reference.

In the same discussion on boundary Goldstein (1994, p. 115) explains another form of boundary adjustment, namely traversing a boundary, when an organisation needs ‘to bring about self-organization’, meaning that organisational boundaries will be ‘firmed up as well as breach’. Similarly, Brock et al’s (2012, p. 113) research on professional organizations revealed an attempt to ‘reconfigure entire system of organization by traversing management boundaries’. In addition, Albert (1995, p. 59) also emphasises way in which organizations seek to keep the group intact by the traversing of boundaries in a self-organized institution. In the end, the different forms of boundary adjustment are a consequence of ambiguous rules/environment that enables organisations to make sense of their actions and reduce the level of uncertainty.

E. Ambiguity and Sensemaking in Islamic Banking Institutions

In this thesis the lens of institutional work is used to explore the process of religious compliance infusion as a form of social action in which the key actors and institutions create, maintain, and disrupt regulative, normative bases. However, reliance only on institutional work might fail to acknowledge the individual dynamic in the process of infusion, especially the role of scholars in the interpretation and implementation of rules. The grey area of religious compliance definition creates ambiguity in interpretation and McCaskey (1982) and Weick (1995, p. 93) explain the characteristics of ambiguous situations, which characterise the Islamic banking environment. Ambiguity includes the existence of multiple and conflicting interpretations, the clash of different values, and vague and contradictory frames of reference.

The types of sensemaking occasion common to organizations are ambiguity and uncertainty. The ‘shock’ in each case is somewhat different. In the case of ambiguity, people engage in sensemaking because they are confused by too many interpretations, whereas in the case of uncertainty, they do so because they are ignorant of any interpretations. (Weick, 1995, p. 91)

Actors engage in sensemaking when they are facing ambiguous, confusing issues or events. It is a process which people work through in order to understand the ambiguity and attempt to find a balance between the maintaining of expectations and support for different interpretations. Divergent interpretations encourage people to reduce uncertainty by extracting and interpreting cues from their environment, constructing a ‘plausible account’ and “making sense” of what has occurred – it is through such a process that they continue to enact their senses the environment (Maitlis & Christianson, 2014, p. 58).

Another important factor that may trigger sensemaking is ‘emotion’, which is defined as ‘a transient feeling state with an identified cause or target that can be expressed verbally or non-verbally’ (Grandey, 2008; Maitlis, Vogus, & Lawrence, 2013). Voronov and Vince (2012) argue that analyses of individuals’ roles in institutional work are incomplete unless the focus on cognition is supplemented with a focus on emotions, but acknowledge that both are fused with systems of domination, or a form of power “that works by altering the range of options” available to people (Lawrence, et al., 2009, p. 178).

Louis (1980, p. 241) describes sensemaking as a recurring cycle comprised of a sequence of events occurring over time with actors forming unconscious and conscious anticipations and assumptions which are eventually utilized to predict future events. In this case, the course of interpreting, attributing meaning to, and understanding actors’ actions and settings are important in projecting and predicting future experiences. Maitlis and Christianson (2014) explain how sensemaking is the result of environmental jolts (e.g. the challenge to organizational routines), organizational crises (e.g. when facing threats to or a failure to confirm organizational identity) and facing planned change interventions.

In addition, Maitlis and Christianson (2014, p. 106) assert that sensemaking can be used to reveal the hidden quality of the unfolding process from moment to moment. It can also capture patterns within the same organizational setting or across organisational context which result in multiple instances of sensemaking (S. Kaplan & Orlikowski, 2013; Maitlis, 2005; Maitlis & Christianson, 2014). In terms of methods of inquiry, sensemaking is most suitable for case study ethnographies, textual analysis, interviews, and observations. Linking it back to the objectives and the nature of this research study, sensemaking matches this study’s method of data collection and analysis.

There are seven characteristics of sensemaking introduced by Weick (1995): it is understood as a process that is (1) grounded in identity construction, (2) retrospective, (3) enactive of sensible environments, (4) social, (5) ongoing, (6) focused on and by extracted cues, and (7) driven by plausibility rather than accuracy. Weick’s concept of ‘grounded in identity’ represents the establishment of an identity through a process that develops and maintains a person’s changing sense of self in response to the need for self-enhancement, the self-efficacy motive, and the need for self-consistency.

How can I know who I am until I see what they do? Something like that is implied in sensemaking grounded in identity. I make sense of whatever happens around me by asking what implications do these events have for who I will be? What the situation will have meant to me is dictated by the identity I adopt in dealing with it. And that choice in turn, is affected by what I think is occurring. What the situation means is defined by who I become while dealing with it or what and who I represent. I

derived cues as to what situations means from the self that feels most appropriate to deal with it, and much less from what is going on out there (Weick, 1995, pp. 23-24).

Ring and Van de Ven (1989) offer similar ideas to Weick's thinking above on the need of individuals to have a sense of identity, which includes a response to a failure to confirm one's self, the need to maintain a positive and consistent self-conception, the desire to learn about their identities and to observe the consequences, the need to simultaneously try to shape and react to the environment they face, to make a self-referential rather than reflecting on the environment. The concept of 'grounded in identity' is closely related to 'threats to images and identity or opportunity to repair and reaffirm them, that affect a person's view of what is out there and what it means' (Weick, 1995, p. 21).

The second characteristic of Weick's sensemaking perspective is *retrospective sensemaking*, which is related to the concept of experiencing and experiences. There are two categories of sensemaking which include retrospective and future-oriented or prospective sensemaking. Retrospective sensemaking is one of Weick's (1995) core notions of sensemaking which represents 'an activity in which possible meanings may need to be synthesized' (Weick, 1995, p. 27). The other form of sensemaking is *prospective sensemaking*, which is described as 'the conscious and intentional consideration of the probable future impact of certain actions, and especially non actions, on the meaning construction processes of themselves and others' (Gioia, Thomas, Clark, & Chittipeddi, 1994, p. 378; Maitlis & Christianson, 2014).

Maitlis and Christianson (2014) consider forward-looking as sensemaking that 'involves 'future perfect' thinking, which Gioia (2002, p. 623) regards as when 'people envision a desired or expected future event and then act as if that event has already transpired, thus enabling a 'retrospective' interpretation of the imagined event'. Weick (1995) and Maitlis and Christianson (2014) explore sensemaking in both retrospective and prospective thinking in order to construct an interpretation of reality.

Enactive of sensible environments is the third characteristic of sensemaking. Weick (1995, p. 30) describes the word 'enactment' as 'the fact that in organizational life people often produce part of the environment they face'. Through the concept of enactment he wants to explore the 'activity of 'making' that which is sensed' (Weick, 1995, p. 30). *Social* as the next characteristic explores that sensemaking is a social process rather than an individualistic process in his remark that 'those who forget that sensemaking is a social process miss a constant substrate that shapes interpretations and interpreting and that human conduct is contingent upon others' (Weick, 1995, p. 30). It represents a social process to develop plausible images to rationalize human conduct.

Sensemaking is also an *ongoing* process - it never starts from a point separated from the socially constructed environment, nor stops cleanly at another point of time. Sensemaking is also *focused on and by extracted cues*, a form-producing process which involves simple, familiar structures that are seeds from which people develop a larger sense of what may be occurring that captures much of the vagueness and indeterminacy of sensemaking (Weick, 1995, p. 50). It needs to be socially constructed, as 'social context binds people to actions that they then must justify' (Weick, 1995, p. 52).

F. Constructing a Combined Theoretical Lens for the Research

In line with the sensitizing framework for religious compliance discussed in Chapter IV, religious order is a collective conscience intended to create a structure of conducts, which is ideally in accordance to letter of the law, and at the same time actors recursively organise self-reflexive control of action. Giddens (1986, p. 3) asserts that 'human action occurs as a *durée*, a continues flow of conduct, as does cognition.' Therefore, IBF compliance action is composed of an aggregate of actors and institutional intentions, reasons and motives.

Institutional pressures play an important role in IBF's religious compliance implementation, which entails dynamic of shareholders' intention and motivation, the extent of regulatory control, and other external pressures (DiVanna, et al., 2009; Warde, 2010). To interpret sacred rules and infuse it in modern financial instruments and IBF the reliance is primarily on the Shariah scholar's tacit knowledge. The role of the Shariah scholar to certify compliance is linked to a high transaction costs, low quality of assessment and bear a risk of certifier bias due to scholar's cognitive limits (Hayat, et al., 2013). Individual interpretation of Islamic rules for institutional rules in IBF might involve creating new rules or creating extensions of existing rules to banking environment.

Thus, scholar's perceptions, interpretations and actions at the micro level shape the macro level rules and institutional strategic conduct. In this case what inquirers (Greenwood, et al., 2008; Lawrence & Suddaby, 2006; Weick, Sutcliffe, & Obstfeld, 2005) recognize as 'the juxtaposition of meaning-making and institutionalization process' of Shariah enactment in IBF context become evident. Reflecting back to dual individual and institutional translations of Islamic law, a multilevel perspective should be taken into account in theorizing the field research findings. The benefit of multilevel analysis and theorizing is to achieve what Jennings & Greenwood (2003) regards as 'completeness' by combining the micro domain's focus on individual and group with the macro domain's focus on organization and environment, and illuminating the integrated strategic conduct (Klein, Tosi, & Cannella, 1999).

Additionally, Klein et.al (1999) also acknowledge the challenge of multilevel analysis as the breadth of potentially useful theoretical choices is so wide. The possible organizational behaviour and organization theories that could be used for a macro-micro perspective of research are listed in Table 5.2 below, together with my own reflections on each:

Table 5.1 Analysis of Theoretical Lenses
Sources: Literatures

Authors	Theory	Main concepts of analysis	Reflection on the Project
Anthony Giddens (1986)	Structuration	Institutional and strategic conduct (actors' level) analysis	The methodology is too free floating, and needs more specification on institutional analysis
Lawrence, Suddaby, & Leca (2009)	Institutional Work	Individual agents and their response of the pressures applied by institution, and the actor's/institutional entrepreneurs capability of artfully navigating, shaping and transform institution	The micro level has not been systematically theorized or empirically investigated, and historically it focuses on either field or organizational level
Jennings and Greenwood (2003), Weick, et al. (2005) Powell & Colyvas (2008), Jensen, et al. (2009), Schultz & Wehmeier (2010), Leung et al. (2013, 2014), Knights & Clarke (2014)	Neo Institutional (including Institutional Work) and Sensemaking	In the macro and meso level; why concepts are institutionalized in social structure evolution and sense making perspectives that focuses on the dimension of meaning or meaning-making on the micro-level.	A comprehensive approach to portray organization responses to conflicting demands, ambiguities, interdependent people search for meaning and settle for plausibility of further rules enactment. It reflects major processes of institutionalization on micro-level (actors of organizations), meso-level (organizations) and macro-level (regulators)

Structuration theory offers two types of methodological bracketing, which emphasise strategic conduct and institutional analyses. Giddens (1986, pp. 288-289) in institutional analysis considered the institution is structured by actors' skill and awareness which shape institutions as chronically reproduced rules and resources. Strategic conduct analysis views institutions as a emerging from an actor's signification/meaning making of rules and resources through their interpretation and communication. Jarzabkowski (2008) argues that structure as institutional realms work to frame the individual realms that are represented in individual day to day actions.

My research found Giddens methodological analysis to be useful as a broader reference point for understanding the social context of Islamic banking. Strategic conduct analysis emphasises contextually situated activities. In Islamic banking, the conduct of individual agents focuses is on how actors reflexively monitor what they do, and how they draw upon rules and

resources in the constitution of interaction (Giddens, 1986; Stones, 2005). This research also acknowledge Giddens' notion of *Boundaries of Consciousness*, in which the conduct of an Islamic bank's agent and the context of Islamic banking institutions as an integrated system are limited to the boundary of the agent's consciousness in translating Shari'ah compliance principles. Reflecting on this idea, in Chapter 3, the conceptual framework shows how I developed a sensitizing concept of Shariah compliance using Giddens two methodological frameworks. It explains Shari'ah compliance as constructed and reconstructed, agent based produced and reproduced as a control system within the Islamic banking industry.

The problem with employing Giddens approach is that the methodology bracketing is too free floating, and needs more specification on institutional analysis. Stones (2005, pp. 7, 120-123) argued that structuration theory is too free floating, and Giddens makes a mistake by simply including institutional analysis in his methodological consideration. Stones (2005, p. 6) argues that structuration theory needs other theories to provide a framework to study the duality of structures, the inherent moments of situation and agency, the 'medium and making' and its interconnection with a wider structure and environment. These inquirers are some of those who blend structuration with other theories, i.e. sensemaking (Balogun & Johnson, 2005; Rouleau, 2005), organisational politic and resourcing (Howard-Grenville, Nash, & Coglianesi, 2008), institutional theory (Jarzabkowski, 2008), and, strategy process (Paroutis & Pettigrew, 2007).

On the other hand, Giddens methodological bracketing does not provide a clear distinction between institutional and strategic conduct analysis. Stones (2005) asserts that what Giddens regards as institutional analysis is merely an agent's context analysis rather than institutional analysis. To enable the two forms of bracketing to function, the substantive potential of structuration theory needs to be released, as the individual agent is reflexive and at the same time confronted by institutional structures. Jarzabkowski (2008) asserts that individuals realize and modify the existing structure, and at the same time interactions between actors have a greater influence in realizing and modifying institutions. In terms of exploring agency versus structure in both analysis, Battilana & D'ahunno (2009) criticizes its inability to transcend such dichotomy.

The previous discussion in Chapter IV on sensitizing concept of Shariah compliance which 'provide a general sense of reference and guidance in approaching empirical instances' (Blumer, 1954) leads the methodological perspective of this research into dual focus of individual and institutional strategic conduct in micro and macro levels. Hitherto, we need to find theoretical approaches that enable both perspective of analysis. Institutional work which focus on 'the

purposive action of individuals and organizations aimed at creating, maintaining and disrupting institutions' (Lawrence, et al., 2009), provides the two angles of analysis.

Institutional work reconciles two disparate traditions in institutional theory, by combining the emphasis on institutional pressures to individuals and organizations, which result in conformity and compliance, and the means of institutional entrepreneurs transform institutions (Voronov & Vince, 2012). Institutional work conceives of individual agents as constrained by institutions yet still capable of artfully navigating, shaping, and transform institutions (Lawrence, et al., 2009). However, the micro level has not been systematically theorized or empirically investigated, and historically it focuses on either field or organizational level (Voronov & Vince, 2012). It misses a richer understanding of how actors locate themselves within organizations, translate, interpret, enact, and making meaning in their context. For example, in portraying agency versus structure, Battilana & D'ahunno (2009) aims to focus more in individual level and their potential in enabling agency. Even though his concept of multidimensional of agency contributes to the existing literatures, the portrait is merely on field and organizational level. Battilana & D'ahunno (2009) concludes with a recommendation that consists of multi-level studies focusing more on when and how individual agents embedded in organizations, as well as in the field, and also engage in different forms of institutional work.

Scholars (Jennings and Greenwood (2003), Weick, et al. (2005) Powell & Colyvas (2008), Jensen, et al. (2009), Schultz & Wehmeier (2010), Leung et al. (2013, 2014), and Knights & Clarke (2014) in further organizational inquiries seek comprehensive discoveries using a multilevel perspective to explore both the macro and meso level why concepts are institutionalized in social structure evolution and sense making perspectives that focuses on the dimension of meaning or meaning-making on the micro-level. In line with those scholars, in the context of Islamic banking industry and the grey area of what constitute Shariah compliance, my combining of theories provides a more complete methodological approach to portray organization responses to conflicting demands, ambiguity, and interdependent people search for meaning and settle for plausibility of further rules enactment. In so doing I help to bridge the literature gap identified above.

Besides, in the grey area and ambiguity of Shariah compliance interpretation, sensemaking occasions are common to organization. Weick (1995) and Maitlis & Christianson (2014) define sensemaking as the process through which people work to understand issues or events that are novel, ambiguous, confusing, in a stream that supports different interpretation at the same time or in some other way violate expectations. An environment with divergent interpretations encourages people to engage in sensemaking. People seek to clarify by extracting

and interpreting cues from their environment via construction of a 'plausible account' that provides order and "makes sense" of what has occurred, and through which they continue to enact the environment to reduce the uncertainties (Maitlis & Christianson, 2014).

To maintain novelty in the theorizing process, Weick (1995) recommends the need to move beyond sequence and exploring the deep structure that underlies a process through an adoption of narrative structure, to attend to focal actors, voice, moral context, and other indicators. In Islamic banking context, religious rule ambiguity opens a room for reinterpretation according to the frame of reference brought upon it (Hamnett, 1967). The internal and external pressures to implement Shariah within every aspect of the bank's operation, combined with the requirement to fulfil local regulatory requirements creates a complexity and paradox that make multiple explanations plausible (James G March & Olsen, 1976; Martin, 1992). March (1994) describe it further in the following definition:

Ambiguity refers to a lack of clarity or consistency in reality, causality or intentionality. Ambiguous situation are situation that cannot be coded precisely into mutually exhaustive and exclusive categories. Ambiguous purposes are intentions that cannot be specified clearly. Ambiguous identities are identities whose rules or occasion for application are imprecise or contradictory. Ambiguous outcomes are outcome whose characteristics or implication are fuzzy. (March (1994) in Weick, 1995)

Using Institutional work and sense making perspectives the findings will reflect major processes of religious rules institutionalization on micro-level (actors of organizations), meso-level (organizations) and macro-level (regulators). Within the multiple perspective of religious rules interpretation, ambiguity in the three levels could also be portrayed in the process of individuals and institution in creating, maintaining, and disrupting the Islamic bank's value and identity. Additionally, Suddaby (2013) argues that from an empirical pragmatic perspective, the combination of the two theories is intended to fill a large gap between how organizations behave and the explanation of their behaviour. He holds this view despite his criticism that neo institutional theory, and sense making (which he classified under a cluster of strategy as practice theory), are based on different ontological and epistemological assumptions (Suddaby, et al., 2013).

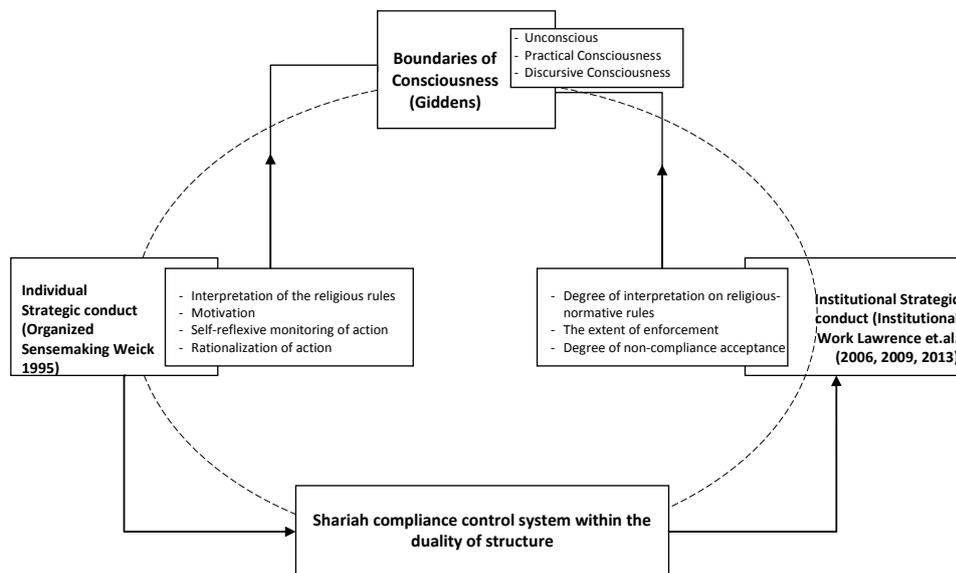
Alford & Friedland (1985), with the same view, emphasise that in an inquiry one should take into account organizational relations, individual behaviour and societal processes. Individual behaviour can never be adequately explained by individual interest, perceptions, and motivations, nor can individual behaviour or social interaction theories explain organizational or societal processes. In the case of Islamic banks, they face two highly institutionalized environments, the regulatory environment with its own imperative, and the endogenous religious rules and governance environment that need to be satisfied to be qualified as a Shariah compliant financial

institution. This research wants to portray the process of Islamic bank as an institution and how its individual actors manage the constraints in the two highly institutionalized environments.

The analysis will be conducted on three levels, regulatory, institutional and individual levels. This research classifies the process Islamic bank interpretation, enactment and implementation of Shariah compliance principles as a representation of religious compliance work. The analysis at institutional level will inductively explore the Shariah compliance work as a concept of institutional work within Islamic banking institution. Learning from institutional work, identity and value works literature (Gehman, et al., 2013; Jennings & Greenwood, 2003; Jensen, et al., 2009; Knights & Clarke, 2014; Leung, et al., 2013, 2014; Musson & Duberley, 2007; Powell & Colyvas, 2008; Schultz & Wehmeier, 2010; Weick, et al., 2005), I therefore conceptualize Shariah compliance work as *a collective process of individuals and institutions that involves multiple cycles of interactions between external and internal identities and refining/changing values, through sensemaking in action, role and rules boundary adjustment to formalise, maintain and transform Islamic banking institution.*

Figure 5.1 Methodology of Research

Sources: (Giddens, 1986; Lawrence, Leca, & Zilber, 2013; Lawrence & Suddaby, 2006; Lawrence, et al., 2009)



G. Conclusion

Reflecting on the objectives of this research, the juxtaposition of institutional work and the sensemaking perspective will be most suitable for examining the process of Shariah infusion in Islamic banking institutions. Weick (1995, p. 36) emphasises the essence of sensemaking as being

the 'institutionalising of social constructions into the way things are done, and the transmission of these products'. It means there is a link between ideas in sensemaking and those in institutional theory.

Moreover, it focuses on ongoing human processes in stabilizing or destabilizing individual and organizational identity. Organizational actors shape what they enact and how they interpret, which affects their image, and the social responses received. The combination of institutional work and sensemaking enables this research to literally explore both individual and institutional purposive action to create/formalise, maintain, and, at some point, disrupt/transform Islamic banking institutions.

Chapter 6 Research Method

A. Introduction

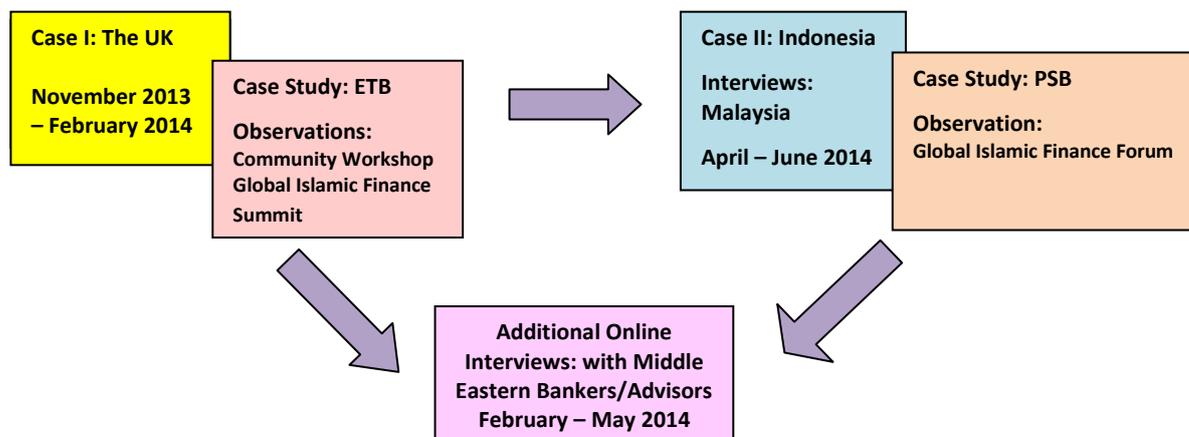
The objective of this chapter is to introduce and outline key aspects of research design, research strategy, and empirical techniques applied based on the philosophical assumptions underpinning my thesis. This chapter explores the processes of the field research conducted in two countries, in a Muslim and a non Muslim country. The course of access negotiation is further explored to show the research trustworthiness. Next, the case studies, the collection and variety of data, and the analyses are explored to show the novelty of research process. In the end, the researcher effort to maintain trustworthiness and ethical preservation are explained to build trust on the research processes conducted, as well as the findings and the conceptualisation being offered.

B. Field Research Processes

This study adopts a qualitative research methodology, framed around case studies and interviews, and field observation in several Muslim countries in Asia and the Middle East, and one non-Muslim country. The case studies are specifically conducted in two Islamic banks in Indonesia as a Muslim country in Asia and in the UK that represents a Non-Muslim country. The interview participants are IFI managers, advisors, internal officers, supervisory board members, and regulators. The data collected from the case studies includes interviews, field observations, and review of documents. To complement the interviews in both case banks, additional interviews are conducted with those practitioners in Malaysia and Middle Eastern countries.

Initially, a Malaysian Islamic Bank was approached as one of the case studies. Based on email correspondence with the internal compliance officer, and in a consultation with the top management, access for a case study was granted. At a later stage in the process - within a week before the planned case study was planned to start, the bank informed me that the access for field research was refused. The reason for the changes in their decision might relate to the newest Islamic finance act 2013, which provides a stricter regulation for religious compliance implementation in Islamic financial institution. It triggers reluctance for the bank to have an outsider that investigates its operational practice. Eventually, field research in Malaysia was still undertaken, even though it was highly based on interviews. The sequence and processes of this research is represented in Figure 2 below:

Figure 6.1 Field Research Sequence and Processes



C. Negotiating Accesses

One of the critical parts of choosing case study as an approach of inquiry is getting an access to the case organizations. Proposal for field research for interviews, observation, and case studies were sent through emails to the authority of the targeted case organizations. At most cases, I sent emails and proposals to the bank’s Director of Compliance and Risk, and the Head of Shariah Compliance Department. The response for the inquiry was very good, and in most cases they provide the opportunity for me to conduct an interview, observation, and case study.

In line with Marshall & Rossman (2010), the proposal was designed to anticipate participant’s questions about the credibility and trustworthiness of the findings. I explain the rationale and the objective of the research transparently, and how the findings will be beneficial for practitioners (auditors, advisors, and Islamic bankers) and for wider community. The proposal also highlights the importance to understand and to seek explanation of the socially constructed problem lies within wider critics of Shariah compliance interpretation and implementation in Islamic banking context. While ensuring to maintain the individual participant/organization confidentiality preservation, the findings are targeted to inductively uncover the embedded issues from the process of religious compliance implementation in the regulatory, institutional and individual perspectives.

D. Case Studies and Case Selection

A case study is the most appropriate design to address the two objectives of this research which is intended to answer the question of “how” of the phenomenon of religious compliance definition, implementation, infusion and enactment in Islamic banking industry. In line with Yin

(2003) case study is the preferred strategy to conduct an in depth analysis of how and why an activity, program, and phenomena are presented within a real-life context. In the Islamic banking context, the how questions are posed to the phenomena relates to organisation and individuals behaviour in infusing, implementing, and enacting religious compliance principles.

As explored in Chapter 2 (p.34 onward), various operational practices appeared in different banks in different countries. In line with the focus of this research as explained in the conclusion of Chapter 4 (p78), I intend to explore and examine the dynamic in the process of Shariah infusion in Islamic banking institutions in Muslim and non Muslim countries which have significant differences of regulatory framework and socio-cultural background. The rationale behind the criteria of selecting the UK, Indonesia and Malaysia as the case countries is the political and government support for the Islamic finance industry to grow that enables me to examine the process at regulatory, institutional and individual level.

At the end, I decided to focus on two Islamic banks in the UK and Indonesia, after getting a refusal from the Malaysian Islamic bank. To enable examining the process of Shariah infusion and enactment as the research focus, I decided the basis criteria for case selection. I chose the Islamic banks that are considered pioneer in each country, have a substantial length of operations, as well as the availability of 'Shariah Compliance Department/Division'. The two case banks selected are matched to those criteria.

a. Interviews

The interviews were conducted with practitioners in the two case organizations, and also some additional interviews with scholars, practitioners and individual in the community, as represents in the Table 5.3 below. A flexible interview guide was used for forty semi-structured interviews, in which we tailored the questions according to the interviewee and the situation. To preserve the comparability between different interviews, the interviews questions were typically centred around three main themes: (1) their interpretation on Shariah compliance concepts, (2) the implementation of religious compliance principles in Islamic banks, the creation/formalisation and the maintenance of shariah compliance principles within its operation, and (3) the dynamic of religious compliance concept and implementation in regulatory, institutional, and individual level of the Islamic banking industry.

The interviews in the UK and with practitioners from Middle Eastern countries were conducted, recorded, and transcribed in English. Whilst for the case of Indonesia the interviews were conducted, recorded, and transcribed in its local language. In the coding analysis process, the coded and quoted themes and interviews were translated in English by the researcher. In this

case, there is no involvement of translator or transcribers other than the researcher. It is in line with Marshall & Rossman (2010, p. 165) view's that the use of other transcribers and interpreter might complicate the process immeasurably, as the terms and vocabulary used in the discussions were very specific and sometimes difficult to understand from a layman's perspective. In addition, to enter the banks as a highly regulated institution, the researcher was bound to legal agreement to observe and preserve confidentiality, which would not allow anyone else than the researcher and supervisors to access the interviews and all data collected.

Table 6.1 Demographic of Interviewees

Stakeholder/Level	Function and Number of Respondent		Additional Respondent	Total Respondent
	United Kingdom	Indonesia		
Regulator	FSA: 1	Central Bank : 2	AAOIFI: 1	
		National Shariah Board: 1	IFSB: 1	
	Total: 1	Total: 3	Total: 2	6
Bank/Institution	Manager: 5	Manager: 7	Manager: 2	
	Senior Officer: 2	Officer: 2		
	Officer: 1	Scholar: 2	Scholar: 1	
	Scholar: 2			
	Total: 10	Total: 11	Total: 3	24
Practitioners	Other Bank: 1	Auditor: 1	Advisor: 1	
	Ethical Advisor: 1	Advisor: 1		
	Total: 2	Total: 2	Total: 1	5
Community	Academic: 1	Academic: 1		
	Customer: 2	Customer: 1		
	Scholar: 1	Ex Banker: 1		
	Total: 4	Total: 3		7
Total Interviewees				42

The interviews were mostly recorded, transcribed using NVivo 9.2 qualitative data analysis software. There are two interviews with an internal auditor and a treasury officer in the UK were manually written, and shown to both interviewees for approval, and even the later then add comments, and drew a mathematical figures to strengthen the interviews verbatim. In order to have a natural discussion and to allow interviewee to express their views and concerns, informal and unrecorded interviews were conducted with the bank's officers and customers in both case studies. The analysis of the interviews was conducted using a combination of NVivo 9.2 qualitative data analysis software and manual analysis. The rationale behind the combination is to enhance the effectiveness and to emphasize the central role of the researcher in the analysis process, as coding and analysis 'is not a merely technical task' and there is 'no mechanism can replace the mind and creativity of the researcher' (Marshall & Rossman, 2010, pp. 218-219)

b. Observations

In addition to the interviews, I observed two annual global Islamic finance conferences each in a Muslim and Non Muslim country. Both conferences held some forum for Islamic banking executives, Shariah scholars, and global Islamic finance regulators. These forums enable me exploring the ideas of Islamic banking practitioners, the development on Shariah opinions, and the updates on recent global regulatory framework. I benefited from these conferences to conduct on site additional interviews with Shariah scholars and regulators. I contacted them prior to the conferences. Then the interviews were conducted based on a specific agreed time during those conferences. Within the two case companies, informal observations were conducted within their every day routines and discussion. The researcher tried to get access to observe any formal meetings, but at the end the two banks did not grant any permission for such activity due to customers' and the institution's confidentiality preservation.

c. Review of Documents

This research involves a wide range of documentary sources that can be used to conduct an in-depth analysis, including public and regulatory documents, mass media, virtual documents, and private documents produced by the case companies (Bryman, 2012, pp. 543-551). Besides public documents produced by regulators and published in mass media, private documents related to Islamic banking operation are also important. The implementation religious compliance interpretations are formalised and certified into documented operational guidance and procedures. Thus, this research traces both public and private documents related to religious compliance interpretation to the control and monitoring systems as represents in Table 5.4 below.

Table 6.2 Documents Analysed

Level	Type of Documents	Documents Availability	
		United Kingdom	Indonesia
Regulator	Policy Prospectus	√	√
	Updates Regulation	X	√
	Religious Compliance Regulations	X	√
Bank/Institution	SSC Products/ Services Certificates/Approvals	√	√
	SSC Pronouncements	√	√
	Procedural Documents	√	√
	Shariah Review	√	√
	Shariah Audit	√	X
	Reports of Shariah Compliance to Regulators	X	√
	Published Documents	√	√

National Guidance	Shariah Standard/Policy (Fatwa)	X	√
	Islamic Accounting Standards	X	√
	Shariah Audit Guidelines	X	√

Some private documents could be found in the SSB pronouncement/product certification, operational and procedures, guidelines, products specifications, minutes of meeting, article of associations, annual report, Shariah review report, Shariah Audit Report and SSB Reports. Thus, review of documents becomes one of the most important parts of analysis. However, due to customers' confidentiality preservation, researcher was only allowed to read and examine the documents. It is impossible for the researcher to duplicate or copying the document for research documentation for example. It is a challenge for me to read review and summarise those documents as a meaningful data for analysis. At the same time it provides an opportunity for me to understanding the process and the changes through the documented fact, and it also opens an avenue to enrich my understanding of the context to then discuss it further with the bank members in the interview sessions.

E. Analysis

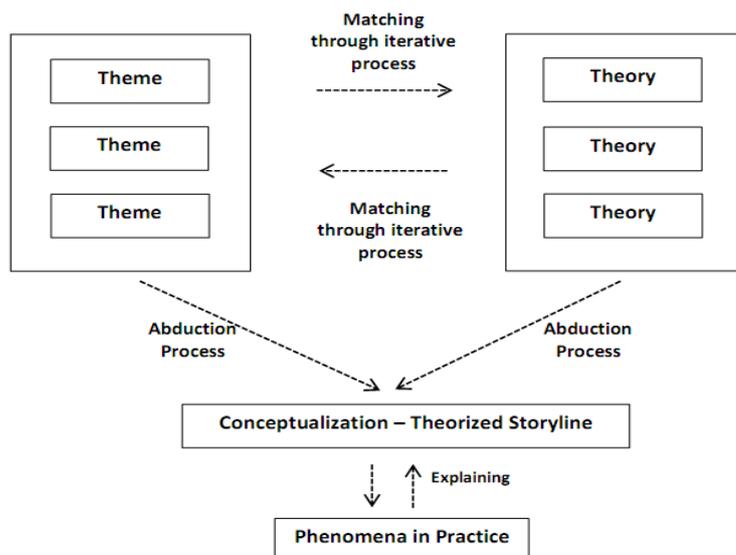
I extracted and selected from the interviews the themes that were prevalent and recurrent in interviewees' comments. I employed thematic analysis on the narratives of our empirical data. A theme is identified through the occurrences or repetitions of certain incidents, words, phrases in a considerable frequency (Bryman, 2012, p. 624). Through an extensive thematic analysis, I inductively revealed the concept of identity rules ambiguities. It was not part of the initial analysis but emerged as an important theme during the course of the research. I have been continuously iterating the analysis of our data with consideration of the literature. I identified attempts to control identities or subjectivities as a sensitizing concept to guide subsequent analysis. The sample of coding the themes and the theoretical processes to define a theorized concept is represented in the Table 5.5 below.

Figure 6.2 Sample Coding, Themes, and Theoretical Processes
 Source: Researcher Analysis

Narrative Vignettes	Narrative Themes	Theorized Concept
But, continuously as the new effort coming to the industry they have their own view , and therefore affected the image of how we view shariah...	Change	Institutional rules ambiguity
At the end of the day if So we need to have the ability to come up with the best transactions. "		
Unfortunately it is a closed box, and we found commodity sales with paper backed transactions. But you cannot have the industry without any solutions for now . Alternative is a transparent commodity paid paper..... If you really want to challenge us for that, you can't find any alternatives...."	Conflicting demands	
We have a number of stakeholders, it's not easy... The other challenge is again how we look at shariah. Do we look at shariah compliance or do we look at shariah inspired? So essentially we always see shariah as something broader than compliance. "	Shariah challenge	

In the process of analysing data from the case study, the researcher needs to take into account the empirical data from the field, and carefully match it with theory as a tool to explain the phenomena in the field, as represented in Figure 5.3 below. The researcher will be involved in an abduction process (Bryman, 2012, p. 380), 'an inductive view of the relationship between theory and research, whereby the former is generated by the later'. In the following process, a case study is basically a process of 'casing' the study by presenting a conceptualization of the data into a theorized storyline 'to show the theoretical significance of events in the field is supported by processual definition of field events' (Ahrens & Chapman, 2006; Ragin, 1992).

Figure 6.3 Conceptualization Process
 Source: Researcher Analysis based on (Ahrens & Chapman, 2006; Bryman, 2012; Ragin, 1992)



The casing process enables researcher 'to objectify general empirical units, setting them up to be viewed through blinders that hide all but theoretical relevant general features' (Ragin, 1992, p. 220). This casing process helps the researcher to narrowing the empirical focus, to avoid to be overwhelmed in the messiness of the data, and to be able to conceptualize the prominent feature from the interrelated themes as a theorized storyline. The result of a casing process presents a theorized storyline that represents the main plot of the story that includes the main themes in data and the matched theoretical lens as a tool to explain the phenomena in the practice.

F. Maintaining Validity and Trustworthiness

Bryman (2012, pp. 390-392) identifies four criteria that he suggests may maintain validity and trustworthiness. The first criterion is *credibility* which parallels internal validity, which represents researcher effort to establish trustworthiness in the findings by seeking respondent validation, corroboration and confirmation of the research participants. Respondent validations were conducted when the researcher summarised the interview with each respondent, and by discussing development of research finding regularly with the Shariah Compliance Officer (SCO). Another technique to maintain credibility is by applying triangulation which refers to cross-checking across different sources of data. To maintain good practice in the research process data from interviews, observations, documentary sources are triangulated to come up with balanced substantial findings.

The second criteria is *transferability*, in which the researcher presents 'thick description', a rich and triangulated account that provide others with reference for making judgment to transfer the finding to other context (Bryman, 2012; Geertz, 1973). The researcher applies these criteria by conducting two case studies in Muslim and non Muslim countries to achieve a wider perspective of findings and at the same time to assess its transferability in other research setting. The third criterion to build trustworthiness is *dependability*, by adopting an 'auditing' approach to establish the merit of the research. In this case complete records are kept of all phases of the research process, the scientific research procedures are followed, and the theoretical inferences can be justified.

The last criterion that needs to be implemented is *confirmability*, whereby the researcher acknowledges the impossibility of achieving complete objectivity. The researcher at all times ensures the transparency and coherence of the research process, to acknowledge researcher's reflexive positions and to take into account a sensitivity to cultural, political, and social context. Especially, in conducting multiple cases in different cultural background, reflexivity is deemed

important to understand and embrace the differences at all stages of research. At the end, though applying the four criteria, trustworthiness is preserved in the research process.

G. Ethical Consideration

In order to obtain access to the case banks, the researcher arrange an initial meeting to explain the research aim, and also the possible contribution of my research for practical implication to Islamic banks. Both researcher and the case bank signed a legal agreement for data protection and confidentiality preservation purpose. Participant selection for interview was based on mutual agreement between the researcher and the bank. The interview arrangement was done through the Shariah Compliance officer in charge. Although the arrangement is done through the Shariah Compliance officer, the voluntary nature of participation will be ensured.

Each participant was informed summarised information about the research, confidentiality of the data, their rights, the output intentions and contact details at the beginning of the interview session. Verbal assurance on the same matter especially their rights and voluntary consent; where they may withdraw their consent at any time during the interview and even after (unless the data from the research has already been made public); will communicated at the beginning of each interview. In both case banks, respondent consent forms were rarely signed and replaced with verbal recorded consent statement and it was also based on the initial legal agreement signed in the beginning of field research.

With regard to the participant observations at meetings/workshops/seminars related to Islamic finance industry, the researcher ascertained that permission to attend, to observe, and to record the discussion are granted, and in all of those events complementary places and invitation were received prior to the events. For the observation in the work place, the SCO introduces the researcher, as far as is practicable, to all relevant staff. This introduction is done to ensure that nobody is misled regarding the researcher presence at the sites. During this introduction, the research objectives and the plan for observations, and the ethical preservation were explained.

With regards to the Islamic banks' documents, both publicly available and non-publicly available data were collected. For those that are publicly available; such as data from Islamic bank's website, annual and governance report, or publicly published documents; no consent is necessary for their use. In terms of documents which are not publicly available, the permission from the concern parties was obtained prior to the use of them in the research.

All collected data was stored using a coded system and where no link can be made between the participant's information and the interview records, interview notes and observations notes. The participant's identifiable information i.e. their original identities and the assigned code or pseudonyms will be stored electronically in a separate password protected file

that is only accessible by me and my two supervisors. When referring to specific participant and quoting them, pseudonyms will be used. This is to ensure confidentiality and/or anonymity for each individuals involved in the research. In the event where consent is withdrawn, this data will be destroyed or deleted to ensure it will not be used. This was also communicated to all participants before the conduct of the data collection work (during the introductions).

H. Conclusion

The research method presented in this chapter meant to show that the research is conducted within an acceptable academic level. The research process are planned to enable the researcher to reveal comprehensive findings to portrait the phenomena in the field. Through the preservation of validity and trustworthiness of data collected, the clarity of analysis process, and the maintenance of ethical aspects, this research warrant a substantial level of novelty.

Chapter 7 Ethical Trust Bank (ETB): a Case Study of an Islamic Bank in a non-Islamic Country

A. Introduction

The objective of this chapter is to describe and explore the case study I carried out in an Islamic Bank in the UK. To maintain an ethical approach in the research, the company name is anonymised in the thesis. In this thesis, I refer to the institution as 'Ethical Trust Bank' (ETB, hereafter). As an Islamic bank in a non-Muslim country, many factors play their own part in the complexity of infusing religious rules into the operation of ETB and enacting them. ETB has to translate and enact the divine rules into modern financial instruments and, at the same time, the bank needs to be flexed to the UK's banking regulation. The enactment and institutionalization of the religious values, as much as regulatory values, will reflect the process of individual and collective purposive action at the societal, organizational, and individual level aimed at formalising, maintaining and transforming Islamic banking institutions.

In line with the ontological, epistemological, and methodological perspectives described in the previous chapter, this case study inductively explores the religious compliance work conceptualised as a collective process of individuals and institutions that involves multiple cycles of interactions between external and internal identities and values works, through sense making in action, role and rules boundary transgression to create, maintain and transform Islamic banking institutions. The following discussion of the ETB case will be conducted from multilevel perspectives in order to obtain a comprehensive picture of the process of religious (Shariah) compliance infusion, and some of the discrepancies, ambiguities and paradoxes in individual and institutional behaviour within Islamic banking institutions.

B. Ethical Trust Bank: the Case of an Islamic Bank in a non-Muslim Country

Ethical Trust Bank (ETB) is one of the four fully fledged Islamic banks in the UK. ETB has operated for almost ten years as a Shariah compliant banking institution. Commencing business in the second half of 2004, ETB initially had 7 branches in London, the Midlands, and the North-West. In its early days, ETB asserts that their existence is to fulfil the religious needs of 5% of Muslims from the total UK population. It also aims to attract investors from Muslim countries, especially Middle Eastern investors who seek Shariah compliant investment instruments. London, as a leading international financial centre, added an important selling point for this new industry.

Formed by Middle Eastern investors, this FSA approved financial institution publicly states that five ethical and social values underpin its operations⁷. ETB declares that everything it does is in line with Islamic values. This development is inseparable from the development of Islamic finance in Muslim countries, and defers to the religious imperative of having financial investment industry alternatives that suit these substantial minority religious values. As a consequence, the values demanded by the religious imperative dynamically shape and continuously reshape the identity and logic of ETB in order to preserve its claim to be a Shariah compliant institution.

ETB formally and informally addresses their vision to offer ethically and religiously based financial alternatives. ETB seems agreed to make *values commitment* to fulfil the religious imperative to provide alternative financial services in keeping with the principles and teaching of Islam. Both individual elements and the institution as a whole are aware of the need to address this imperative. The idea of providing alternative financial products and institutional arrangements based upon and derived from Shariah principles with consequent ethical and social justice features is signified as a specific ETB values commitment and, in turn, shapes its identity.

.....the central operating capability being rapidly expanded to enable the Bank to satisfy in a wholly Shariah compliant way the financial needs of the modern consumer..... (TBE Annual Report 2005)

The Islamic bank offers an Islamic banking solution as a non-exploitative financial alternative for people. It still has to be competitive and at the same time be able to offer solutions for Muslims in the West. (Senior Treasury Manager – interview)

ETB values commitment governs how the institution fulfils the religious imperative. ETB needs to present religious commitment and a transcendental frame of reference to achieve institutional legitimacy. At the same time, it needs to secure an acceptable level of financial and economic performance. However, to combine these goals and balance them within the boundary of religious rules is not easy. As explored in Chapter 5, the theoretical framework of this thesis, inspired by Weber's view of divinity in social order, Friedland and Alford (1991) explore five core institutions in society which bring their own logic to the creation of rules and constraints for individual, organizational and societal behaviours.

The five institutions with different value spheres form various types of institutional logic which provide a *cognitive frame of reference, orientation for action and a sense of self and identity* (Friedland & Alford, 1991; Glynn, 2013). In this case, ETB is trying to combine the logic of both religion and the capitalist market, since a bank is a product of a capitalist market. At the same time, it cannot avoid the commercial logic embedded in financial institutions. ETB was initiated in order to provide a new alternative for religious and ethical finance, thus requiring it to blend the

⁷ There are five values of ETB, which includes Shariah compliance and ethical/good values. The other two are kept undisclosed to preserve ethical aspect of research

two belief systems. ETB's values commitment, identity, operational frame of reference, and orientation are formalised, and it has been documented in the Article of Association since its initial inception. In the same line, members perceived their identity to be shaped by the institutional values commitment, which in turn provides an action orientation.

It is intended that the business affairs of the Company shall be conducted in accordance with Shariah. Activities of the Company will at all times be supervised by the Shariah Supervisory committee. The Directors of the Company are obliged to ensure that the business of the Company is at all times Shariah compliant. (Article of Association - Incorporated 11 July 2002 and amended - special resolution 17 August 2010 p.8)

Formally, ETB frames the conduct of business and institutional actions so that it is obliged to comply with religious values. From the institutional perspective, the consequences are that the bank should infuse the religious principles within its governance and control system, as well as having its products services follow the religious tenets. The religious imperative is symbolised at an individual level which, in turn, is manifested as an individual identity as well as in a values commitment by members of the bank.

For non-Muslim members, for instance, they learn to understand and behave within the religious boundaries. Avoiding smoking and the drinking of alcohol in the bank's environment is one of the examples. In an informal discussion prior to an interview session with the Compliance and Risk Manager who had the experience of working with several conventional banks, he informed me that the culture and environment of the bank is different. Compared to his previous experience, the ethical principles shape the mode of relationships between members. He sensed that he had never experienced such a close relationship between staff compared with his previous work experience – he stated that even when staff leave the bank, relationships are still well maintained. The Head of Human Resources affirms, *“It's good to be a part of something that doesn't have the legacy of a big bank, that isn't tainted by the history of a big bank. That is young and fresh, and we can make it whatever we want it to be”*. This all shapes the picture of an identity that the bank wants to show to the public from both individual and institutional perspectives, especially in their newest commercial videos that can be found on the bank's website and some online media.

C. Maintaining a Level Playing Field: Ambiguous Rules in Secular Regulatory Environments

The UK – and London in particular – has already become a centre for Islamic finance. More than a dozen banks deliver Islamic finance transactions. There is hardly a large professional services firm that does not have specialist Islamic finance teams. And Islamic finance has helped transform London's skyline by financing in whole or in part developments such as The Shard, Chelsea Barracks, Harrods and the Olympic Village. (David Cameron, UK's Prime Minister – World Islamic Economics Forum 2013)

The extract above is from a David Cameron speech at the World Islamic Economic Forum in 2013 which was seen to symbolically open a wider door for the Islamic finance industry in the UK. The UK Government decided to set up the first Islamic Finance Task Force in March 2013 to facilitate the first Islamic bond (*sukuk*) issuance in a non-Islamic country. The intention was to legitimise the position of London as ‘the hub’ of the Islamic finance industry, with the expectation that there would be an appeal for inward investment to strengthen the UK economy (Dewar & Hussain, 2014). The UK government’s new move - a plan to issue a £200 million *sukuk* and to develop London as ‘the greatest capital of Islamic finance anywhere in the world’ - has attracted criticism.

The commercial logic has led the FSA and HM Treasury to accommodate the regulatory framework to support the growth of Islamic finance in the UK. They issued a number of legislative measures to remove tax and regulatory barriers to Islamic finance in the UK (Ainley, et al., 2007; HM Treasury, 2008). The FSA and HM Treasury emphasise the importance for the new industry to meet the existing regulatory framework. It is then intriguing to raise some fundamental questions: how does the regulator accommodate Islamic finance and ensure the fitness to the existing regulatory regime at the same time? To what extent does the regulator maintain ‘flexibility’ and ‘accommodation’ of a different form of imperative within the UK’s mature regulatory framework?

The FSA has been, and is, willing to play its part in supporting these developments, within its regulatory powers under FSMA. Although we cannot promote Islamic finance (or any other particular kind of finance) we can give a clear regulatory framework which is flexible enough to adapt to changes in the market.....If there is future growth in this market, it should benefit UK consumers and develop London further as an international financial centre. (FSA Report, 2007 p.32)

The basic regulations for banks in the UK is the requirements for all Islamic banks.....it means they need to meet regulatory feasibility, so all banks will have to do this....(FSA Officer – Interview)

It seems that the regulator ‘flexibility’ applies to the facility provided to remove any regulatory barrier for Islamic finance to offer their products, in this case double stamp duty on Islamic mortgages. At the same time, by accommodating the basic required rule, it enables the UK to attract Muslim investors which, in the end, will bring economic benefit for the country. In a later process, however, Islamic financial institutions are bounded by law to follow all regulators’ requirements. Both the FSA and HM Treasury have declared that the adapted regulation for the new industry does not reduce its obligation to comply with the existing codified rules of conduct. The regulatory identity and values are clearly exposed and imposed to maintain the regulatory imperative, as explored in the following discussion.

a. The English Law Domination

English law is already the preferred legal jurisdiction for many Islamic finance transactions.
(FSA Report, 2007 p.9)

In their report, the FSA places a strong emphasis on the notion that English law is the only legal jurisdiction for all financial institutions, including Islamic financial institutions. It means the religious values dictated by Islamic law need to be in line with the values of English law as a practical legal reference. Within the mature legal system and regulatory framework of the UK, the importance of Shariah principles enactment as a fulfilment of the religious imperative cannot override the position of English law whatsoever. Instead, Shariah principles, as an underlying rule for the operation of Islamic financial institutions, should be adjusted to meet the existing regulatory imperative, in which the regulatory ignorance of this aspect leads to ambiguous institutional rules. Besides, the UK regulators want to prevent the 'unforeseen consequences' resulting from the social and political impact as consequences of Islamic law implementation (Birchall, 2013; Kurti, 2013). The other factor is that the regulator applies self regulatory approach for all companies operating in the UK (Bichta, 2003)

b. Maintaining Position as Secular Regulator

....the Government does not intend to adopt a state-led approach to improving standardisation in Islamic finance. The Government believes that such an approach would be inappropriate in the UK the UK Authorities are secular bodies, not religious regulators. (HM Treasury Report 2008 p.24)

The FSA ascertains its position as a secular regulator that will have no mandate to cover any religious compliance requirements. There would not be any space for variation of regulations to address the uniqueness of Islamic finance contracts, as they want to maintain the position as a secular regulator. In the case of a profit and sharing (*mudharabah*) deposit product for example, the FSA require a deposit protection scheme. From an Islamic law perspective, customers as investors should bear any risk of loss as much as the potential profit generated. By operating in the UK market and within the FSA regulatory framework, this contract cannot be fully applied. It then forces an amendment of the basic Islamic financial contract to meet the regulatory requirements. It appears that the Islamic principles operate below the FSA standards and regulatory requirements.

Shariah scholars interpret the principles of Shariah in light of community consensus and analogical reasoning, issuing a fatwa in order to give the go ahead to a product they deem to be permissible. Because the Shariah principles can be subject to varying interpretations... for Islamic finance there can be differences of opinion, either within or across national borders, on the permissibility of certain instruments. (HM Treasury Report, 2008 p.23)

The nature of Islamic financial products derived from an interpretation of Islamic law through consensus, and analogical reasoning, creates the possibility for varying interpretations among scholars. Islamic financial institutions could have various opinions on the permissibility of certain products, either within or across different legal jurisdictions. From a regulator perspective, the possibility of having different interpretations of Islamic law is problematic. The FSA seems to want to avoid the potential arbitrage problems due to the uncertainty and ambiguities of Islamic law interpretations.

What we don't want is a situation where firms undertake arbitrage because one form of regulatory treatment has favour over another. For example, if this firm A does not care about Shariah compliance or not, they just want to have a lower legal or regulatory build. Then they may look at the regime, apply cost benefit analysis, when actually it is more cost effective for us to be Shariah compliant than non Shariah compliant or vice versa. (FSA Officer – Interview)

The FSA does not want to get involved in any Shariah aspect of Islamic products as any conflicting Shariah opinion will induce legal issues. It leaves the interpretation and implementation of Shariah principles to be ambiguous and multi-interpreted and for rules to be self-regulated in Islamic financial institutions. With a concern about the long process of Shariah certification, and the lack of Shariah knowledge on the internal institutional process, the FSA consciously left the solution and decision to the Islamic finance industry.

c. Maintaining a Level Playing Field

There is, therefore, a 'level playing field'.....it would not be appropriate, nor would it be legally possible, to vary its standards for one particular type of institution.....The FSA's approach can be summed up as 'no obstacles, but no special favours'....One of the main ones identified was the fact that Islamic mortgages attracted double stamp duty.....and government legislation in 2003 to remove this anomaly was welcomed by both the Bank of England and the FSA. (FSA Report, 2007 p.10-11, 13)

The main concern for the FSA is to regulate the Islamic finance industry's investments and deposit taking activities to avoid any risk on non-regulatory activity. As a mature regulator, the regulation for financial institutions in this country is rigid and well developed. In this case, the regulatory imperative binds all players to implement the existing rules and policy. The UK regulator applies the same level of regulation and regulatory approach to both Islamic financial institutions and its conventional counterparts.

Certainly we'll leave it to the industry to establish policy practices....We're trying to facilitate as much as possible while still maintaining a level playing field..... (FSA Officer – Interview)

As a result, they are facing dual, highly institutionalised environments that need to be maintained. They need to preserve the legitimacy as religious compliant institutions through the enactment of religious compliance principles. At the same time, the fulfilment of regulatory

guidelines is inevitable in order to maintain its position as a legally approved financial institution to operate in the UK market. Within the dual imperatives and the ambivalent rules to follow, the business of combining and enacting the two different sets of rules is deemed complex and dynamic. Fulfilling one imperative might involve a dismissal of the call of the other imperative.

d. The UK's Light Touch Regulatory Approach

The UK regulators are reluctant to address religious compliance in their standards and guidelines. This relates to their identity and value as regulators. The UK regulators apply a 'light touch' regulatory approach based on an embedded economic philosophy of self-correcting markets and responsible management, and their political attitude to avoid heavy and intrusive regulation (Black, 2010). The regulators' rationale for the light touch approach is to prevent the country losing the economic value of the business due to regulatory arbitrage, and left the industry to be self regulated (Tomasic, 2010). In many sectors, including in financial institutions, this approach facilitates a focus on the letter of the law rather than the spirit (Woods, Humphrey, & Lim, 2013).

.....It's difficult to define appropriately what constitutes Shariah compliance or non-compliance....The thing needs to be taken case by case, basically... (FSA Officer – Interview)

Islamic finance in the UK faces the challenge of a lack of religious compliance rules due to self regulatory approach imposed the regulator. At the same time, the industry has to adapt to the existing regulatory imperative and adopt it into their operation, including in the implementation of religious compliance. The difficulty in defining what constitutes Shariah compliance induces an ambiguity in Shariah compliance enactment in Islamic financial institutions. As the FSA officer suggested in the above narrative, Shariah compliance assurance needs to be taken case by case, without a standardised approach.

It shapes the politically contested nature of religious rules in Islamic financial institutions, which represents Mahoney and Thelen's (2010) viewpoint where the lack of Shariah compliance enforcement opens a different degree of openness in the interpretation and implementation of these rules. Additionally, the lack of codification of the sacred rules due to different religious interpretations, the absence of globally accepted religious rules, and the non-binding power of the existing standards adds to the complexity and creates *institutional rules ambiguity*. Within this ambiguous rules environment, it will be interesting to explore how the religious principles play their role in the conception of the banking institution, and accordingly take a position as an institutional rule.

In the context of ETB, Shariah compliance is the unique value this Islamic bank has to offer to fulfil the need of the religious imperative from an economic and financial aspect. In terms of a

Shariah compliant aspect, ETB has created a values commitment in all of its activities. In a later process, however, there are many factors, pressures, and obstacles that might affect the way ETB delivers on its promises to offer Shariah compliant banking solutions. Therefore, it would be interesting to investigate how the endogenous Shariah compliance principle works within the ambivalent rules in the ETB institutional environment.

D. Religious Compliance Works: Ambiguous Rules Interpretation in Islamic Banking Institutions

ETB is trying to fulfil this maqsood (objective) for Muslims here to preserve their wealth according to Shariah. Now, I think they have been successful to a certain extent. Why do they have 60,000 clients in a few years? Most of these people didn't have any banking account. (Shariah Supervisory Committee Member 2)

Within the UK regulatory environment, the self regulatory approach of Shariah compliance principles creates a rules complexity, and has an impact on their implementation. Besides, at the regulatory level, the lack of codification of the sacred rules due to different religious interpretations, and the absence of globally accepted religious rules leads to institutional rules ambiguity in enacting Shariah compliance principles. ETB features two highly institutionalized environments at the institutional level. The UK's secular regulatory environment and the religious rules have different imperatives for ETB to be qualified as an authorised Shariah compliant financial institution in the UK regulatory setting.

How does ETB as an institution and its individual actors cope with both religious and regulatory constraints in the two highly institutionalized environments? To address this question, the analysis at this level inductively explores the concept of religious compliance work represented in the process of Shariah compliance interpretation, enactment and implementation within the ETB institution. In line with the concept defined in the methodology chapter, Shariah compliance work in ETB is *a collective process of individuals and institutions that involves multiple cycles of interactions between external and internal identities and refining/changing values, through sense making in action, role and rules boundary transgression to create, maintain and transform Islamic banking institutions*. The following discussion and analysis at this organizational level will then be divided into three sub-sections which explore religious compliance work in ETB as the bank's effort in creating or formalising, maintaining, and transforming Shariah compliance principles.

a. Retrospective Actions in Formalising Religious Compliance: Role and Rules Boundary Transgression

The role of the in-house scholars in their role as the Shariah Supervisory Committee (SSC), as discussed in the Chapter 2 (p.28), is very important for ETB as an institution which declares

Shariah as the values basis for its operation. The SSC is an independent body designed to perform religious law translation and interpretation, and to oversee the implementation of religious compliance principles in the operation of banks. ETB has three Shariah Middle Eastern scholars on its board of scholars. They have multiple board memberships in various Islamic banks globally.

The SSC is comprised of experts in the interpretation of Islamic law and its application within modern day Islamic financial institutions. They are world leading scholars representing a wide spectrum of the Islamic faith. They ensure that Shariah-compliance is at the heart of everything ETB does and every product and service that it offers. (Head of Retail – Media interview)

The bank's products, including the current account, deposit account, home finance, and personal finance products, needed to be approved by the SSC before release to the market. The SSC certifies the Shariah compliant aspect of every product, transaction and agreement of the bank by issuing a legal opinion (*fatwa*). They also issued Shariah Compliance Certificates on those products. So far, the SSC has approved 15 Islamic finance products and issued certificates for these products. An excerpt from one of the certified product certificates is as follows:

In compliance with the Terms of Reference of the Committee, having reviewed the Master Murabahah Agreement documentation including all related contracts, literature and all associated processes, and after making all required amendments, we the 'Shariah Supervisory Committee' for Trust Ethical Bank confirm that in our opinion the Master Murabahah Agreement is in accordance with the Murabahah principles in Islamic finance and therefore we allow the bank to provide this facility to its customers. (Shariah compliance certificate – Master Murabahah Agreement)

In this case, the role and function of the in-house religious scholar is central to the internalisation of Shariah compliance principles for the overall aspects of ETB operation. AAOIFI's governance and auditing standards guides Islamic banks to separate the roles and functions of the internal Shariah reviewer and the independent board of scholars. The Shariah board responsibility to audit the implementation of the pronounced Shariah compliance rules should be separated with the Shariah compliance officer function as an internal religious compliance to review all activities in day-to-day operation.

I think because the bank is fairly small in size, and the products are fairly limited, so there is no difficulty for the SCO to do both tasks (Shariah review and Shariah audit). But of course in an ideal situation, if the bank is [bigger and it has more variety of products], and [it has the larger number of clients and customers], you need to segregate. (Shariah Supervisory Committee Member 2 - interview)

In practice, however, the Shariah scholar's position as the board member of AAOIFI which has developed the standards for the role of the Shariah board does not necessarily guarantee that they will perform as the standard guided. As represented in the above narrative, the SSC must be able to come together to make sense of the grey areas within an increasing level of religious rules ambiguity. In the process, the SSC, as represented in the above narratives, are being retrospective

in order to develop plausible images that rationalize what they are doing (Weick, et al., 2005). It reflects what Weick (1995) senses as *retrospective* behaviour, when ‘any intellectually conceived object is always in the past and therefore unreal. Reality is always the moment of vision before intellectualization takes place. There is no other reality’ (Weick, 1995, p. 24 cited from Pirsig). To work within the limit of Islamic law, the in-house scholars’ retrospectively work within *boundary transgression*⁸ in which their judgment and decision making are based on various alternative frames of reference at the same time. They allow themselves to adjust their decision to the best choices among multiple perspectives available. In the case of ETB, this retrospective action takes the form of role and rules boundary transgression, which will be explored further in the two following sections.

Transgressing the Role Boundary: a Retrospective Action

We are doing [the Shariah supervisory role/function] based on the current practises. For the current practises, the Shariah scholars set the rules, but the rules are to be executed and obeyed by the employees. So the Shariah board is the writer of the rules, and they are themselves at the end of the year the verifier that those rules were observed or not. They are helped by the internal officer. (Shariah Supervisory Committee Member 3 - interview)

The Shariah board responsibility is delegated to the internal Shariah Compliance Officer (SCO) in the Shariah Compliance Department for the day-to-day Shariah assurance process. The SCO covers all of the process of the Shariah compliance review of every single transaction and undertakes an audit of Shariah compliance, namely a Shariah audit, for all operational aspects of the bank. ETB confirms that the SCO line of reporting in terms of Shariah compliance is solely to the Shariah Supervisory Committee, as represented in the following narratives:

The SCO advises the Bank as an internal representative of the Bank’s Shariah Supervisory Committee (SSC), and undertakes regular Shariah compliance audit and monitoring of the Bank’s operations. (ETB website)

As an internal Shariah compliance advisor and supervisor, the SCO receives a full delegation from the SSC to oversee the bank’s Shariah compliance. His role as internal representative and an assistant of the SSC should be more on providing additional support for the SSC. The SCO position and his relationship with the SSC are as equal as the role and relationship of audit manager and audit committee within the bank’s governance system.

Ideally, the SCO is responsible for reviewing and ensuring that religious compliance guidance codified by the in-house scholar is implemented. In reality, however, the picture is the other way around. The SCO plays the central role in the religious enactment process. He drafts and

⁸ Inspired by the concept of boundary judgment from Werner Ulrich (2006), which consists of boundary expansion, boundary shifting and boundary transgression.

proposes religious policies and resolutions for any Shariah related issues happening in the daily operation. The SSC approval seals the religious policy in the form of Shariah pronouncements for operational activities.

They (SSC) trust me based on my knowledge in Shariah, and also the regular Shariah review and Shariah audit reports that I regularly submitted to them. (The SCO – interview)

On a regular basis, the SCO submits the complete reporting of the Shariah review and audit to the SSC. The SCO will arrange the audit plan for overall aspects of the bank once a year, and consult the plan with the SSC. After getting the SSC's approval, he will start the audit, and at the end the findings will be reported to the SSC as a report on Shariah compliance. The reference in relates to the separation of their role is ambiguous. At the same time, they want to preserve their legitimacy as the central religious decision maker and certifier.

The SCO is not a member of the board; there are three of us in the SSC. The SCO is an internal Shariah auditor, but he is not a Shariah board member. He is an assistant, but he is not part of the board legally. He is part of the bank, he is not part of the board. (Shariah Supervisory Committee Member 2 - interview)

The above remark shows that the SSC wants to limit any doubt about their legitimacy as an independent board authorises any religious compliance aspects in overall banking activities. In this case, the *role boundary transgression* is evident. Using their personal reference, they transgressed the boundary of their role when they insisted that the SCO is an internal representative of the SSC within the bank, and he does not have a legal position and decision authority on the board. On the other hand, to preserve their legitimacy, they cover the lack of a specific standard on Shariah compliance in the UK by referring to the AAOIFI standards, as represented by the third member of the SSC confirmation below.

The audit of course there are two levels, internal and external. Once the audit is completed, the figure audit by the charter accountant and the Shariah audit by the internal officer, then the internal Shariah officer devise the report format based on the AAOIFI standard. (Shariah Supervisory Committee Member 3 - interview)

The SSC confirmed that AAOIFI standard become a reference for Shariah audit report. His explanation above shows the fact that the SCO performs a role in preparing Shariah audit report. This is contradicts the governance standard of AAOIFI in relates to the role and responsibility of the SSC. The AAOIFI's Governance Standard No. 1 guides the SSC to undertake a Shariah review and audit, as represented in the excerpt below. It is become a responsibility for Shariah board to base their opinion on their review and audit, and eventually present it in a report.

We [Shariah Supervisory Committee/Board] have reviewed the principles and the contracts relating to the transactions and applications introduced by Example Islamic Financial Institution during the period ended. We have also conducted our review to form an opinion as to whether the Example Islamic Financial Institution has complied with Shariah Rules and Principles and also with the specific fatwas, rulings, and issued by us. (Example of

AAOIFI's guidance for the SSC to undertake a comprehensive assessment of every transaction in the bank's operation is somehow irrelevant, as the SSC and the SCO boundary of roles are transgressed. The main role for all decisions, assessments, and monitoring, including the annual shariah audit is the hand of the SCO. They justify the role boundary transgression through a creation of a different boundary on monitoring and supervisory. The basis of the SSC's opinion is the management and the internal officer's review and audit report. The excerpt of SSC's shariah audit report below clearly shows that the monitoring, including reviews and audit of shariah compliance are the SCO's responsibility.

According to Management, the Sharia Compliance Officer of the Bank and documents evidencing the facts, the Bank's funds were raised and invested during this period on the basis of agreements approved by us. Therefore, based on the report of our representative and representations received from Management, in our opinion, the transactions and the products entered into by the Bank during the period from 1 January 2011 to 31 December 2011 are in compliance with the Islamic Sharia rules and principles and fulfil the specific directives, rulings and guidelines issued by us. (The SSC's Shariah Audit Report – Excerpt from TEB Annual Report)

It is a huge responsibility for the SCO to ensure that Shariah compliance assurance is in place, and to serve the institutional demand at the same time. Even for the Report of the Shariah Supervisory Committee, the SCO drafts the report based on his audit, and at the end submits it for the SSC's final approval. The signed report is then submitted to the bank management, to be included in the bank's annual report together with the external audit report. The SSC retrospectively ignores the role reference that they have agreed before, and making sense of the multiple references and interpretations of their role is driven by plausible reasoning, which is reflected in the following remark:

We are, Alhamdulillah, we think we feel comfortable, that the Shariah supervisory and advisory role have been followed up absolutely. We think that the internal team, which is led by the SCO, is doing a good job, keeping us well informed. We are in good contact with each other by email, by telephone, by fax. (Shariah Supervisory Committee Member 2 - interview)

The scholars allow themselves to be reflexive with regard to the codified standard in terms of their roles and functions. The standard of reference in practice differs with the one that they have produced for the AAOIFI. The burden of ensuring Shariah compliance in ETB operations rests on the SCOs' shoulders. In this case, the SSC transgressed the boundary of its role, in between an advisory and supervisory role, to preserve both the bank and their legitimacy. Thus, sitting on the AAOIFI standards board with comprehensively defined Shariah standards that guide them to perform the role of Shariah board role cannot override the current practices in the

industry. It is even more complex when Shariah scholars sit in various financial institutions, which situate them in complex tasks which they need to perform with a lack of adequate time available.

Transgressing the Boundary of Religious Principles: a Form of Ambiguous Rules Interpretation

The logistic work, the field work could be done by someone else. The Internal Shariah audit is overseen by the Shariah board, and the Shariah board is not part of their internal operation. The Shariah board has a supervisory role and it has an arm's length [standard] to set the rules. So after a year the Shariah board checks whether the rules have been heard or not. (Shariah Supervisory Committee Member 3 - interview)

Through the narratives above, the SSC seeks stability through building an argument that the logistical work of religious compliance assurance could be conducted by the SCO. The SSC's reflexivity of pattern of action represents an ambiguity in translating their role in assuring Shariah compliance within the bank. The institutional rules ambiguity at the UK's regulatory level has drifted into the institutional level. The drifted rules ambiguity at the regulatory level creates *rules interpretation ambiguity*, another form of ambiguity at the banking institution level. It reflects what Weick (2005) observes as '*retrospective editing of actions and meaning*' of a recognisable pattern of their role and functions in formalising and overseeing the bank's religious compliance. It is a natural feature of them as human beings to reduce and avoid ambiguity and uncertainty, as well as discharge individual and institutional anxiety at the same time.

We meet regularly according to the need, sometimes three times a year, sometimes two times a year. Sometimes we meet by telephone, and Alhamdulillah. Of course as you know there are not too many products offered. So, these are all repetitive contracts, which is not difficult to monitor. (Shariah Supervisory Committee Member 2 - interview)

The SSC's ambiguity in translating their roles, which in turn highly delegated its function to the SCO, has an impact on the enactment of Shariah compliance principles. Linking back to the values commitment, ETB and all members ought to ensure all activities are Shariah compliant. The religious compliance principles guide the bank in avoiding any interest based transactions, excessive uncertainty, and highly speculative activities. In the field, however, the pieces of the puzzle show a different feature. From an Islamic perspective, transactions should be based on actual assets and should be involved in a real transaction. In practice, however, its meaning has been retrospectively edited.

Islamic consumer financing transactions represent an agreement whereby the company buys a commodity or goods and then sells it/them to the customer with an agreed profit mark-up with settlement of the sale price being deferred for an agreed period. The customer may subsequently sell the commodity purchased to generate cash. (ETB annual report 2005, 2006)

The Islamic financing product offered by ETB to customers in the above report shows the potential for a lack of involvement of a real sale and asset based transaction. It, in structure, represents a virtual sale and buy-back transaction, without any real exchange of assets, as the

customer's and the bank's intentions are to get and to provide cash financing with a deferred payment. Many criticize this transaction as a back door to interest (*riba*) - its structure has a resemblance to interest based financing. This scheme is well known as a *tawarruq* (sale and buy-back) contract.

It attracts different opinions from scholars, especially Middle Eastern scholars, as some of them think it is non-Shariah compliant, in essence seeing it as just a camouflage for a lending transaction covered by a sales based transaction. It represents a *rules boundary transgression*, where the scholars' frames of reference to the rules are multiple. In the case of ETB's scholars, most of whom are Middle Eastern, and also AAOIFI's Shariah board members, they share the view that such a transaction is non-permissible, as regulated by the AAOIFI standards. In their view, through the AAOIFI standards, it is considered to be *hilah*, a legal trick to have a permissible contract in its form, but in essence it resembles an interest based transaction.

In terms of a semantic definition, the ambiguity or ambivalence concept or behaviour can be considered to belong to two or more frames of reference, according to the interpretation applied to it (Hamnett, 1967). The OIC Fiqh Academy spells out their fatwa on organized *tawarruq* clearly, stating that organized *tawarruq* is a deception which will have a significant impact on the Islamic finance industry, as it may comply with the letter of the Law, but it does not comply with the spirit of Shariah (Goud, 2010). However, this is not the case in the UK - the rules and their boundaries that they have codified before have been transgressed.

ETB employs this contract in the personal finance and commodity *murabahah* products. The scheme of this contract shows the bank virtually buys metal on the spot market, sells it to the customer for the spot price plus a profit margin and then acts as the customer's agent to sell the metal again on the spot market. The SSC interprets the permissibility of such a contract due to certain boundaries in the regulatory environment, as one of the members explores in the following narrative:

The problem is they cannot.....Because the consumer protection act and the sales protection act will be implemented if we do ordinary murabahah. If we buy a car and sell it, if an accident happened and there's a fault in the car, the bank is first responsible, liable. Nobody wants to take such liability, it's very dangerous. So for this reason, the bank is only doing tawarruq and commodity murabahah. For the exemption of the housing which is the leasing, there is no other product to use, nothing else...(Shariah Supervisory Committee Member 2 - interview)

Islamic law guides the financial institution to provide asset based finance in both contracts, however, there is almost no physical commodity exchanged. The economic result of the transaction is nothing but the customer ending up with cash as well as a deferred liability to the bank. It equals the cash received plus a pre-agreed, fixed rate of expected profit, a semantic symbol of profit to replace the interest term within the contract. In this case, even though most of

the SSC members are also OIC Fiqh Academy members, they changed their interpretation of Shariah compliance rules in relationship to such contracts to suit both regulatory imperatives and the bank's demand for a steady profit and risk avoidance behaviour.

In addition, the implementation of non-Shariah compliant accounting techniques clashes with the requirement from the regulator to implement IFRS in their accounting and reporting system. The use of a discounted cash flow model in determining provision and income from commodity *murabahah* and *wakalah* does not represent the characteristic view of Islamic finance that the time value of money ought to be avoided. Looking at the ambiguous interpretation of their role, the lack of a supervisory process from the SSC itself results in a heavy reliance on the SCO. In turn, the SCO has insufficient time and power to oversee the regulatory imperative, as represented in the information below from ETB annual reports:

Income, on both Commodity Murabahah and Wakalah receivables, is recognised on an effective yield basis. The effective yield rate is the rate that exactly discounts the estimated future cash payments and receipts through the agreed payment term of the contract to the carrying amount of the receivable. The effective yield is established on initial recognition of the asset and is not revised subsequently. (ETB annual report 2006 p.15)

Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of cost of funds and, where appropriate, the risks specific to the liability. (ETB annual report 2007 p.24)

The rules boundary transgression is inevitable in this case, as the SCO has been confirming in many aspects that his reference is AAOIFI's Shariah standard. In terms of accounting and reporting, the SCO has been playing an important role in guiding the Manager of Finance, who has a conventional banking background, to translate the accounting treatment and financial reporting so that it is in line with the Shariah compliance principles. Through the lens of the UK regulatory requirement, however, AAOIFI standards are unacceptable; on the contrary, they require the IFRS to be implemented. As a result, as the Manager of Finance explains in the following narratives, the rules boundary transgression and ambivalence in interpretation of Shariah compliance rules are foreseeable due to the necessity to fulfil the regulatory imperative.

It's integrated, because the way we report our performance is consistent with the product we provide, so as far as I know financial reporting of Shariah products is consistent with those we have to apply from an IFRS perspective. So, the reporting we do again should be in line and consistent with Shariah perspective. (Manager of Finance – Interview)

In facing all regulatory pressures and conflicting rules, the SSC shows ambiguities in interpreting Shariah compliance principles within modern financial products. The SSC faces difficulties in maintaining the balance between religious rules and the existing regulatory imperative. Without any clear regulatory framework on religious compliance, it allows any differing interpretations and classifications of Shariah compliance features in the bank's

commercial products. In turn, collective actors undertake retrospective action to transgress the rules boundary, diverting and recreating the religious rules. The formalised Shariah compliance principles at the end are a product of competitive editing of rules and converging meaning of what constitutes Shariah compliance within the boundaries of both religious and regulatory imperatives.

b. Cognitive Framing in Maintaining Enactive and Sensible Environments for Religious Compliance

When people enact laws, they take undefined space, time, and action and draw lines, establish categories, and coin labels that create new features of the new environment that did not exist before. (Weick, 1995 p.31)

In line with Weick's view above, Lawrence et al. (2009, p. 7) explore how 'institutions provide templates for action, as well as regulative mechanisms that enforce those templates'. Actors preserve the maintenance of institutions through ensuring adherence to rules systems. Weick (1988) regards enactment as a social process by which 'a material and symbolic record of actions' is laid down and maintained through ensuring its adherence. In the case of ETB, a part of the religious compliance work is the individual or collective actors' efforts to maintain the Islamic banking institutions through ensuring compliance to Shariah rules. They undertake cognitive framing/bracketing to reproduce existing norms and belief systems, in order to maintain a sensible and enactive environment for Shariah compliance infusion in Islamic banking institutions.

It consists of two steps: firstly, 'portions of the field of experience are bracketed and singled out for closer attention on the basis of preconceptions' (Weick, 1988, p. 307). In the initial step, with ambivalent and grey areas of religious compliance rules, ETB's Shariah scholars and the SCO bracket or frame their cognition from a preconception of religious principles based on their knowledge, experiences and consideration of all boundaries in the field. At the same time, they select a practical concept of what constitutes Shariah compliance as guidance in the form of religious pronouncement for all activities and operational procedures.

In the following step, Weick (1988) explains that people's actions tend to confirm preconceptions, by acting within the context of these bracketed elements, under the guidance of preconceptions, and often shape these elements in the direction of preconceptions. In the case of ETB, the SSC pronounces the Shariah compliance principles applicable for every aspect of operation based on their cognitive framing or bracketing of what constitutes Shariah compliance. In the enactment process, however, religious compliance principles and its interpretation in daily implementation are ambiguously shaped due to dynamic institutional pressures.

Conscious of all external and internal pressures, the SCO has a huge burden to fulfil the values commitment, to follow all regulatory requirements, as well as replacing the SSC's main role

in ensuring the religious principles implementation in all aspects of ETB operation. The SCO tries to produce an enacted and sensible environment for ETB values commitment and its constructed identity to be preserved in the organization life. On the basis of SSC religious pronouncements, the SCO develops an enactment process to keep the cognition of religious values commitment and institutional actions together.

In maintaining the Shariah compliance principles in all aspects of ETB operation, the SCO implements a monitoring system in the bank through several phases. The first phase is creating Shariah compliance awareness. The second phase is daily or routine Shariah review and compliance assurance. The third phase is the annual Shariah audit process and reporting. As an Islamic bank in a non Muslim country, with a self regulatory approach, review, monitoring, and Shariah audit are all in place. The main factor for the good practices is the internal Shariah officer commitment and willingness to implement the religious compliance principles. This is represented in his effort to create trainings to increase employee awareness on Shariah compliance.

If in doubt staff must seek guidance from their line manager or contact the Shariah compliance officer (SCO). All staff will be responsible for reporting to their line manager any procedures or activities that might have an implication for the bank's compliance with Sharia. The SCO will always be included in the sign off process for new or amended products, services and associated procedural documentations. The SCO reports directly to the SSC. (ETB Shariah Training Handbook)

The SCO creates a Shariah compliance awareness program through regular and refreshment training, and operational guidelines for employees. The main objective of the training program is to create understanding of Islamic finance and the importance of Shariah compliance, and to minimize risk of non-Shariah compliance. In daily basis, every contractual agreement with other third parties should be in line with Shariah compliance, besides fair and equal treatment of any contract. The wording of clauses and aspects of the contractual agreements and procurement procedures should be in a Shariah compliance manner.

In terms of Shariah compliance assurance.... the SCO will do the checking on three main elements at least. First of all, he will review the documentation, and in this case is the Master Murabahah Agreement, which allows multiple commodity murabahah transactions. The next review is the Shariah and Legal review, in which both banks exchange documents, and then those documents will go through a Shariah review and sign off from the SCO.... In this process, the SCO gathers documents and sends them to the SSC for approval. Once the SSC agree to provide an approval, then the deal can proceed. (Senior Treasury Officer – Interview)

To maintain public trust, the legitimacy of its ethical values and to create an enactive and sensible environment, ETB, through the former SCO, has been endogenously formalising and maintaining religious compliance principles within the area of risk management. He was inductively exploring the possibility of Shariah non- compliance activities in each department and

element of the bank. From the data, he discovered and summarised the Shariah compliance risks for each department, procedure, and activities. He identified the risks owners, probabilities, impact, and controls, and the risk metrics for each item of religious non-compliance risks. In the documented risk metrics, however, it seems to just follow the FSA risk template, and limited Shariah aspects are attached

We have 450 risks in the main risk register. There are about 20.....maybe.... that are associated with Shariah. I gave a copy of these to the SCO actually. Of those, they will return and report what the metrics were, whether Red, Amber or Green. (Manager of Compliance and Risk – interview)

The Shariah Compliance Audit process has been conducted once a year by the SCO himself to review and assess Shariah compliance in the bank. The review plan was designed to ensure that all the bank's products, services, transactions, financial statements, contracts, agreements, memorandum and articles of association, reports, procedures and policies are in compliance with Shariah Principles, and the Shariah Supervisory Committee specific rules. In the Shariah compliance audit report, the SCO stated that the review undertaken by the SCO is in line with the industry practices and also based on AAOIFI professional standards. The scope of the audit are all departments within the bank, products, services, activities and transactions, management's awareness and attitudes towards Shariah Compliance.

We have an annual review by the SCO on Shariah compliance; he will review a number of areas that we covered. We also do things like contracts sign off, and all of the treasury deals processing. So there is a special area that he will look at in terms of compliance with Shariah, and very much we use the SCO for guidance as well on anything that we feel may have an impact from a Shariah perspective. (Manager of Finance – interview)

Besides those good practices, the unresolved ambiguity of Shariah rules at regulatory level creates another ambiguity in the bank level. In addition, the role boundary transgression has an impact on the increasing burden of monitoring on the sole responsibility of the SCO. The rules interpretation ambiguity enables rules adjustment due to multiple references of Shariah compliance used in the Shariah implementation process. The following discussions are presented to show the cognitive framing conducted by the SCO to reduce the rules interpretation ambiguity.

c. Framing the Use of Interest based Benchmark

Apart from focusing on internal awareness, the SCO has the aim of increasing customer understanding of Shariah compliance principles. Regularly, the SCO arranges seminars for staff, customers and non-customers in ETB's branches, and sometimes members of the SSC support the programs. Two hour seminars and discussions are held by the bank for staff and customer educational purposes. In the case of customer awareness program, the SCO builds consciousness

of religious compliance principles through cognitive bracketing to maintain customer expectation of the fulfilment of the religious imperative.

Islamic banks use BBR or LIBOR to price their products as these are the most accurate, widely accepted and consistent benchmarks for financing. This allows Islamic banks to meet the important Sharia criteria of avoiding uncertainty. If rental rates were to be used as a benchmark instead, there would be too much variation. Not only would this go against the Sharia it would also be more costly for the customer....Hence, the Islamic bank would end up offering many various rental rates which would not be practical. (SSC Member – minutes of Q&A in Shariah Scholar Public Forum)

The above narratives from the minutes of shariah awareness programs show the way TEB's scholars and the SCO to conceal the ambiguities of shariah interpretation perceived by customers through maintaining the cognitive bracketing processes. The use of interest based benchmarks for the home finance product attracts criticism from the wider public. To maintain public perception of their value commitment, TEB applies Weick (2005) concepts of noticing and bracketing. With a focus on TEB's operational practicality, and the pressures to have a stable financial outcome, the SSC tend to benchmark TEB shariah compliance enactment towards the best practice, rather than the religious rules itself. The SSC notices and brackets the sign of the need to dynamically interpret the concept of interest prohibition within the product offering, in line with what Weick (1995) describes in the following concept:

The process of sensemaking is intended to include the construction and bracketing of the textlike cues that are interpreted, as well as the revision of those interpretations based on action and its consequences. (Weick (1995) p. 8)

TEB scholars engage in framing and bracketing the situation that requires them to account for the need to reduce operational complexity by applying the real concept of profit and loss sharing. They ended up following market practices and labelling the surrounding phenomena as a widely acceptable industry practice which bring no harm to the ethicality of the actual contract. They label it as a form of following a principle of avoiding excessive uncertainty to shape the main important feature of interest prohibition. Within the cognitive bracketing process, the TEB's scholars and the SCO break down the concept of home financing product into micro mechanism, and reluctant to notice its implication to the ethicality concept of the product as a whole. They break down the view of home finance transaction into separate pieces. Arguing the use of a widely acceptable benchmark for rental fee to meet the principle of avoiding excessive uncertainty, the scholars ignore the essence of the transaction as a whole picture that have to be in line with the concept of religious compliance.

d. Bracketing a Symbolic Shariah Compliance Risk Management

Ambiguities are inevitable when the UK's light touch regulation applies in this case, leaving self controlled religious compliance risk framework to be inherently monitored. The current SCO's tacit knowledge also plays as an important factor in the escalation of ambiguity in Shariah non-compliance risk interpretation as part of the processes of value maintenance. The maturity of the FSA regulation on risks does affect the symbolic religious non-compliance risk formulation. A lack of supervision from the SSC and the regulators light touch approach, however, inherently opens up space for change and differences in the enactment process between the previous SCO, and the one in his current position.

The Arrow risk framework is the FSA version. Mmm...we have our Shariah non-compliance risk in our risk framework. So there is a section in there [discussing] Shariah and all the risk associated with Shariah. So we work to that. The FSA would not necessarily work for that. So what they would do is they have a copy of our risk management framework. So in there they would say that we are covering Shariah. The FSA does not require Shariah reporting....They want to know about HPP sales. They never want to know anything [being reported]from Shariah perspectives. (Manager of Compliance and Risk – interview)

In line with the risk management, governance, and audit framework of the bank, the previous SCO classifies the review and audit findings into four levels of rating. The rating is designed to note any improvement in the implementation of the Shariah Control System, and take into consideration the management response and the existing Shariah compliance control. The main concerns of Shariah non-compliance risk monitoring, however, seems only to conform to both regulatory imperatives. It concentrates on customer complaints related to Shariah, which in a sense is led by the FSA's customer protection rules. Any Red or Amber ratings disclosed are highlighted and discussed and it needs further action to rectify non-Shariah compliance action or activities.

e. Roles and Rules Boundary Transgression in Shariah Audit Process

Through the Shariah audit, ETB fulfils and presents a symbolic form of monitoring religious compliance. Even though the SCO, in many opportunities for discussion, always links his decision to the AAOIFI standards, the religious audit report shows a different story. The report does not represent its linkage or compliance to the AAOIFI standards, despite the two SSC's members' position on the AAOIFI Standard Board. The SSC's terms of reference with its embedded potential change (i.e., changes in company's ownership and its impact on the SSC's formal role) is the benchmark for the religious compliance assurance.

It is the responsibility of the Sharia Supervisory Committee to form an independent opinion, based on the review of the operations, agreements and transactions conducted by the bank. It is the responsibility of the bank's management to implement the decisions of the Sharia Supervisory Committee. In compliance with the Terms of Reference of the Bank's

Sharia Supervisory Committee, we submit the following report.... (The SSC's Shariah Audit Report – Excerpt from ETB Annual Report)

AAOIFI's guidance for the SSC to undertake a comprehensive assessment of every transaction in the bank's operation is in some ways irrelevant, as the benchmark for assessment is ambiguous. The boundary of the SSC's role has been transgressed by leaving the annual Shariah audit in the hand of the SCO. Justifying their cognitive framing to reach certain decisions, the SSC expands the regulatory boundary to make sense of the role and rules transgression. It is evident in the excerpt of the SSC's Shariah audit report above that the monitoring, including reviews and audit of Shariah compliance, are clearly the SCO's responsibility.

....the bank does not pay zakat on behalf of its shareholders and it is the sole responsibility of the individual shareholders to make their zakat payments. (The SSC's Shariah Audit Report – Excerpt from ETB Annual Report)

In addition, *zakat* as a form of social activity which is linked to Islamic bank identity has been left as a more individual identity. It justifies the role and rules boundary transgression when at one point individual identity is needed to strengthen the disappearance of institutional identity, whilst at a different point ETB makes sense of the shifting of institutional social responsibility into merely individual willingness and effort. At the end, a call for a Shariah audit has been accepted to maintain a sensible and enactive environment for the religious compliance rules. Rules interpretation ambiguity has been continuously identified in all processes.

f. Transforming Shariah Compliance Rules: a Grounded in Identity

The company is a Shariah compliant bank which operates according to the Sharia'a guidelines. The Sharia'a will govern these articles as long as they do not conflict with the applicable laws of the land. (Article of Association after recent company takeover)

The current article of association after a recent ownership takeover has omitted all Shariah compliance commitment outlined in the above discussion. The Middle Eastern Islamic bank which now holds around 95% of ETB ownership has changed the role of Shariah guidelines, which will only govern the company operation '*as long as they do not conflict with the applicable laws of the land*'. This ownership changes is a way for ETB to overcome some losses that it has almost every year since its inception. ETB suffers from low profits from investment as compared to the amount of depositors' funds and the personnel and administrative costs. As there are limited Shariah compliant investment alternatives, most of depositor's fund are invested in other financial institutions. For liquidity injection purposes, ETB has been taken over by two Middle Eastern banks within the past five years.

The balance sheet isn't big enough. We don't have enough assets... We have not got critical mass in terms of retail assets.....the significant drop in the base rate and the plunge in the

low base rate. You know the last two years nowthe earning on the treasury assets has been substantially reduced....which has impacted the ability to achieve profitability. Hmm....particularly where we were sitting on a large amount of essentially cash, short term funds, short term customers' funds, that we couldn't then use to finance longer term retail assets. (Manager of Finance – interview)

According to a Senior Officer in the Treasury Department, 50% of ETB's customer deposits are reinvested in the home finance product. In 2010, during the economic downturn, Islamic banks in the UK suffered from the slump in the housing market. Media reported that some conventional banks with Islamic windows, including Lloyds and HSBC, had withdrawn from the UK market for Shariah compliant loans and tried to reach better growth opportunities in Muslim countries. For ETB, with a high proportion of home finance products in its investment portfolio, it has had a significant impact on the bank. It has triggered the need for ETB to have fresh cash for the business and to fulfil the FSA capital adequacy requirement.

The current majority owner of ETB has changed the direction of ETB's values commitment by accepting the local law and regulatory rules as its main compliance reference. In line with the nature of the new owner, ETB follows the values brought by this firm as one of the biggest firms in the Middle East with various business interests ranging from oil business to financial institutions. If we look at the annual report and governance report of the current parent company, including its Islamic banking line, this firm does not really view Shariah compliance as a significant priority. In their governance report, for example, Shariah non-compliance risk is not even included as part of its risks framework. The excerpts from their reports show a pattern that might have an impact on the new interpretation of ETB religious values commitment in its recent article of association.

The company is responsible for applying Shariah governance. Our responsibility is limited in fatwa and the review of transactions introduced to us through the Shariah Audit within its permissible capabilities. (Shariah Committee of Parent Company – Shariah Audit Report)

The excerpt from the parent company's Shariah Audit Report above shows clearly that Shariah compliance implementation is left at the ETB's discretion. The in-house Shariah scholars are only responsible for producing religious opinion; the enactment of it will no longer be a concern for them. It seems to be applied to ETB when the company acquired its majority ownership, as represented in the amendment of Shariah compliance principles in its article of association. The new corporate decree is publicly available on the ETB company website. It might have an impact on the customers' trust of ETB's 'Islamicity' represented as the bank's compliance to the religious principles. At the same time, certain parts of the community and potential customers believe that ETB has not really addressed their need for a religiously compliant financial alternative.

In responding to the new company form, the SCO really carefully reviewed any marketing tools deemed in line with Shariah compliance principles. Previously, video commercials were mostly animations. The SCO also consistently warned the marketing department about not using female figures in any of its marketing tools. Recently, after the acquisition was executed, the bank produced many commercial videos that presented most of the individual member in the bank. In the narratives below, every member expressed their identity driven by the institutionally accepted values commitment:

The bank is an amazing place to work. The people are absolutely great, and you get a lot of satisfaction in helping people, not just financially, but also from a spiritual and religious point of view, which is really important. (Business Development Manager - advertising video/website)

From a personal point of view, from a religious aspect, to be able to be part of an organization which provides a halal Shariah compliant alternative to the conventional bank is very important to me. (Customer Service Advisor – advertising video/website)

It is a new transformation from its initial values commitment in ETB's early inception. It represents the third phase of institutional work, when ETB's identity as an institution is disrupted by disassociating the practice and rule from its moral foundation and its undermining core assumptions and beliefs which stabilize it as an Islamic banking institution (Lawrence & Suddaby, 2006; Lawrence, et al., 2009). As an impact, ETB presents what Weick (1995) identified as a form of being *grounded in identity*, when the bank explores the individual identity and values to cover the initial values commitment that has become meaningless.

Through the videos, besides the economic benefit gained from working in the bank, individual members of ETB sense that working in the bank is part of their manifestation and expression of religious needs. The commercial videos represent the way ETB want to show their self-reflection on their organizational identity. In this case, the actors within ETB are clarifying their personal identity to justify organizational identity. The need to maintain a sense of individual religious imperative, and projected as a general orientation and one's self conception, is in line with Weick's (1995) concept of being *grounded in identity*. Through intentional sense making and individual projection of itself onto its environment, ETB develops a self-referential appreciation of a religious banking identity (Ring & Van de Ven, 1989; Weick, 1995).

Weick (1995) regards *grounded in identity* as being triggered by ETB's failure to confirm 'one's self', when ownership changes impacted on the values commitment that were initially declared in the previous articles of association. Weick's (1995) concept of 'grounded in identity' becomes useful or can be applied when the institutional identity and values become blurred. The ambiguity of Shariah compliance interpretation and the rules boundary transgression result in a clearly documented 'acceptable legal breaching' in the current article of association.

In the event that there is such shortfall, the directors shall first, and before reverting to the company funds, utilise any funds available in the profit stabilisation reserve to satisfy any shortfall in the principal amount, and not the profit, of any profit sharing account. Although utilising the company funds to make good any principal loss of any profit sharing account holder will not be in accordance with Islamic principles governing these accounts, the Shariah Supervisory Committee has allowed this condition to comply with current banking regulations until such time that these regulations are amended, or the company given an exemption by the Financial Services Authority (Article of Association after recent company takeover)

AAOIFI guidelines on profit equalisation reserve, a reserve from the profit and risk sharing account (*mudharabah*), was designed to stabilise profit distribution to investment account holders. Utilising the reserve to cover any principle loss is considered non-Shariah compliant. ETB's Shariah scholar, however, ambiguously interprets it differently and transgressed the boundary of the religious rules using the FSA requirement of the deposit protection scheme to justify its acceptability. In the end, rules interpretation ambiguity has been continuously identified in all processes, including in a disruption that transforms Shariah compliance enactment.

E. Reliance on Tacit Intellectual Power: Ambiguity in Religious Rules Enactment

I discussed my unique position in the bank to the SSC, as I work as a Shariah compliance officer and product development officer as well. I want to put a disclaimer in the Shariah audit report which explains my positions, but they told me it does not matter, and I don't have to give the explanation. They believe there will be no conflict of interest as my reporting line is to the SSC and I try to keep everything separated. (SCO – interview)

The current SCO has been working in the bank for almost 7 years. Originally from one of the Middle Eastern countries, the SCO has a Shariah education background in religious studies (*Ushuluddin*), a postgraduate degree in Islamic banking and finance, and also a postgraduate diploma in Islamic literature from several universities in the Middle East and the UK. He also holds a licence as a certified Shariah auditor and advisor from AAOIFI. This gives him ample knowledge to be in the position of ensuring the enactment of Shariah compliance principles in the bank.

The SCO has multiple responsibilities on Shariah compliance assurance and the Shariah audit and is also responsible for product development. His multiple positions are linked to limited resources available in the bank, particularly human resources that have knowledge of Islamic law and the need to ensure the element of Shariah compliance assurance in each product.

"They would not do it if we don't ask them" the previous SCO commented on the lack of the SSC involvement in the annual Shariah audit process whilst, in this period, ETB, on his initiative, asked a local member of the SSC to get involved with the Shariah audit process, including sampling examination. This increases the level of difficulty for bank members to follow and comply with the rules guided by its values commitment. It would be even harder for non-

Muslim members, with the very limited knowledge they have, to work on the Shariah principles that are still ambiguous at the operational level.

The grey area of Shariah compliance boundaries coupled with a high reliance on the SCO creates ambiguity in Shariah compliance rules enactment. It appears that *rules enactment ambiguity* is inevitable, as both the function of internal and external monitoring are handled by one person in the internal institution. The SSC members might give different decisions on Shariah compliance approval in one bank compared with another. It is merely a reflection of the internal officer's process of cognitive framing in how a certain decision is arrived at. He is the one who blends the information provided for the SSC. It is very much related to his style, power, personal religious views, and his independence.

Due to role interpretation ambiguity, the SSC ignores the issue of multiple positions held by the internal Shariah officer. The SCO receives a full mandate from the SSC to cover daily monitoring, review processes as well as supervisory roles at the same time. The size of the bank, which is relatively small compared to other Islamic banks that The SSC have supervised so far, has become a rationale for them to dismiss the issue. The line of reporting in terms of Shariah compliance is solely to the Shariah Supervisory Committee, on the basis of regular and complete reporting of the Shariah review and audit submitted to them. In this regards, for the SCO, this is a sign of significant trust from the SSC which has a big impact on him as he has the responsibility to have a proper Shariah compliance assurance and develop awareness among the bank's members.

They (SSC) trust me based on my knowledge in Shariah, and also the regular Shariah review and Shariah audit reports that I regularly submitted to them.....It's not an easy job for me to work in the bank in the last 5 years. It needs not only somebody who has a strong background in Shariah, but also someone who has a strong way in convincing people. (SCO – interview)

Being in the bank for more than three months enabled me to observe the tension and debates that appeared around daily Shariah compliance approval. At one point, a debate between the Manager of Credit and the Shariah compliance on Shariah compliance aspect that needed to be fulfilled in deciding customer financing provides an overview of the dynamics behind enactment of religious compliance principles. A senior officer in the marketing department also shared the same experience that the SCO had been strictly following the religious compliance principles in the assurance processes.

From the marketing department perspective, many times there's been things that from our point of view were okay, but internally from the Shariah officer point of view they were picked up. We had to go back. We changed a lot of points, and sometimes completely started from scratch, from very basic, because what we were doing was not appropriate from a Shariah compliance point of view. The process is in place, everything is strictly followed. He does the job well. He doesn't look at anything from marketing, he looks at it from a Shariah point of view. From internal monitoring, from Shariah compliance

committee, I would say the process is strictly followed. (Senior Marketing Officer – interview)

a. Reliance on Tacit Knowledge

The SCO's knowledge of Shariah compliance is action oriented, has personal quality, and can only be acquired through practical experience (Lam, 2000). Thus, the bank member tends to learn the pattern from their own experience to understand what constitutes Shariah compliance for a specific task or function, as represented in the below officer's concern. The boundaries and limits of religious compliance are understood as a continuous learning process. The rules and principles for the Shariah implementation process from a more micro perspective are subject to change and are merely a self-learning process.

We have guidelines, but that's more verbal. I personally haven't seen the documents. From a Shariah point of view, what is and what isn't....You can't be involved in any of the lotteries, such as gambling activities, but a free price draw, some argue, is allowed, though some argue it isn't allowed. Some banks, Islamic banks that I've seen, are using people imagery - for our product, the SCO doesn't allow us to do this. But what is the real argument? ... Is it a personal point of view or Shariah point of view? What is the clear guidance? What is the background? (Senior Marketing Officer – interview)

The ambiguity in interpreting religious rules for compliance seems to have drifted into the micro and individual level. Each aspect and issue is treated case by case, based on the SCO's experience and intuition as a form of tacit intellectual power, without any clear and well documented guidelines. The senior officer in the marketing department asserts that instead of relying on the SCO, a reference for a codified standard is essential. A guideline is deemed important, especially for non-Muslim members of the bank. It helps them to understand and appreciate the rationale behind each ruling and decision. It also provides them with clearer boundaries and limits so that they can still stand within religiously permissible areas.

Maybe it might be worth producing a guideline, not only for us, but probably for a wider audience, something from the Shariah standards that you know. For example, in English or the western world, when you talk about saving, the first idea that comes to your mind, the image is the piggy bank...If you're not Muslim, you might not know that you can't associate pig with Islam, right? But if you're Muslim you will know, you will not use this analogy....I mean this is common sense, a lot of people will know, but probably producing some guidelines for non Muslims, who don't know Shariah much...for everything that you produced, that you have to stay under this limits. (Senior Marketing Officer – interview)

The SCO's interpretation is a further process for ensuring religious compliance merely based on his cognitive framing of each case and phenomena in the organisation. Apart from a section explaining Shariah compliance aspects in each procedure and process documentation, the guideline available is a sort of verbal guideline provided by the SCO. As a result, the enactment of Shariah compliance rules is also ambiguous. The internal monitoring and supervisory function

reflects a high level of key man reliance and the knowledge of what constitutes Shariah compliance is tacit in nature.

I see one of the Shariah members is part of an Islamic bank in Abu Dhabi, that bank uses people imagery. We don't use people imagery, the Shariah members are sitting in the same banks, how can they allow it in one bank, and not for the other bank? What's the reason behind it? Another thing is, if we use hands in an image, probably you want to use a male hand - why can't we choose a female hand? Is that the person's preference or something not allowed by Shariah, something not permitted by Shariah? These things are the very...very...basic stuff, which makes things different when you bring it to the real world. (Senior Marketing Officer – interview)

The background to his religious views - most Middle Eastern scholars follow the Hanbali school of thought which is known as the most literal approach to interpretation (Diwany, 2010) - shapes the way religious compliance has been enacted in ETB. Forbidding female hands or imagery for marketing tools reflects his strong view of enacting the religious rules in the process. At one point during my stay in the bank, he informed me of his concern about how, in his opinion, some Shariah scholars from other countries, particularly those from Malaysia, displayed a liberal view when they were all invited by the UK government to propose an Islamic student loan product. According to the SCO, their proposed opinions were unacceptable from the Shariah perspective.

In the process, a high reliance on the SCO for all religious compliance approvals resulted in more ambiguous rules for operational activities. Every decision is highly dependent upon the Shariah officer's tacit knowledge. Polanyi (1962) and Lam (2000) describe tacit knowledge as being intuitive, unarticulated and embedded in human skills, techniques, and know-how routines. It cannot be easily communicated in codified forms. In turn, Shariah compliance principles depend on the officer's cognitive limits and become non-codified rules for the purpose of operational reference. Shariah compliance enactment relies on the SCO's *tacit intellectual power*.

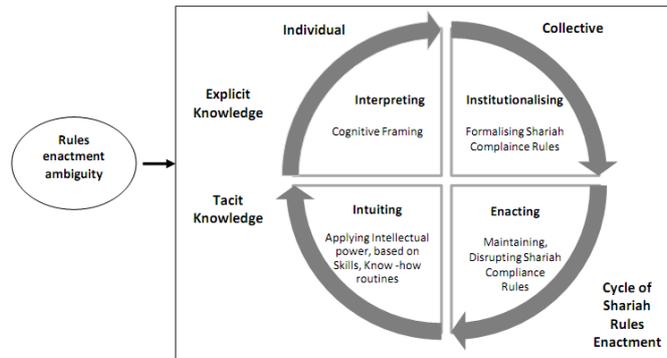
With time we get the experience. We sort of now know key things that have to be there for us to get the sign off. So rather than making a mistake, you guess something for the sign off, something was missing, image was wrong, we are now understood what the boundaries are that we can't cross, where the limits that we have to stay, in what limit that we have to stay. That's more understood by the everyday work that you've done. (Senior Marketing Officer – interview)

b. The Cycle of the Shariah Enactment Process

Practically, the internal Shariah officer's tacit knowledge plays an important role for every decision on Shariah compliance approval for each product and operational aspect. He is the main player in the *cycle of the Shariah enactment process* from the conception of the product until the monitoring of its implementation, as represented in Figure 6.1 below. The SCO individually goes through an *intuiting* process to make sense of any operational issues and link it with his tacit

knowledge; he then lifts it up to a more implicit understanding using cognitive framing in *interpreting* the facts based on religious compliance principles.

Figure 7.1 Dynamics of Religious (Shariah) Compliance Work in ETB: A Case in the UK
 Source: Analysis of the UK's case study, (Lam, 2000; Polanyi, 1962; Tovstiga, Odenthal, & Goerner, 2005)



In the following process, the SCO needs to present to the SSC his interpretation and decision based on his cognitive framing, in order to receive a stamp of approval. At this *institutionalization* stage, the Shariah compliance decision is formalised as legally approved institutional religious (Shariah) compliance rules. These implicit rules are thus being accepted as collective conscience, ready to be applied to certain operational contexts. The final stage in the cycle is the process of *enacting* the rules at the operational level. At this stage, all processes are highly reliant on the SCO, and once again such processes fall into a tacit knowledge level where the SCO has to maintain and, at some point, disrupt the rules.

In terms of guidance, he always refers to AAOIFI standards. In practice, he could not overrule any regulatory boundaries. He could not avoid the bank's obligation to FSA for business conduct and the IFRS for accounting and reporting. Even though the practice of revenue recognition, for example, turns out to be non-Shariah compliant. What is more, in the case of ETB's takeover, he is supposed to follow all newly amended rules, which has an impact on the disruption of ETB's values commitment.

A product of the officer's cognitive framing provides rules to be formalised as guidance. The SCO proposes the rules to the SSC in order to grant approval. In the further stage, the SSC will, at the end, give moral guidance in the decision making process. The SSC's approval symbolised the collectively agreed decision for any religious decision being made. The SCO, in the enactment stage, then develops programs to maintain the formalised rules, ranging from raising members' awareness to conducting an annual formal audit of Shariah compliance. In the process, if, for certain reasons, the rules are disrupted due to different objectives and considerations of shareholders, for example, the rules need once again to be reformulated through the same cycle.

For them as non-Muslim members, I think it's difficult. They're not just working in a bank, working in marketing. They're literally working on Shariah principles. The Shariah banking doesn't come on its own. There's a whole set of of guidelines, a whole set of rules. They have to [work within] the rules boundary, what can be done, what cannot be done. If it can be done, how can it be done? If it cannot be done, why can't it be done? Why is this not allowed? Why is this allowed? So probably a more wider guidelines in terms of what Shariah is permitting, and what Shariah isn't permitting [are deemed important]. (Senior Marketing Officer – interview)

'I gave him the freedom to decide' said the Managing Director of ETB in our discussion. This gives the SCO ample room to produce religious decisions within all boundaries of the ETB environment. On the other hand, with inherent guidance in his mind, all Shariah compliance review and monitoring processes are kept secluded. In turn, ambivalence in rules enactment is inevitable, when there is lack of rules codification, and the compliance rules have been formulated and enacted based on tacit knowledge.

F. Conclusion

This chapter has reported findings from a case study of Ethical Trust Bank (ETB), one of four recognised Islamic banks in the UK. This FSA approved financial institution has publicly stated that, as part of its five ethical and social values, its banking operation is based on Islamic values. This chapter has inductively explored the concept of religious compliance work represented in the process of Shariah compliance interpretation, enactment and implementation within the ETB institution. At the regulatory level, ETB faces the challenge of lack of religious compliance rules, and needs to adapt and adopt the existing regulatory imperative into its operation, including in the implementation of religious compliance.

The UK's regulators are reluctant to address religious compliance in their standards and guidelines, as they want to secure their identity as secular regulators, and maintain regulation for everyone on a level playing field. It relates to their identity and value as regulators and their 'light touch' approach to regulation that leave the bank to be self regulated (Tomasic, 2010). This regulatory identity intended to prevent the country losing the economic value of the business due to regulatory arbitrage (Black, 2010), which facilitates institutions to focus on the letter of the law rather than its spirit (Woods, et al., 2013). The UK's self regulatory approach creates competing regulatory imperatives for ETB, both from religious and local legal authority perspectives. Additionally, the lack of codification of the sacred rules due to different religious interpretations, the absence of globally accepted religious rules, and non-binding powers of the existing standards add to the complexity. It leaves ETB to formalise its own religious compliance principles as an endogenous rule. At the regulatory level, in the end institutional rules ambiguity is inevitable, particularly for religious compliance in ETB.

The ambiguity of religious compliance rules drifts down from regulatory to individual level and, in turn, shape the politically contested nature of religious rules in ETB, where the lack of Shariah compliance enforcement creates a different degree of openness in the interpretation and implementation of these rules (Mahoney & Thelen, 2010). The conflicting identity increases the level of internal dynamics, both from a regulator's perspective and within the bank where both religious and commercial values and identity are somehow competing. Besides, the reliance on the role of Shariah scholars with their cognitive limits, power and independence adds more complexity and creates another form of ambiguity in the interpretation of Shariah compliance rules.

Within the multiple perspective of religious rules interpretation, ambiguity in the three levels is also portrayed in the process of individuals and institutions creating, maintaining, and disrupting the Islamic bank's values and identity. Using institutional work and sense making perspectives, the findings reflect the process of institutionalising religious rules at the micro-level (actors of organizations), the meso-level (organizations) and the macro-level (regulators). In the end, rules ambiguities are continuously identified in all processes, and have drifted from the regulatory to the operational level. Within the micro level, the enactment of Shariah rules depends on the internal officer's tacit intellectual power, as the knowledge behind the rules and all related decision making are non-codified, based on intuition, skills and the officer's know-how routines. It creates another ambiguity in the enactment of religious compliance rules which, in its cycle, the tacit knowledge and rules become more explicit when the rules are formalised. The cycle will be restarted when the rules are disrupted, which triggers a need to re-formalise the rules for a further enactment process.

Chapter 8 Pure Sharing Bank (PSB): A Case Study of an Islamic Bank in an Islamic Country

A. Introduction

The objective of this chapter is to describe and explore the case study I carried out in a major Islamic bank in Indonesia. To maintain an ethical approach in this research, the company name has been anonymised in the thesis and is referred to as 'Pure Sharing Bank' (PSB, hereafter). As an Islamic bank in a Muslim country, many factors play their own part in the complexity of infusing and then enacting religious rules, which have mostly been codified, into the operation of PSB. PSB has to translate and enact the codified divine rules into modern financial instruments and, at the same time, the bank needs to preserve institutional performance and sustainability. The enactment and institutionalization of religious values, as much as regulatory values, will reflect the process of individual and collective purposive action at the societal, organizational, and individual level.

This case study inductively explores the religious compliance work conceptualised as a collective process of individuals and institutions that involves multiple cycles of interactions between external and internal identities and refining or changing values, through sense making in action and role and rules boundary adjustment to formalise, maintain and transform Islamic banking institutions. The following discussion of the PSB case will be conducted from multilevel perspectives in order to obtain a comprehensive picture of the process of religious (Shariah) compliance enactment, while bringing out some of the discrepancies, ambiguities and paradoxes in individual and institutional behaviour within Islamic banking institutions.

B. Pure Sharing Bank: An Islamic Banking Institution within the Indonesian Context

The religious imperative to have a form of financial dealing in line with Muslim religious principles emerged in Indonesian society in the period 1970 – 1980 (Solihin, 2008, p. 11). Such societal demand was partly a response to Islamic banking developments in other countries, particularly, in the Middle East (as explained in Chapter 2 p.25). At this time, however, there was strong resistance from the political regime to Islam and religious activities, which constrained Indonesian society's effort to fulfil a religious imperative of this type. In 1990, there was a substantial change of government support for an Islamic revival served as a starting point for the development of an Islamic political economy in Indonesia. This started with a response from Majelis Ulama Indonesia (abbreviated as MUI, known in English as the Indonesian Religious

Scholars Council, and founded on 26 July 1975), who conducted a series of workshops from 18 -25 August 1990. The workshops were conducted in order to discuss the concept of loan interest in the banking industry.

The Ikatan Cendekiawan Muslim Indonesia (abbreviated as ICMI or known as the Indonesian Muslim Scholar Association in English translation) was founded on 7th December 1990 by Bacharuddin Jusuf Habibie, the Minister of Research and Technology at that time (later on he became the third president of Indonesia between 21st May 1998 and 20th October 1999) - as the first chairman of ICMI he played an important role in the further development of an Islamic political economy in Indonesia. ICMI obtained considerable support from the government to develop young Muslim scholars through training and fellowships. Eventually, together with the role of MUI, ICMI became a driving force behind the growth of Islamic banking in Indonesia - the first Islamic bank in Indonesia was founded in 1992 with MUI, ICMI and some prominent Muslims in Indonesian society as shareholders.

In a further process, along with the increasing numbers of Islamic banks, the Central Bank of Indonesia (BI) introduced the foundations for regulation of Islamic banking in Indonesia, as stipulated in Act No. 10 of 1998 concerning dual banking and the monetary system. Act No. 23 of 1999 was then amended by Act No. 3 of 2004 to formally permit Islamic banking to operate alongside conventional banking (Ismal, 2013). There are two main regulatory bodies for the Islamic finance industry in Indonesia: Bank Indonesia, which plays the role of the banking regulatory and supervisory body, and Dewan Syariah Nasional (abbreviated as DSN or National Shariah Board in English), which regulates all aspects related to Shariah decisions or fatwa and appointment of the in-house scholars within Islamic banks. As part of its role, Bank Indonesia is also an active member of international organizations for Islamic banking and financial services, including AAOIFI and IFSB. Recently, Bank Indonesia was replaced by the Otoritas Jasa Keuangan (abbreviated as OJK or Financial Services Authority in English).

The latest 2014 statistical report of Bank Indonesia shows that the Islamic banking industry has been developing for a period of twelve years and has experienced over 65% growth in the past four years. It serves the Muslim population, which accounts for around 85% of Indonesia's population of 220 million people, and offers enormous market potential. Indonesia's Pure Sharing Bank (PSB), the case company for this research, is one of the first Islamic banks in Indonesia. PSB currently has 79 branches, 240 sub-branches and 123 cash offices. The bank also collaborates with the National Post Office to widen its point of sales through 4,137 branches of the National Post Office (PSB Annual Report 2013). By the end of March 2014, this bank has more

than 60 billion Rupiahs or equal to more than £30 million with consumer banking accounting for 67.1% of the bank's financing assets.

C. Transmutation of Filth into Faith: Ambiguous Rules in the Duality of the Regulatory Environment

In a world dominated by strikingly uniform globalization slogans which proclaim that there are no alternatives to neoliberalism, financial integration, or capital mobility it is important to insist on the experiential metaphysic of this thrill of wonder, and to recuperate the uncanny within it...their effort to make change-literally and figuratively-hinge on a transmutation of filth into faith. Riba [forbidden interest] becomes zakat, obligatory charity and the essence of fealty to God and social justice. US dollars become the abstraction of transcendental value. As Freud remarked, gods and demons are doubles and duplicates of each other. (Maurer, 2003 p.336)

Maurer's view above represents explores a reflection of the way the uncanny works in concert with critical analyses of capitalism, when a transfer of revenue from non Shariah compliant activities to a charitable fund becomes a purification method. The IFI reveal the transcendental in the failure of equivalence materialised in their social activity, where its actors perform as the play-within-a play of the capitalism game, in making change, providing alternatives or failing to do so, in giving *zakah* or seeking to avoid it (Maurer, 2003).

At the end, the alternative industry (IFI) gives up its identity by following market characteristics to reconcile alternative value formations. The transcendental values required by the religious imperative add another layer of stifling complexity to the IFI, in addition to other regulatory demands. This is illuminated on the Islamic banking institutions in Indonesia that have to incorporate three different values, as regulated by Act 21, from which the below extract is taken. The industry needs to ensure the fulfilment of Shariah and banking prudential principles as well as the spirit of economic democracy as imposed by the regulators.

Shariah (Islamic) banking is conducting business based on the Shariah Principle, economic democracy, and prudential principles. The objective of Shariah (Islamic) banking is to support the implementation of national development in the framework of improving justice, cooperation, and the people's welfare [through] equitable distribution. (Islamic Banking Act No. 21 2008 Article 2-3)

The Act also guides the Islamic banking industry to set an overarching and as yet ambitious objective for the developing industry to support the national agenda of improving justice, cooperation, and people's welfare through equitable distribution. It is a huge agenda for the infant industry to achieve. The identities and values created by the

regulator are represented in the Islamic banks' functions described in the Islamic banking Act No 21 2008, most of whose characteristics are explored in the following discussion.

a. The Islamic Bank's Socioeconomic Functions

(1) The Shariah (Islamic) bank and UUS (Islamic windows) have the obligation to execute its functions to mobilize and distribute public funds. (2) The Shariah (Islamic) Bank and UUS may conduct social functions in the form of baitul mal institution, receiving funds from "zakat", "infaq", "shodaqoh", grant, or other social funds and distribute it to a "zakat" managing organization. (3) The Shariah (Islamic) Bank and UUS may raise social funds originating from "waqaf" money and distribute it to "waqaf" management (nazhir) according to the will of the "waqaf" (wakif) donator. (4) The social function execution as considered in paragraph (2) and paragraph (3) shall be according to the provision of laws and regulations. (Islamic Banking Act No. 21 2008 Article 4)

Islamic banks' functions described by the Act above are indicative of more than an ordinary banking institution. Besides the ordinary banking roles, Islamic banks need to perform the functions of being social as well religious and philanthropic institutions. Combining these functions is challenging for the regulators as they have to integrate the multiple functions into their guidelines and regulatory framework.

On the other hand, Islamic banks have an extraordinary responsibility to bear compared to their conventional counterparts. More than the basic function of a banking institution in mobilizing, distributing, and managing public funds, Islamic banks (widely known as Shariah banks in Indonesia) are expected to play the role of social funds manager. In this case, the banks have to collect and distribute many forms of voluntary and mandatory religious levies and even Islamic endowment funds (*waqf or waqaf*). In addition, the Islamic banks are expected to offer a philanthropic programme as part of the distribution of social funds. It is indeed a huge task for a financial institution called 'a bank', no matter what ethical and religious values underlie its operation.

b. The Duality of the Regulatory Environment

Besides prudential banking, another important factor for Islamic banks is Shariah compliance. These two factors are equally important and need to be covered in Islamic banking operation. (Head of Prudential and Banking Regulation – Bank Indonesia)

Within the dual banking system in Indonesia, Islamic banks regard compliance with Shariah as being as important as compliance with the standard banking regulations. DSN and BI play their roles as regulators for the Islamic finance industry in Indonesia, especially with regard to Shariah related rules, guidelines, and associated decision making. At the beginning of the development of Islamic banking regulations, some Islamic scholars affiliated with the Majelis Ulama Indonesia (MUI) served as the central bank/BI's Shariah advisory team.

In general, the Islamic banking system in Indonesia has been regulated by Bank Indonesia, until a point of agreement that the Shariah decisions (fatwa) for Islamic financial products are regulated by DSN (National Shariah Board). The Islamic Banking Act No 21 2008 has codified these two regulatory bodies for the Islamic finance industry. (The Chairman of DSN-MUI, and also the Chairman of PSB's Shariah Supervisory Committee - interview)

In a further process, a separation of regulatory authority and responsibility was laid down in Act No. 21 2008. Under Act 21 the central bank (BI) serves as the overall regulator, setting prudential and banking rules and regulations from both national and international perspectives, whilst the National Shariah Board's (DSN) main role is to produce Shariah policy, guidelines and operational guidance through the DSN-MUI's fatwas. Religious rulings (*fatwa*) produced by the DSN play a central role in the regulatory landscape, as highlighted by one of the architects of the Islamic finance industry in Indonesia.

The DSN produces fatwa, which in turn become a basis for the central bank (BI) regulations. At the end, the central bank regulation serves as an operational guidance for Islamic banks. (The Chairman of DSN-MUI, and also the Chairman of PSB's Shariah Supervisory Board - interview)

The religious policy/guidance expressed in the fatwa becomes the underlying basis for BI to develop the banking regulations. Moreover, most of the banking and accounting regulations were developed on the basis of the fatwa issued. As a response to the fatwa issuance, Islamic accounting standards and guidelines for auditing Islamic financial institutions were produced based on related fatwa. Without the fatwa, it would not be possible to introduce any of the important rules and guidelines to the industry. In turn, the fatwa on Islamic products and services coupled with the regular prudential banking regulations play an important role in providing operational guidelines from the central bank for the Islamic banking industry.

c. The Religious Rulings (Fatwa): Reflecting the Transmutation of Filth into Faith

We have our National Shariah Board (DSN) who produces fatwa. It is very vital for the industry. No matter to what extent we acknowledge the importance of the fatwa, the Shariah compliance will be shaped directly by the requirement to follow the fatwa in a proper manner. (Former Director of Central Bank's Training Centre for Islamic Bankers and Former PSB's Executive Director - interview)

Religious rulings (*fatwa*) govern all supported regulation including accounting and auditing guidelines. So far, there are 89 fatwas that have been specifically developed and codified for the Islamic finance industry in Indonesia. Initially, the first eleven fatwas served as the Shariah compliant guidelines for basic Islamic financial products and services, and ranged from saving products to guarantee (*kafalah*) contracts linked to a Letter of Credit (L/C) product.

Over time there has been a shift in the nature of the fatwa produced. Eight fatwas produced encourage the Islamic banks to offer products that compete with conventional ones. They ranged from the rulings on transfer of debt contracts, which allow Islamic banks to expand its market share by taking over the conventional debt financing, to securing risks and return of *murabahah* (sale based financing) as the highest portion of an Islamic banks' lending portfolio. In addition, the fundamental change prevalent in the DSN fatwa No. 15 allows Islamic banks to shift the basis of return distribution, between the bank and the customers under a partnership (*mudharabah*) contract, from the original profit sharing to a revenue sharing method.

The fatwa basically breaches the spirit of the partnership agreement which was initially dedicated to position the bank to empower customers through capital injection in a venture project where profits and losses are shared equally between partners. Sharing the project's revenue means the bank wanted a fixed return without considering the costs or the risks of the project. This represents the changing nature of the fatwa to accommodate the needs of the industry to avoid risks and to preserve the industry's financial interests in its customers. The Islamic banks move away from sharia principles in pursuit of market share.

Our principle is that the permissibility of certain practice depends on the growing needs with strict requirements (Ujizaa li hajatin bi syuruti). We always choose to be in the middle in drawing Shariah rulings. We don't want to be too rigid or too liberal. Liberal means there are no limits which make us similar to the conventional [banks]. We have to ensure that this is prevented. But we don't want to be too conservative as if it's not alive.... (The Chairman of DSN-MUI, and also the Chairman of PSB's Shariah Supervisory Board - interview)

This shifting of definition of what is permissible within the rules (based on industry needs) creates a dynamic within the codified Shariah rulings. Following the needs of and the pressure on the Islamic banking industry, the DSN through its fatwas and other regulatory agencies directly and indirectly demands that the industry's competitiveness, sustainability and good financial performance be equal to its conventional counterparts. Such changing in the nature of all fatwas is a reflection of the underlying philosophy, which is represented in the following narrative:

Indonesia as represented by the DSN-MUI has chosen a moderate school of thought... to fulfil the market (society) needs is a challenge in the process of collective authoritative interpretation (ijtihad) with full consideration and responsibility to offer solutions and innovation of financial products in a professional manner....The basic principles include 1) The permissibility principle unless legally proven otherwise, 2) the voluntary principle, 3) the social services principle, 4) the fairness and balance principle, 5) the non misleading/transparency principle, 6) the profitable principle, and 7) the principle of bringing benefit and avoiding harm....(A member of DSN-MUI, and also the Central Bank's Shariah Scholar – autobiography)

One of the DSN-MUI' Shariah scholars emphasises the moderate way of thinking behind the set of religious rulings codified for the Islamic finance industry. This central religious body has

decided to respond to market pressures. The transcendental values required by the religious imperative are modified and justified in a forward looking perspective, in the interests of the industry's financial performance. Another Shariah scholar describes the two theories used in deriving fatwas:

The theory of separating the haram (non-permissible) from the halal (permissible) (tafriq al-halal 'an al-haram) has been developed with a consideration that Islamic finance and economic activities are still difficult to be separated from a conventional interest based system. The DSN Chairman developed this theory on the basis of the fatwa of Ibn Shalah, Imam al-Nawawi, and Ibn Qayyim al-Jauziyah which clearly explain the method to purify the mixed halal and haram wealth through sacrificing what is believed as haram wealth into charitable funds/activities....The second theory in developing Islamic economics is revisiting the previous fatwa that is irrelevant and difficult to be implemented in the current situation (theory i'adah al-nadzhar).... (A Shariah Scholar and a member of DSN-MUI – autobiography)

The quote above represents the vision of Indonesian Shariah scholars to adopt a middle view, between liberal and conservative stances, in the process of decision and policy making. Due to the difficulties in separating its operation from non-permissible activities within the dual banking system, the DSN argues that the two theories explained offer a perfect solution. They accommodate the mixing of both halal and non-halal income, and they simply recommend that at the end of the process is a separation of the *haram* income and for it not to be recognized as part of an Islamic bank's revenue. This perspective is confirmed by, the Chairman of DSN, the highest authority in deriving fatwas, as he explains how the two theories have been applied in the capital market:

We apply several criteria for the screening of Shariah compliant companies listed in the Jakarta Islamic index. First, the core business shouldn't be haram; it has to be completely halal business. Second, the non-halal capital should not exceed 50%. We can have mixed [halal and haram] but then we separate it or we name it tafriq. At the end, we only recognize the revenue proceed from the halal capital. (The Chairman of DSN-MUI, and also the Chairman of PSB's Shariah Supervisory Board - interview)

The Chairman's opinion above represents Maurer's view (2003) of the Islamic banks practice as transmutation of filth into faith. He criticizes the ambiguous practices of Islamic banks that work in concert with critical analyses of capitalism, when a transfer of revenue from non-Shariah compliant activities to a charitable fund becomes a method of purification. This phenomena reveals the transcendental in the failure of equivalence materialised in their social activity, where its actors perform as the play-within-a play of the capitalism game, in making change, providing alternatives or failing to do so, in giving *zakah* or seeking to avoid it (Maurer, 2003).

From another perspective, the transmutation of haram into halal revenue/income seems very simple, but would it be that simple in practice? So far there is no practical guidance for

implementing it in practice, even though the Indonesian Islamic accounting standard (in line with AAOIFI) requires that non-halal income cannot be counted as part of the Islamic bank's income. To what extent do the listed companies or Islamic banks clearly separate the non-halal revenue proceeds from the operation? How do Islamic banks operationalize it in its daily operation? How do Islamic banks maintain it consistently? It might be expected that such ambiguous rules might result in different treatments from one Islamic bank to another.

d. The Charismatic Figure behind the Religious Rulings (Fatwa): A Modern Day Cultural Broker

...When people think Islamic law is a normative knowledge with limited approach to critical reasoning, he [the Chairman of the National Shariah Board (DSN)] came with a view that Shariah is easy to be digested by human minds... He is a reformer who opens a new discourse in the modern Islamic law. He would not consider himself as a liberal or textual Islamic thinker. He is an Islamic law expert who always considers social changes and society development into any decisions made. (A leading professor in Islamic law - autobiography)

The Chairman of the National Shariah Board (DSN), who also has been serving as the Chairman of Majelis Ulama Indonesia (MUI) for more than a decade, is the most influential person in the regulatory map of the Islamic finance industry in Indonesia. He is an Ulama (Shariah scholar) who originated from West Java, but has had many years of education and training in one of the centres of Islamic educational institution (*pesantren*) in East Java. This combination has helped him become well accepted in all regions and with his progressive view has become the leader among all *ulama*. His role as the chairman of the DSN MUI is to lead this organization along with other Shariah scholars to handle problems in society related to Islam, ranged from investigation of a perceived breach of Islamic rules, making decisions as to when Ramadhan (fasting month) or the Eid celebration should take place, to developing and codifying fatwa.

More than forty years ago, Geertz (1960) investigated the role of *ulama* or *Kyai* as a cultural broker in Javanese society. Geertz (1960, p. 235) describes *Kyai* as 'a court of last resort' [noting] how the *Kyai* 'stands apart, [is] immediately obeyed in all matters, [and] not to be disturbed with ordinary trivialities'. A similar structure can be found today, where the fatwa produced is general in form, and left to the practitioners to interpret the substance of it into different facets of practice, as represented in the view of an Islamic law expert below:

The DSN has a unique position, as it has dual roles of producing and supervising the implementation of the fatwa when each of its members becomes the in-house scholar within the bank. In addition, they also on the basis of the fatwa produced are involved in the development of the related regulations with the parliament. The dilemma that happens now lies in the inexistence of rationale and detail implementation guidance of the fatwa....The fatwa should bring no more doubts in practice.... (A professor in Islamic law – Media report during an International fatwa symposium)

In the context of Islamic banking, then, the *ulama* and particularly the Chairman of the National Shariah Board plays a key role. The view of the expert above has the same sense as what Geertz (1960, p. 235) found in the distant role of the *Kyai*, when he described how the *Kyai* creates the condition in *pesantren* (Islamic school) when his students ‘elect their own officers, set up spartan rules and regulations to govern their own conduct, and distribute the necessary domestic tasks among themselves’. In the modern world and in the environment of financial institutions, where pressures and demands are high, it would be difficult to expect the rules set through the fatwa to be implemented smoothly without clear operational guidance, as described in the following concern:

There is nothing wrong with the DSN’s fatwa. The ground for the rulings is clear and widely acceptable. The problem is that there is no operational guidance for it. At the end it might turn to be really wild in practice. Each Islamic bank might have a different interpretation, depending on the view of the scholar who interprets it. Once I asked for the opportunity to have such operational guidance for the fatwa, but he said that it’s not necessary to have one. He said it will be a burden for the Islamic bank itself, as everything might be very restrictive. (PSB Shariah Officer – interview)

The SSB has the authority to interpret and to derive an opinion. If they were in doubt, the DSN is ready to assist. Most of the in-house scholars are members of DSN, which means they should have the same interpretation of the fatwa. (The Chairman of DSN-MUI, and also the Chairman of PSB’s Shariah Supervisory Board - interview)

The Islamic banking institution, however, is a different environment to that of the *pesantren*’s, and we could not expect ‘unlimited obedience to the *Kyai*, [where] a regulated life, equality and brotherhood among the pupils are laws that are maintained unchanged by the *Kyai*’ (Geertz, 1960, p. 236). The cultural broker in the modern era, in turn, needs to realize that the scrutiny is left to the discretion of each Islamic bank. It represents what Maurer (2003) regards as the in-house scholar’s neat and self-fulfilling prophecy, whose main effect is the aura of technical precision for outside observers and regulators. The reliance on the charismatic figure who brings the Islamic revival in the form of religious rulings into modern financial instruments, and eventually leaves the implementation to the in-house scholar to interpret it for operationalization, represents *institutional rules ambiguity* in the environment despite a codified law.

This is inline with Mahoney and Thelen’s (2010, p. 11) view, which has been discussed in Chapter V, that even in a formally codified institutional rules based environment, ‘the guiding expectations often remain ambiguous, and always subject to interpretation, debate and contestation’. The problem is greater than the extent of the rules certainty. Relatively, the Islamic banks are struggling to maintain the meaning, interpretation, application, and enforcement of

institutional rules which are even more complex within the limited resources available and the increasing pressures for institutional performance and sustainability.

D. Religious Compliance Work: Ambiguous Rules Interpretation in a Mature Institution

We define an Islamic financial institution as a banking institution operating on the basis of Shariah principles. It has both sides of uniqueness and challenges which most of the time are being neglected by the human resources within the Islamic bank. It is a unique institution to combine the nature of financial institutions and the operating activities to support the real sector. It is not easy to combine the two features in one institution. Most of us only see it as a financial institution; we are applying the old conventional game, and seem to forget the profit and loss sharing contract, which I think is inappropriate. In doing so, it creates a sense that we have lost the spirit of Islamic banking. (PSB Shariah Officer – interview)

Within Indonesia's dual banking system and regulatory environment, Pure Sharing Bank (PSB) as one of the earliest players in the Islamic finance industry has been actively engage in seeking to infuse Islamic law, and Shariah compliance principles into its operations. The ambiguity of institutional rules is inevitable when there is a lack of clarity in operational guidelines and a reliance on the in-house scholars, even though a set of religious opinions has been codified, supported with the central bank's guidelines, and clear rules codified through Islamic banking acts. The challenge is increased still further in the light of the bank's wider roles compared to regular banking institutions, as represented in the Shariah officer's opinion above.

This complexity raises an important question 'how does PSB as an institution and its individual actors cope with both religious and regulatory constraints in the mature regulatory environment?' To address this question, at the bank/institutional level, the analysis inductively explored the concept of religious compliance work represented in the process of Shariah compliance interpretation, enactment and implementation within the PSB institution. According to the conceptualization in Chapter 6, Shariah compliance work in PSB is *a collective process of individuals and institutions that involves multiple cycles of interactions between external and internal identities and refining/changing values, through sense making in action, role and rules boundary adjustment to create, maintain and transform Islamic banking institutions*. The following discussion and analysis are divided into three sub-sections which explore religious compliance work in PSB as the bank's effort in formalising, maintaining, and transforming Shariah compliance principles.

a. Prospective Actions in Formalising Religious Compliance: Traversing Role and Rules Boundary

....The revitalization of Islamic law should be based on the principle of the possibility of the changes on fatwa (Shariah rulings) due to different eras and customs, and the changes of places, conditions, and objectives (taghayyur al-fatwâ bi taghayyur al-azminah wa al-amkinah wa al-ahwâl wa al-niyyât wa al-awâid). The objective is to bring Indonesia into a better economic condition and social justice, and to strengthen society's welfare. This principle aims at revitalizing the Islamic law as a flexible and contextual law, in line with the dynamic and the changes in modern society, especially to answer new issues and the revival of some issues (al-masail al-jadidah wa al-mustajaddah). This is also to change the view that Islamic law is sacred and unchangeable.... (The Chairman of DSN-MUI, and also the Chairman of PSB's Shariah Supervisory Board - Speech)

In the above quotation, the Chairman of PSB's Shariah Supervisory Board (SSB), who is also Chairman of DSN-MUI, outlines his view on developing fatwa as well as his policy in implementing the fatwa in banking operations. He has a forward looking perspective in developing and implementing the fatwa. His policy considers both interest in the implementation of Islamic law and the needs and interests of Islamic banks. The extract below shows one of the examples of how he changed the widely accepted policy of a non-permissible contract into one acceptable under shariah principles, subject to strict requirements for its implementation. In effect he rewrites the rules.

We consider tawarruq (sales and buy back contract) as a non-permissible contract, as it represents a tweak of the exchange contract. Most scholars in different countries disagree with its structure. However, the report that comes to us, including from the Accounting Standard Board, shows that the bank could not 'move and fly' without this contract. At the end we allow the contract to be offered based on the increasing needs with strict requirements (ujizaa li hajatin bisyuruti). We are taking the middle position, we did not give full permission and we did not prohibit it. It is permitted with very strict requirements. (The Chairman of DSN-MUI, and also the Chairman of PSB's Shariah Supervisory Board - interview)

As a charismatic and leading figure, his view becomes a reference for not only the other members of SSB within PSB, but also by other Shariah scholars in all Islamic banks in the country. In terms of actions and policy, it represents an individual and collective prospective sensemaking of action to cope with ambiguous situations that require the development of new and novel understandings and long-term strategic vision that helps the bank towards achieving its future objectives (Gioia, 2006; Gioia, et al., 2002; Gioia, et al., 1994; S. Kaplan & Orlikowski, 2013; MacKay, 2009; Maitlis & Christianson, 2014; Stigliani & Ravasi, 2012; Weick, 1995). In the case of PSB, the SSB, led by the Chairman, envision their roles and set the religious compliance rules based on the past/sacred principles, highlighting and adjusting to the practical difficulties and boundaries through the process of 'present perfect thinking' (Weick, 1995, p. 199) to stabilize the growing Islamic banking industry, and to achieve the same level of performance as its

conventional counterparts. The prospective sensemaking process is represented in the below quote.

Our fatwa are all applicable. We have discussed it through working groups and teams of Shariah scholars. We've gone through a comprehensive process. We looked at the guidance in Islamic jurisprudence, the general view of ulama, and the applicability in the field. We consider the losses of every party. If we considered that the loss is immaterial then we can proceed to codification, otherwise we will give incentive for short time period. We discussed the fatwa with the central bank and the accounting standard board as well for its applicability. (The Chairman of DSN-MUI, and also the Chairman of PSB's Shariah Supervisory Board - interview)

In the case of PSB, this prospective action takes the form of traversing both role and rules boundaries. As discussed in Chapter V, traversing boundaries is defined as a process of firming-up as well as breaching organizational boundaries to connect to the environment (Albert, 1995; Brock, et al., 2012; Goldstein, 1994). It is a means whereby the Islamic bank scholars and actors' actions can create a safe and bounded arena for change, and provide a safe holding environment for anxiety inducing or uncomfortable experiences. The prospective actions through traversing the role and rules boundary are explored further in the two following sections.

Traversing the Role Boundary: a Prospective Action to achieve 'Local Wisdom'

We have to cancel the meeting next week as the Chairman is still in the recovery process after having an operation. He usually attends the meeting regularly. The two other members of SSB would not want to have a meeting without his presence. (A secretary of Shariah Compliance Department --- conversation after confirming a regular meeting to the SSB members)

Within the PSB as an Islamic bank, the Chairman's position among the other two SSB members is prominent. Regular meetings of the SSB, which are scheduled once or twice in a month, would certainly be cancelled if everyone knew he would not be able to attend the meeting. A senior employee of the Compliance Division confirms that the Chairman regularly attends the meetings, and the other two members usually are not confident enough to arrange a meeting and make any decisions without his presence. The charisma of the leading in-house scholar and his way of thinking has strongly influenced the other members to rely heavily on him.

I really like and agreed on what our previous and current SSB's chairman said that we apply Islamic law with Indonesian wisdom. In the current stage, we have done it in our maximal capacity. We have been applying Shariah compliance from an Indonesian perspective, since we have to consider the central bank's rules and regulations, taxation and other guidelines. I have reduced my standards recently, as I am working in the bank. In line with the views of our SSB's chairmen, Islam needs a local wisdom, as long as we still have the motivation to purify it [the practice]. If we would say everything is non-Shariah compliance, then we will end up with nothing. (Senior Shariah Officer – interview)

At the same time, he could influence the internal Shariah officer to change and lower his standards in performing his role. He prioritises the bank's business model, as represented in the

above interview extract. In line with the spirit envisioned by the Chairman of DSN and SSB's philosophy, he takes the lead in transmuting the conventional banking activities into Shariah compliant operations. He emphasises the importance of understanding the nature of the business and the spirit of purifying the banking activities.

If I didn't change my view, nothing will work. Referring to an Islamic scholar, Islam is the process of becoming, not the set of being. How we should behave like ulama, we are transferring the message, preserving and protecting with wisdom.... We might have our message accepted at the end. I think we have to do it; there is no black and white approach in muamalah [business]. Not everything could be seen as black and white, this is what we call the local wisdom. (Senior Shariah Officer – interview)

In a further discussion, I was intrigued to explore the rationales behind the changes in his point of view. He further explained his reasons in the above narrative. He adjusts his definitions of what is required to ensure Shariah compliance to a level that takes into account the bank's challenges and opportunity to grow. This adjustment has advantages for the bank's interests, but, in another perspective, to some extent, the SSB leads the internal Shariah officers to make important review findings subservient to the wider bank's demands. This issue is clearly illustrated by a debate which commenced in the first quarter of 2005, on the use of methods to determine the bank's margin over sales based (*murabahah*) financing started.

Business division group requested SSB advised on the use of the annuity method to recognize the murabahah (sales based contract) margin over all financing period, when Bank Indonesia rules guided to use a proportional method. The SSB opinions are: after financing cost is settled it is in the bank's interest to decide any method of calculation or recording, as Shariah does not enter the recording/bookkeeping area. Any method, either annuity or proportional, are not violating Shariah principles, as long as it is a pre-agreed term and would be changed within the financing period. (Minutes of SSB Meeting First Quarter of 2005)

The discussion in the minutes of the meeting above was started when the internal Shariah officers found the use of the annuity method in the calculation of *murabahah* margin to be contradicting Shariah principles. This method represents the time value of money, and is linked to the interest (*riba*) used in the procedure for determining the internal rate of return. Moreover, the Indonesian Islamic accounting standard No.102 on *Murabahah* transaction, on the basis of the codified fatwa, recommended the use of the proportional method for calculating the *murabahah* margin in Islamic banks' financing contracts. Islamic banks should follow standard No.102 and use the proportional method so PSB is breaching the guidelines. It is an example of how rules are reinterpreted to meet redefined needs.

The PSB management, through the Business Division, responded to the findings of the internal Shariah review conducted by the Shariah Compliance Department with an appeal submitted to the SSB. In turn, the SSB considered the needs of the bank by allowing the adoption of the annuity method to enable the bank to reduce the risk of a financing default even though it

contradicts the Shariah compliance principles in general, and the previous fatwa, the related accounting standard, and the central bank's regulation (Deloitte, 2013). Following high demand from the industry, the SSB's Chairman, who is also the Chairman of the DSN, advised the bank to propose an amendment to the previous fatwa.

Both proportional and annuity methods are applicable for recognizing revenue in murabahah and murabahah financing with specific requirements guided in this fatwa...this is permissible as long as it is in line with the custom ('urf) among Islamic financial institutions. (DSN-MUI Fatwa No.84)

In the end, in December 2012, fatwa No. 84 on revenue recognition for a *murabahah* contract was codified. The excerpt of the fatwa above allows Islamic banks to either use the proportional or annuity method with a rationale that the industry is eligible to follow the local custom. In this case, similar to what Goldstein (1994, p. 115) described, the SSB's and the DSN's Chairman has been *traversing the boundary of the SSB roles* as a rule maker and supervisor. They are traversing their own role boundaries through a process of firming-up as well as breaching the essence of the formalised Shariah compliance rule in relation to revenue recognition.

We challenged the Islamic bankers that they cannot use the standard No. 102 for murabahah transactions, as the annuity method contravenes the spirit of Shariah compliance within it. They have to choose either to go back to the standard for conventional banks, or otherwise if they wanted to use the standard for Islamic banks, they need to apply the proportional methods in recognizing revenue. The Chairman of the Islamic standard board and I were very surprised when the Islamic banks collectively decided to go back to the standard No. 50 and 55 that were more suitable for conventional banks. The spirit of taking both risks and return has gone.... (Senior officer of the Central Bank – interview/discussion)

The above quote shows how ambiguous the Shariah rules are in their implementation. By allowing the breaching of rules, the *ambiguity in rules interpretation* is represented through the use of annuity method.

Traversing the Boundary of Religious Rules: Trade-off in the Ambiguous Rules Interpretation

*In theory, the bank has to own the asset 100% before selling it to customers in murabahah transactions. In practice, however, Islamic banks do not offer 100% financing. Provided the customers contribute at least 30%, we will obtain the asset and sell it to customers. In the Middle East people even consider it as partnership (*musharakah*), but we keep calling it sales based financing (*murabahah*). So you cannot judge and consider these changes as *haram* transaction. (Senior Shariah Officer – interview)*

The prospective sensemaking of how the Shariah compliance rules should be implemented is further evidence in the above quote from the Shariah officer in PSB. The rules for *murabahah* transactions have been traversed and firming-up into a new structure in Islamic bank operations. The requirement for Islamic banks to only sell assets that they own has been violated and reshaped into new criteria to identify it as a redefined Shariah compliant transaction. This is

because they need to meet performance target and chase the market share held by their conventional counterparts.

We are very innovative by having mudharabah with fixed return, a genuine style of our jurisdiction....regulation is not restrictive, enough to support us to have many innovative and genuine tools...we don't want to get bored with the complexity of the structure...
(PSB's Division Head of Financial Institutions & Transactional Banking – speech 2013)

The speech of one of the PSB's leading managers at a global conference held in Jakarta above shows that a similar traversing boundary has happened in respect to the profit and risk sharing venture (*mudharabah*) contract as well. The spirit of sharing risks is too difficult to achieve, as represented in the fixed return applied to such contracts. When I discussed the manager's speech with the Shariah officers, they actually felt really disappointed. They showed me that their Shariah review several years ago found the same problem, as noted in the excerpt from a Shariah audit report below:

Profit sharing on mudharabah contract is not in line with the realized revenue. The findings showed that in practice some branches use projected revenue that resembles interest based transaction. Bank Indonesia found this fact and warned both the management and SSB to tighten the monitoring process. The SSB already reported this to the Board of Directors. (Shariah Audit Report PSB - second quarter 2007)

The Shariah Compliance Department and the SSB received a warning from the central bank in relation to the above Shariah audit findings, and also from Bank Indonesia monitoring. The AAOIFI standard in this case also prohibits such practices. However, the fatwa enables the bank to change the structure of the *mudharabah* contract to suit the bank's needs by putting the bank as no longer being the fund owner (*shohibul maal*). Instead, the bank plays the role of an agent between the financier and the lender. In this case, at any point the bank will still receive a certain amount of fees as an agent.

The AAOIFI standard is not suitable for the Indonesian context. We have to handle customers properly. We have to assess whether they are in difficulties or just want to take an advantage from the contract. We have to tolerate them if they are really in difficulties. We are using an approach of balanced benefit for both sides. We want to avoid losses for both sides - it should be equal. We don't want the bank to bear the losses as well... (The Chairman of DSN-MUI, and also the Chairman of PSB's Shariah Supervisory Board - interview)

The Chairman's view above represents his vision of an Islamic revival for the Islamic banking industry through traversing the rules boundary. The spirit of transmuting filth into faith is manifested in the way he, both as the in-house scholar and the national rules maker, creates new structure in infusing the Islamic law. He breaks through the religious rules boundary and stimulates a new sense of Shariah compliance principles that take into account fairness and equality for both industry and society. He firmed up the revived rulings in line with the local

wisdom. From another perspective, however, he tends to ignore the importance of continuous monitoring and reliance on the consciousness of the reviewer to balance the logic of religious law and business logic.

We should carefully try to understand the reason behind the fatwa. Practitioners tend to only look at the conclusion, and try to figure out how to tweak it. They didn't explore the fatwa comprehensively. Relying on the summary of the fatwa sometimes make us biased. It triggers diversity in its implementation. (Junior Shariah Officer – interview)

One of the Shariah officers concluded that in practice the implementation might be described as having 'gone wild' in depending on the actor's intention, consciousness and power to balance both religious and business objectives. Such biases result in *ambiguous rules interpretation* in infusing the sacred principles into this modern banking institution. In the end, balancing the religious and commercial objectives is a matter of trade-off.

b. Maintaining Enactive Environments for Religious Compliance: A Bounded Responsibility

The basic principle in muamalah is that everything is permissible unless proven otherwise, thus we have to follow the principle. In the current murabahah gold transaction for example, the bank holds the gold, and the customer pays on an instalment basis. There is nothing wrong. The combination of lending (qard) and pawn brooking (rahn) of gold is acceptable as well. The bank lends the gold to the customer, and in turn, the customer pledged it to the bank until the end of a certain period. The bank and the gold are both available. The problem is that central bank is too frightened to let the market work. With the recent central bank's restriction to limit the lending proportion to 80% of the gold value, the transaction is decreasing and the players become reluctant. (The Chairman of DSN-MUI, and also the Chairman of PSB's Shariah Supervisory Board - interview)

The quote above exhibits the rationale behind the DSN policy codified in the national fatwa on gold transactions both in selling and lending. The issue is controversial as many jurists prohibit gold selling and lending transactions that use in deferred payment. Most *ulama* agreed to approve spot/cash/direct transactions of gold, but not deferred payments. Ibnu Qayyim al-Jawziyya (in Vogel & Hayes, 1998) explains that the exchange of goods, including gold, should be equal and without delay.

Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, and salt for salt - like for like, equal for equal, and hand-to-hand. If these types differ, then sell them as you wish, if it is hand-to-hand. (Ibnu Qayyim al-Jawziyya in Vogel & Hayes, 1998, p. 73)

Scholars might, however, have a different interpretation to the above. Unlike the other leading Islamic banks in Indonesia, the Shariah compliance department managed to enable PSB to avoid offering such a product. The senior Shariah officer described how the product tends to induce high speculation and has an impact on customers and bankers' behaviour, as follows.

It has been happening now, the customers progressively saving and pawn broking gold. They call it 'planting gold'. They brought the gold to the Islamic bank, and they did secured a loan by pledged the gold. They used the money and proceeded to buy some more gold and then engaged in pawn broking it again and again. They were waiting for the highest level of gold prices, in order to then sell it to obtain the highest return. This is highly speculative. In the first three months, there were 3 billion rupiahs worth of gold traded. A friend of mine, who works in an Islamic bank, even asked his wife to control the gold prices. He was really busy with speculating with his 'gold businesses'. (Senior Shariah Officer – interview)

The description above shows the unexpected impact of such rulings that are driven by the market demand. The practitioners tend to pick up the part that they have been waiting for - the green light to permit the industry expected rules to be implemented. The requirements and procedures to control it were being neglected, even though it has been comprehensively written in the fatwa codified by the DSN. These become the reason for the internal Shariah officer to work so hard to prevent PSB from offering the increasingly popular product to the market, even though the three Shariah officers have to have a long debate with the management. He is seeking to follow the spirit rather than the letter of the law. This is in line with what Maitlis and Lawrence (2007, p. 20) regard as *bounded responsibility*, which triggers and enables the Shariah officers to certain practices based on 'limited motivation to construct meaning for others, doing so only when they perceive a need to take some responsibility for an issue'.

I used to warn the management, that they face two risks if they are contravening Shariah principles. They will have a reputation risk, everybody will lose their trust, and the bank will lose its competitive identity. The second risk is financial risk. They would not be allowed to recognize the non-compliant revenue; they have to transfer it to charitable funds. We, the DPS, will report to the public, and they will lose their income. The main problems behind it are the branch managers. They have limited knowledge, and they wanted to achieve certain financial targets. (The Chairman of DSN-MUI, and also the Chairman of PSB's Shariah Supervisory Board - interview)

In the limited power they have, they sense the responsibility to maintain the enactive environment to meet the Shariah compliance principles. It is simply an *ongoing* game of maintaining a balance in the interpretation of ambiguous rules, which Weick (1995, p. 43) regards as 'the ways in which people chop moments out of continuous flows and extract cues from those moments'. In the above narrative, the SSB Chairman himself, with the SSB right to use a Shariah compliance veto, in an extreme situation might warn the PSB management if they go too far.

The business division and the sales person should think in a wider perspective than just selling the products. We have values to be preserved here. Don't they think they will endanger the bank not only from the Shariah compliance and reputational perspective, but also from the risk of financing perspective by lending to this high risk customer? I decided to reject the proposal. They should think about it before bringing it to the credit decision

meeting. Things just changed. When I was in their position, I used to be really careful in handling this problem. (Senior officer of Compliance Division – Discussion after a credit risk meeting)

In the end, the game to balance the sense of enabling the bounded responsibility and the business demand will never be an easy task. An ongoing embellishment of products and religious rulings to meet the PSB business model is as difficult as maintaining the spirit of the values they want to preserve. The trade-off of the business and religious values, and the spanning of the role and rules boundary, has been a heavy burden to bear for the in-house scholars. For example, the Head of the Shariah compliance department stated: *'I am actually scared; this has never been an easy job. God and angels are watching us all the time. But if we decided to run away, who will stay to preserve the values?'* His concern reflects the dynamic of maintaining Shariah compliance so that it is preserved and enacted in the operation of PSB.

c. Transforming Shariah Compliance Rules: Silencing of Other Voices

The SSB advised the external auditor that in investment activities the bank already had a member of the committee, with a speciality in Shariah law, to consider every rule of Shariah within any investment transaction. The external auditor findings on the violation or fraud in one or two transactions conducted by branches could not be generalized to conclude that the bank is not Shariah compliant. SSB confirmed that the bank was committed to improve the monitoring of Shariah compliance. This is proven by the bank's initiative to invite the Islamic International Rating Agency (IIRA) to audit the Shariah compliance aspect of the bank. It includes interviews with BOD and the SSB. (Minutes of SSB meeting – First Quarter 2007)

In the first quarter of 2007, the external auditor conducted a financial audit of PSB. They found several issues related to Shariah compliance in PSB's contracts and transactions. The excerpts of the minutes of the meeting between the auditor and the SSB above represented the tension and different views on the audit findings. The auditors were questioning the changing of contracts that they sensed might relate to the bank's need to sell the collateral assets for default financing contracts. The SSB was not quite happy with the findings, and they insisted that all Shariah compliance aspects had been properly implemented. To legitimately defend the SSB view, they argued with the auditors and so post 2007 they did not get an external audit assessment.

In fact, the IIRA assessment was planned to support sukuk (Islamic bond) issuance. Since 2005, in line with the guidelines for auditing Islamic banks introduced by the regulator, auditors were deeply involved in both financial audit and Shariah compliance monitoring based on the codified fatwa. After the big findings of the external auditor in 2007, I cannot find any documentation that shows external auditor involvement as it was

before. The guidelines for the auditor to assess Shariah compliance aspects in an Islamic bank's transactions were neglected, even though the clause for such a review as narrated below has become a reference for PSB.

In planning an audit, the auditor should pay attention to the Shariah compliance and the interrelated rules and regulations that might have an impact to the assessment on the Islamic bank's financial report. Even though the main responsibility of monitoring Shariah compliance lies in the bank's management, the auditor, however, needs to be aware of any Shariah compliant violations that might bring material impact to the financial reporting as a whole. (Guidelines for auditing Islamic Banks 2005 – Chapter III, section 71 p. 26)

In the end, to replace the auditor, the Shariah Compliance Department and the Internal Shariah Audit Officer, which previously attached to the Research and Training Division, were separated into a single department under the Compliance Division. In this case, the SSB has symbolized what Varaa and Monin (2010) and Monin et al. (2012) regard as *silencing of other perspectives or voices*, which means hiding particular ideas or refusing alternative perspectives and findings found by the external auditors.

All regulatory guidelines are based on fatwa. The central bank's regulations come from fatwa. At the bank level, there are two monitoring systems. The central bank monitors the compliance to the regulation and we monitor the compliance to the Shariah principles. We are on the right track. We are conducting audits on the operational level of the bank. We are monitoring the products... The SSB is the external auditor positioned within the bank...Management activities are not included in our audit scope. It's the central bank's authority to perform such an audit. (The Chairman of DSN-MUI, and also the Chairman of PSB's Shariah Supervisory Board - interview)

Referencing the existing monitoring and audit work conducted both at bank level and regulatory level, the Chairman claimed that Shariah compliance implementation and monitoring are at an acceptable level. In the case of auditing management activities, the Chairman defended his position as being limited to monitoring of the operational level and left the responsibility to the central bank. This is merely a representation of maintaining the legitimacy and taking the consequences of ambiguous rules interpretation. The external auditor view quoted below makes the picture even clearer.

...What I found in Indonesia is that so far they are still abusing the Shariah label. For mudharabah they are projecting the return when the Shariah law guided it to be shared base on the real project's profits or losses, or in murabahah they are mimicking conventional banks by adopting the annuity method. The DSN and the OJK (FSA) finally supported them with the new fatwa and rules that allow those practices. Through a discussion with several SSB members, I found that they are supporting that view as well. In the end, in auditing we only look at the Shariah compliance through the Shariah aspects in the accounting standard. We are looking at their financing portfolio and the revenue recognition in particular. I think the logic of the regulatory process is driven by the industry. My question is why is their main objective positioned at achieving Islamic finance capitalization? (Senior Auditor of a Big Four Audit Firm)

In this case, the SSB overrides the roles of the auditor - the regulation and guidelines are no longer an important reference point. The regulators and the rules and regulations are merely driven by industry demands. The logic of regulation, monitoring and business logic becomes mixed when the Chairman is an actor involved in making, monitoring and implementing rules at the same time. In the end, the Islamic bank is a game with the game of capitalism transformed into a different form.

E. The Tacit Intellectual Power of a Charismatic Figure: Ambiguity in Religious Rules Enactment

We have given the incentive to consider it as a halal transaction with some restrictions. It means we have to maintain the limits and the boundaries. If we were too restrictive, it would be very difficult, but if we cross too far, we might end up with destruction. Many friends who were working here with a strong Islamic spirit are questioning the banking practice. This is our bank isn't it? Are we purely Shariah compliant? I think I wanted to resign, they said....I replied to them that we have to be more patient. This is the dynamic, as we are a banking institution....In the end some of them decided to resign.... (Senior Shariah Officer – interview)

At the actor level, the rules interpretation ambiguity seems unresolved and has drifted to the implementation level. The concerns of some employees on the purity of the Shariah values are expressed in the above narrative. The dynamic in addressing both business and Shariah compliance logic are sometimes unacceptable for those who have a high level of religious expectations regarding the operation of PSB. The game of boundary spanning is everlasting, as at the implementation level everything seems to be taken on a case by case basis, and it creates *the ambiguity in rules enactment*.

We have to maintain the limit of the incentive to have the 'emergency period' for permitting certain practices. It shouldn't be too long. Thus, we create the rules, and then the incentive is added at the end. If it's impossible to apply certain rules, with clear reasons, then we offer the incentive for a limited emergency period. I will ask them, for how long? Sometimes afterwards, I'll check, can we lift up the incentive now? If so then the main rules are implemented. (The Chairman of DSN-MUI, and also the Chairman of PSB's Shariah Supervisory Board - interview)

At the micro level, the rule maker seems to be very dominating. The reasoning behind how the rules are enacted is solely in the Chairman's mind. The decision to add incentives to the codified rules that break the predetermined Shariah compliance principles is possible through his power, and with his tacit knowledge he determines the point of where and when the incentive should be lifted allowing the real rules to be enacted. This all relies on his tacit intellectual power to control, to balance, and to make decisions. However, what would happen if he is not there in PSB and what has happened in other Islamic banks that are far from his control as rules maker and codifier? What would happen in the future,

and what would be the impact on the Islamic banking industry, if he was not sure how to transfer and entrust his tacit knowledge and power?

F. Conclusion

The Pure Sharing Bank is an Islamic bank in Indonesia, a large Muslim country in East Asia. The case study of this institution analysed the individual and collective actions used to infuse religious (Shariah) compliance principles. Some of the discrepancies, ambiguities and paradoxes in individual and institutional behaviour occur due to tensions between internal and external identities and values. Through the vision of transmuting the profane into the transcendental in banking operation the rules have been codified to facilitate the bottom up growth of the Islamic finance industry. Individually and collectively, actors are traversing the role and rules boundaries and making sense of the prospective action to formalise, maintain, and transform Islamic banking institutions.

The charismatic figure of the Chairman of the National Shariah Board (Dewan Shariah Nasional or DSN), who also serves as the SSB Chairman of PSB, has been very influential at the regulatory, institutional and individual level of PSB operations. In the Islamic finance industry in Indonesia, transmutation of forbidden into permissible contracts and transactions, a haram into halal banking products and services, and a set of codified religious rulings (fatwa) have been produced and implemented. He has collectively gathered power to manifest the Islamic revival in the Indonesian banking industry. His spirit and vision, however, could not be separated from his traditional position as a *Kyai* or *ulama* that tends to create rules and let the practical guidelines of the rules be endogenously created (Geertz, 1960). In the end, PSB relies on his tacit knowledge and power to control and to balance the ambiguous religious rules to meet the business demand. The rule maker and codifier in the end is the rules breaker and refiner. Finally, the rules ambiguity remains unresolved at the individual level.

Chapter 9 Discussion and Conclusion

A. Introduction

In line with the central goal highlighted in Chapter 1 (p.18-19), this thesis has explored the approach of the Islamic banking industry in defining and implementing a religious compliance concept at regulatory, institutional, and at the level of individual IBF professionals. In addition, my research has examined the discrepancies, ambiguities and paradoxes that are exhibited in the individual and institutional behaviour in relation to the infusion and enactment of religious exigencies [or sensitivities] into compliance processes in IBF. Through two case studies of Islamic banks in both Islamic and non-Islamic countries, for which interviews and observations were conducted, this study empirically investigated how the banks dynamically redefine the sacred realms to suit practical world of contemporary finance.

In the early chapters of the thesis, it was shown that IBF reflect the religious imperative to provide alternative financial services in keeping with the principles and teaching of Islam (Chapra & Ahmed, 2002; Iqbal & Mirakhor, 2007). The second chapter explored how, in a more institutionalized form, IBF investment alternatives seem ambiguous in much of their translation of the divine law (Shariah), and apparently in conflict with societal expectations of IBF ethicality and philanthropic motivation (Maurer, 2012; Pitluck, 2012). The interpretation of Islamic law in a commercial context, as discussed in Chapter 1 and 2, remains under defined and thus creates major challenges in IBF attempts to ensure Shariah compliance.

The global Islamic finance industry as evidenced in Chapter 2 (p.34-45) lacks consensus and accepted standards of what constitutes Shariah compliance. Over several years, IBF actions and product developments have created ambiguity and uncertainty in establishing and defining religious compliance. This results in local variations in legal and regulatory systems. Another feature in the industry is that, in the absence of globally accepted religious codified law, each IBF establishes its own Shariah Supervisory Board (SSB) to determine whether individual financial products are compliant. This system of institutionally specific decision making creates further ambiguities. A product may be approved by one institution but an identical one may be rejected by another IBF.

It was suggested, in Chapter 4 (p.67-78), that the absence of a coherent definition of what constitutes compliance, was needed to provide a sensitizing concept, as a tool to facilitate further examination of the infusion of Shariah compliance within IBF. This sensitizing is the core theoretical lens used in this qualitative research study to analyse and understand Shariah

compliance, and to explore the paradoxes and ambiguities found in the interpretation and implementation of the rules. The underlying frame of Shariah compliance highlights the industry's lack of consensus and accepted standards regarding what constitutes Shariah compliance, and the outcome is ambiguities at regulatory, institutional, and individual levels. In addition, the sensitizing concept also illuminated how the level of compliance is a product of the enactment process.

I developed the framework for sensitizing concept of religious compliance using Giddens' dual institutional and individual strategic conduct and boundaries of consciousness (Giddens, 1986). An entanglement of individual and institutional strategic decision making and business conduct is apparent within the translation of Islamic law. Thus, Giddens' dual strategic conduct is indeed valuable as theoretical lens to takes into account individual and institutional perspective in the process of religious compliance infusion and enactment in Islamic financial institutions

Giddens' explores the level of consciousness in actors' reflexive monitoring of their own conduct and that of others. This level of consciousness is useful to explain compliance in both societal and religious dimensions of compliance in Islamic perspective. In IBF context, religious compliance represents an enactment of Islamic law as virtual rules in the sense of what Giddens regards as a range between simple rationalizations of their conduct to a level when compliance become inherent memory that embedded within its institutional strategic conduct. The enactment of religious rules in IBF might be symbolic to some extent or decoupled in a more formal monitoring.

Reflecting on those levels of compliance, there is an interesting question on how IBF might falls into one of those levels, how the dynamic in its process. The shariah compliance rules derived from Islamic law in the IBF environment is ambiguous and drifts into the institutional and actor levels. The institutional rules ambiguity at regulatory level, rules interpretation ambiguity at institutional level, and rules enactment ambiguity at actor's level create room for agency and creativity. Inconsistencies of Shariah compliance implementation become evident, when the codified rules are vague or even not exist, coupled with conflicting demands. In the end, actors and institutions exploit the endogenous rules in line with the degree of openness in interpretation of the rules; this, in turn, then shapes the compliance according to their preferred direction.

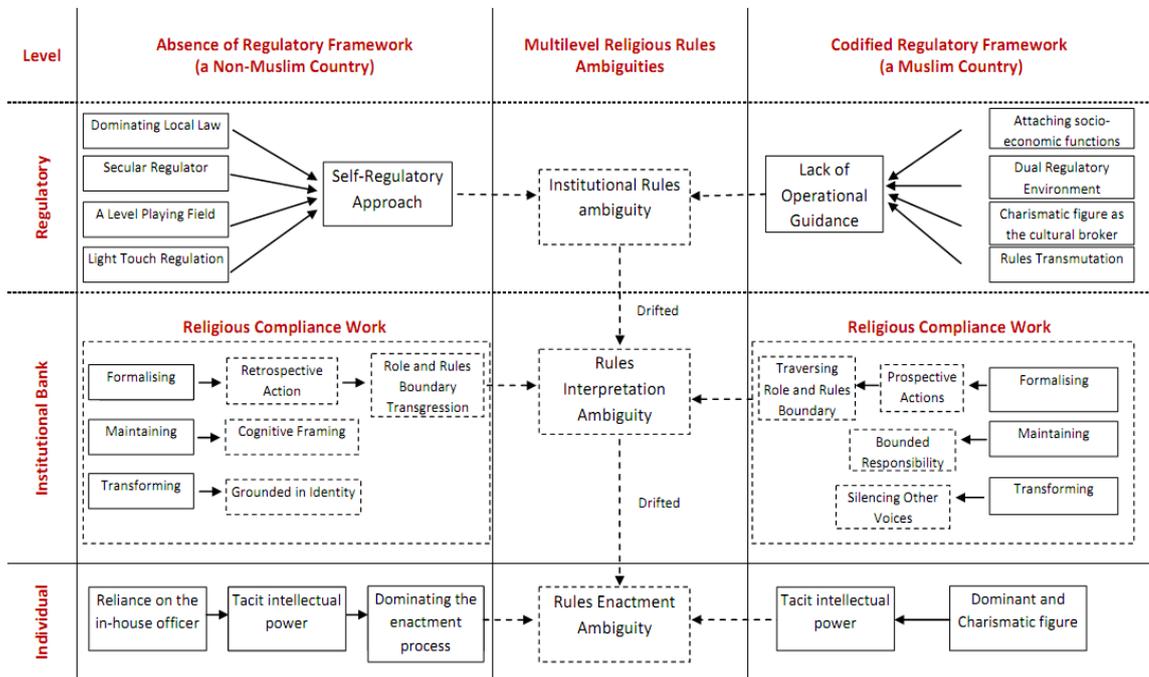
The actors in IBF, especially the Shariah scholars, play their important roles in the dynamic within the process of formalising, maintaining, and transforming religious compliance rules. In line with Powell and Colyvas (2008), Thornton, et al (2012), and Suddaby (2013), the use of sensemaking (Weick, 1995) enables me to acknowledge the micro perspective in an ongoing and strategizing activities within the process of religious compliance work. Through the two case

studies (Chapter 7 and 8) carried out in two countries (one non-Muslim and one Muslim country) observations I identified several main themes in the research. More specifically, the data analysis was centred around three main themes for each case: (1) their interpretation of Shariah compliance concepts, (2) the implementation of religious compliance principles, and the creation/formalisation and maintenance of Shariah compliance principles within its operation, and (3) the dynamic of the religious compliance concept and its implementation at the regulatory, institutional, and individual level of the Islamic banking industry.

The analysis was conducted at three levels - regulatory, institutional and individual - which classified the process of interpretation, enactment and implementation of Shariah compliance principles as a representation of religious compliance work. Most importantly, the concept of ambiguities of interpretation of Shariah compliance rules at multiple levels across Islamic financial institutions emerged as an important story/theme. Through repeated analysis of the data and consideration of the literature, I identified attempts to control the lack of orientation of religious compliance principles, through sensemaking in actions (S. Kaplan & Orlikowski, 2013; Lockett, et al., 2013; Maitlis & Christianson, 2014; Maitlis & Lawrence, 2007; Monin, et al., 2012; Schultz & Wehmeier, 2010; Vaara & Monin, 2010; Weick, 1995) and boundaries adjustment (Albert, 1995; Brock, et al., 2012; Goldstein, 1994; Mahoney & Thelen, 2010; Sheingate, 2010; Ulrich, 2006), in response to conflicting value spheres within IFI institutional complexity. The findings show unresolved uncertainty has continuously drifted from the macro to the micro level of IFI environment.

At the institutional/Islamic bank level, I explored Shariah compliance work as a form of institutional work within Islamic banking institutions. In response to recent development in the literature, I considered the juxtaposition of institutional work linked to identities and values with a sensemaking perspective (Gehman, et al., 2013; Jennings & Greenwood, 2003; Jensen, et al., 2009; Knights & Clarke, 2014; Leung, et al., 2013, 2014; Maitlis & Christianson, 2014; Maitlis & Lawrence, 2007; Monin, et al., 2012; Musson & Duberley, 2007; Powell & Colyvas, 2008; Schultz & Wehmeier, 2010; Vaara & Monin, 2010; Weick, et al., 2005). In so doing I conceptualized Shariah compliance work as a process undertaken by both individuals and institutions that involves multiple cycles of interactions between external and internal identities the outcome is continually refining or changing values, through sensemaking in action and the adjustment of roles and rules boundaries so as to formalise, maintain and transform Islamic banking institutions. The findings from the two case studies discussed in Chapter 7 and Chapter 8 are summarised in Diagram 9.1 below.

Figure 9.1 Dynamics of Religious (Shariah) Compliance Work in the Two Case studies
Source: Analysis of the two case studies



The summarised findings in Diagram 9.1 above will be discussed in three parts. Firstly, I compare and contrast the rules ambiguity in the two regulatory environments that were the locations for my two case studies – Indonesia, with its well codified Shariah rules and the United Kingdom which has no specific Shariah compliance rules at all. Next, I explore how the ambiguity remains unresolved at both institutional and individual levels. Finally, I conclude with my perspective on the theoretical and practical implications of this research.

B. The Loose Tie that Bind: Ambiguous Shariah Compliance Regulation

So, essentially we always see Shariah as something broader than compliance. But, continuously, as the new effort coming to the industry, they have their own view, and therefore have affected the image of how we view Shariah....At the end of the day; the parties are comfortable with certain contracts and products. There's a need to manage risks and define the counter party that is willing to deal with us. So, I need ... the ability to come up with the best transactions. (Manager of an Asian Islamic bank)

The view of an Islamic banker above represents the idea that architecture of compliance implementation is not static, but reflects the tensions of new values and opportunities that result from dynamic economic processes (Wilson, 1992). This corresponds with the case study evidence of a dynamic definition of religious compliance in two different regulatory environments of the UK, as a non-Muslim country, and Indonesia, as a Muslim country. The religious compliance rules

are absent from the UK's regulatory framework and the regulatory environment is characterized by the domination of the local law and regulators who do not incorporate religious ideas in their drafting of rules and regulations.

As consequence, all rules alien to the regulators' identity, including religious rules, are neglected. The regulators aim is to produce a level playing field for all market participants regardless of the particular type of institution and their religious belief. The focus of regulation is to eliminate any obstacles without giving any special favour. This can in part be explained, from a cultural perspective, 'for the first two thirds of the twentieth century, British industrial relations were characterised by a high level of voluntarism and minimum of formal legislation' (Bichta, 2003, p. 33). As consequence, reliance has been placed in a self-regulatory approach for companies operating in the UK, including Islamic financial institutions.

Industry efforts in the 1990s (Cadbury Committee in 1992, Greenbury Committee in 1998, and Turnbull Committee in 1999) affirmed this approach and set down some regulatory rules to eliminate government intervention - the UK government agreed to the initiative of 'industry self regulation and minimal government interference' (Tomasic, 2010, p. 19). Thus, in line with the cultural and legal background, the regulator ignores the suggestion of providing religiously based regulations. The self-regulatory approach thereby creates *institutional rules ambiguity*, when the institutional rules for religious compliance are neglected, and left to the individual institution's discretion.

In Indonesia, in response to the spirit of Islamic revival and the religious imperative demanded by society the regulatory environment is characterised by a well codified religious framework in which the regulator also attaches socioeconomic functions to the Islamic banking industry. Islamic banking institutions have additional social and ethical functions as part of their role. In response, the regulator and instigator of the Islamic revival in economic and financial activities, who played an important role in the first initiation of an Islamic political economy in Indonesia, invited the Shariah scholars (*Kyai* or *Ulama*), to take the lead on Shariah regulations.

In this Muslim country, the powerful, sacred figure of the Shariah scholar, a socially and culturally constructed religious authority, has been playing as 'a court of last resort' (Geertz, 1960, p. 235). This religious figure disseminates religious law (Shariah) and the translation of the doctrine across society. The *Ulama* within the National Shariah Board plays as a modern day cultural broker (Geertz, 1960). Their approach in deciding religious rulings is based on the spirit of transmutation of filth into faith, the transformation of forbidden (*haram*) to permissible (*halal*) financial and economic activities and the motivation to revisit complicated sacred rules.

Under the charismatic figure and strong leadership of the National Shariah Board's chairman, religious rules were revisited and transmuted into religious law inspired by local wisdom. This charismatic figure is obeyed in all matters through the codified religious rulings (fatwa). In line with Geertz (1960, p. 235), however, the profile of *Kyai* in the modern day remains 'aloof' and 'separated from the ordinary trivialities'. Furthermore, the rulings were too general, and lacked operational guidelines. The interpretation and implementation of Shariah rulings, and how to operationalise them in modern banking, is left to institutional discretion in Indonesia. In the end, the lack of operational guidance creates *institutional rules ambiguity*, even though the religious compliance rules are codified in the formal regulatory framework

I think standardized or centralised Shariah supervision is way ahead.... I think in the concept of Shariah rulings or fatwa, it's inherent...that you have different opinions, and that you don't have a single authority pushing for one single solution for a given question.
(Senior manager of regulatory and compliance services of a Big 4 Accounting Firm)

As highlighted in the above narrative, the differences of Shariah opinion are inherent in scholars' decision making processes. The two case studies in two different regulatory environments and socio-cultural backgrounds show the same feature of ambivalent religious rules for Islamic banking institutions. Both the regulatory ignorance in the UK where there is no religious compliance regulation and the lack of operational guidance in Indonesia with its well codified regulatory framework create *institutional rules ambiguity*, as represented in the first (regulatory) level of the Diagram 9.1 shown in the beginning of the discussion. In the end, the ambiguous Shariah compliance rules have positioned Islamic banks in a liminal condition between the boundary of 'the poles of certainty' associated with Islamic belief and naturalistic rationalism as human beings (Morgain, 2012).

C. Religious Compliance Work at the Institutional Level

Eventually we need a solution. I think the question is going back to the [Shariah] scholars; the challenge is beyond the bankers who seek alternatives. (Representative of an International Rating Agency)

The above remark explains how the unresolved ambiguity has drifted down to the bank level. The lack of clarity in the regulatory framework coupled with low pressure on the Islamic banks creates a grey area. It leaves room between the rules and Islamic banks' institutional understanding and interpretation. At the institutional level, as explained in the last section of Chapter 5, Shariah compliance work is manifested in the course of *a collective process of individuals and institutions that involves multiple cycles of interactions between external and*

internal identities and refining or changing values, through sensemaking in action, role and rules boundary adjustment to formalise, maintain and transform Islamic banking institution.

In the case of an Islamic bank in the UK, the absence of a Shariah related regulatory framework shapes the exigency of how the bank formalises, maintains, and transforms Shariah compliance rules within its operation. In formalising Shariah compliance principles, the bank is heavily reliant on the in-house scholars, both those serving on the Shariah Supervisory Committee (SSC) and the Shariah Compliance Officer (SCO), all of whom are originally Middle Eastern Scholars. Two of the SSC members also sit on the AAOFI's Shariah Board at the implementation level and retrospectively interpret religious compliance rules into modern financial instruments. Nonetheless, being the rules maker at international level does not necessarily guarantee that their guidance will serve as the 'standard guide' for Islamic banks.

The scholars make sense of the grey areas but in so doing they demonstrate an increasing level of religious rules ambiguity, as they seek to develop plausible explanations that rationalize what they are doing (Weick, et al., 2005). They are retrospectively working within *boundary transgression* in translating and performing their role, and in interpreting the religious compliance rules. The in-house scholars' judgments and decision making are based on various alternative frames of reference at the same time, which allow them to adjust their decisions to the best and most suitable choice at the time. As a consequence, the SCO has to try to fulfil the values commitment and comply with all regulatory requirements. In this role he is replacing the SSC's main role in ensuring the implementation of religious principles in all aspects of banking operation. In doing so, the internal officer uses cognitive framing to produce an enacted and 'sensible' environment that fulfils the bank's values commitment and preserves its Islamic identity.

As a new form of banking institution in a secular country, the Islamic bank works hard to achieve sustainability within the competitive Western financial market. Consequently, changing of ownership and low levels of performance may at certain points in time disrupt its identity and values commitment. To preserve the legitimacy of Islamic banks as religious and ethical banks in a Western market, the banks built what can be termed a 'grounded in identity', an identity constructed from an individual perspective that demonstrates the religious and, ethical identity that the Islamic banks want to present. This shows that ambiguity also exists at the individual level.

In the other picture of the banking world - the case of an Islamic bank in a Muslim country (Indonesia) - the lack of operational guidance in the codified Shariah compliance rules at the regulatory level drifts down to the institutional level and leads to another form of rules ambiguity.

In the spirit of rules transmutation, the in-house scholars performed prospective actions to enable the implementation of the Shariah principles insofar as they achieve an acceptable level of business and financial performance. They performed *traversing role rules boundary* when, through violating religious rules boundaries, they stimulated a new sense of Shariah compliance principles, and shaped the revived rulings in line with local wisdom. They ignored the importance of continuous monitoring and reliance on the consciousness of the reviewer to balance and trade-off the religious and business logic.

In preserving the religious compliance principles, the internal Shariah officers performed a bounded responsibility within the traversed rules. The Shariah officers reject the transmuted rules, and seek to follow the spirit rather than the letter of the law. They perceive a need to take some responsibility for the future impact on the spirit of the religious rules and the institutional values and identity. In the implementation process, the in-house scholars disrupted and transformed the codified rules endorsed by the central bank that guided the external auditor in making an assessment of religious compliance.

The scholars tend to hide another perspective found by the external auditor, which in a sense has limited capacity to assess Shariah compliance. In this case, they are silencing other voices in order to maintain their legitimacy as the main decision maker and interpreter within the ambiguous rules environment. The process of formalising, maintaining and transforming Shariah compliance features the *ambiguous rules interpretation* that occurs in infusing the sacred principles into this modern banking institution. The regulators and the rules and regulations are merely driven by industry demands, and Islamic bank is at the end merely a game with the game of capitalism transformed into a different form.

How does the Shariah board come to a conclusion? What are the procedures? What is the reasoning behind the fatwa? I think there should be discussion and solutions in that respect, but there is some way to go. (Senior manager of regulatory and compliance services of a Big 4 Accounting Firm)

As described by the advisor above, the religious interpretation and approval of contracts and financial products in both case studies are heavily reliant on scholars' cognitive limits, competence and effectiveness in scrutinizing complex financial instruments (El-Gamal, 2006, 2007; Hayat, et al., 2013; Unal, 2011). The ambiguous decision making process, and the divergent degree of openness of interpretation intermingled with the extent of SSB power, creates the *rules interpretation ambiguity* at the Islamic bank level, as represented in the second level of the Diagram 9.1 presented in the beginning of the discussion.

D. I'll know it when I see it: Rules Enactment Ambiguity at the Micro Level

There are three factors that drive any Islamic bank; first of all, the intention and objective of shareholders - do they really want a real or a fake Islamic bank? Number two, the presence of Shariah scholars - are they strong enough? And number three, the commitment of Shariah officers - is he qualified and efficient enough? (A Shariah officer who has almost 20 years work experience in several Islamic banks)

Most religious compliance assessment tends to be undertaken by individual scholars who serve as the front line in compliance enactment. In such cases, the rules interpretation ambiguity that exists at the institution level then drifts down to the actor's level. In the case of a bank without any binding religious compliance regulatory frameworks, the reliance on the SCO means that this individual is required to cope with the multiple roles of proposing, institutionalising, and enacting the rules. Due to a lack of a well-functioning independent advisory board which, in the end, formally performs the role of making the final approval, the independent internal reviewer clashes with his function in the IBF managerial structure. He is both the rule maker and the one who evaluates the rules, resulting in *rules enactment ambiguity*, as represented last part of the Diagram 9.1 presented prior to the discussion section.

A similar picture with slight differences was apparent in the case of the Islamic bank operating within well codified regulatory rules in Indonesia. The charismatic figure of *Kyai*, who serves as the rules maker, becomes the rules interpreter as well as the dominant figure that drives the enactment of Shariah compliance rules. The *rules enactment ambiguity* is manifested through the charismatic figure who serves as the rules maker and codifier, and who, in the end, is also the rules breaker and refiner. In this Muslim country, the modern religious scholar's spirit and vision, however, could not be separated from his traditional position as a *Kyai* or *ulama* who tends to create rules and let the practical guidelines of the rules be endogenously created (Geertz, 1960).

In both case studies, with his tacit knowledge and power, the individual religious scholar controls and balances the ambiguous religious rules to meet the business demand. There is a heavy reliance on the tacit knowledge of the individual scholar, an individual who performs multiple roles in his position as the rules maker, the rules fine-tuner, the rules refiner, and the rules auditor. Finally, the rules ambiguity remains unresolved at the individual level when the corporate/Shariah governance main functions are mostly handled by a single individual. Thus, the ambiguity in interpreting religious rules for compliance drifts right down to the individual level.

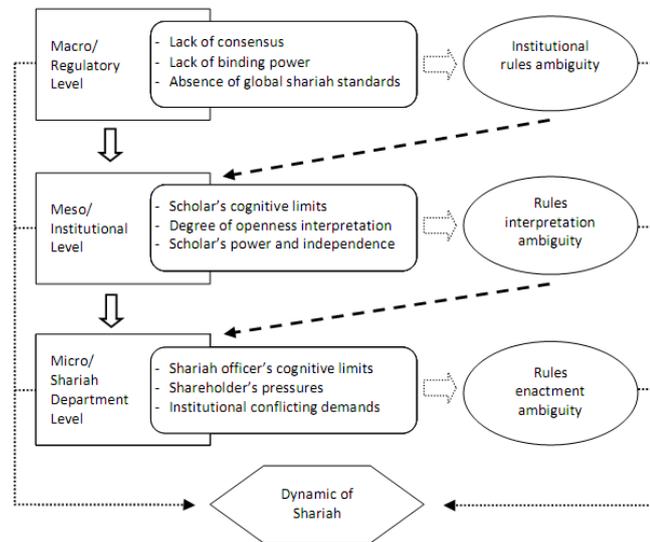
Each aspect and issue is treated case by case based on the scholar's experience, and intuition here is a form of tacit intellectual power. As a result, the enactment of Shariah compliance rules is ambiguous when the internal monitoring and supervisory function reflects a high level of reliance on one key man and the knowledge of what constitutes Shariah compliance is tacit in nature. Ambiguity in the enactment of the rules is inevitable, as both the function of internal and external monitoring are handled by one person who deals with religious compliance related issues through a case-by-case approach. The SCO is the one who blends the information and puts a lot of effort 'to make change – literally – [which] hinge[s] on a transmutation of filth into faith' (Maurer, 2003, p. 336). This process of intellectual uncertainty is very much related to the scholar's personal style, power, personal religious views, and independence.

E. Conclusion

Linking back to the questions raised and the defined objective outlined in the first chapter, this research has uncovered the approach in the Islamic banking industry to defining and implementing religious compliance concept at a regulatory, institutional, and individual level. The findings show that the industry, both globally and at the country level, suffers from a lack of consensus and accepted standards of what constitutes Shariah compliance which ultimately, creates ambiguities at regulatory, institutional, and individual levels. In addition, this thesis has shed light on the discrepancies, ambiguities and paradoxes in individual and institutional behaviour of religious compliance infusion and enactment within Islamic banking institutions, both in the case of a Muslim and a non-Muslim country.

Based on the two case studies, this study revealed the Islamic banks' dynamic redefinition of the sacred law into instruments suited to contemporary finance. Through the combined lenses of institutional work and a sensemaking perspective, this research portrayed the practice of infusion of Islamic law in the Islamic bank environment as ambiguous and drifting down to the institutional and actor's levels. In instances of both well-codified and non-codified regulatory frameworks for Shariah compliance, institutional rules ambiguity, rules interpretation and enactment ambiguities were found to be prevalent. This creates room for agency and creativity, which enables the ambiguous religious compliance rules to emerge from the inexistence of codified rules, inconsistencies and lack of operational guidelines. Thus, the unresolved rules ambiguity at the regulatory level drifts down to the institutional and actor's level. The findings reaffirmed the drifted ambiguity at the three levels of the Islamic financial institutions' environment discussed in the sensitizing concept in Chapter 4 (p.73), which is represented in Figure 9.1 below:

Figure 9.2 Ambiguities and Dynamics of Shariah Infusion in IFI
Sources: DiVanna et al. (2009) ; Hayat et al. (2013); Mahoney and Thelen (2010); Warde (2010)



From both case studies, it can be seen that Islamic banks seem ambiguous in their response to conflicting demands and institutional complexity. As a result, the nature of compliance of Islamic banks is unpredictable and change dynamically, and the degree of religious compliance is linked to various factors, including the cultural and legal background, the power and the existence of charismatic and dominant figures. The result is ambiguity in institutional rules. The IBF suffer from a lack of formally codified religious rules and are heavily reliant on the in-house religious scholars and officers, creating a risk of certifier bias. Furthermore, the interpretation of the divine law is a reflection of religious diversity, the maturity of the regulatory framework and legal system, and the cognitive limits, power and independence of in-house religious scholars (DiVanna, et al., 2009; Warde, 2010).

A gap between rules and enforcement creates rules ambiguity in relation to religious compliance, and this becomes wider when the rules maker is also the rules auditor. The lack direction of religious compliance principles as a result of a lack of rules consistency and the absence of operational guidelines enables actors and institutions to exploit the inherent openness of rules interpretation, and shape the compliance according to their preferred direction. In both environments where rules are lacking and are formally codified, it is envisaged that it seems impossible to resolve the inconsistency of Shariah compliance definition, interpretation and implementation.

Religious compliance behaviour is a dynamic process reflecting the trade-off between two poles of religious and business logic and the rationalization of power and resource allocation. In

the end, the ambiguous nature of transcendental values – Islamic values and market values – remains irresolvable, and people avoid becoming aware of this conflict of values by implicitly and explicitly choosing which values to serve in certain circumstances (Friedland, 2013; Maurer, 2003; Weber, 1993; Weber, et al., 1946). The verse below, extracted from the Holy Book of Islam, describes the root of ambiguous religious compliance.

But they have taken besides Him gods which create nothing, while they are created, and possess not for themselves any harm or benefit and possess not [power to cause] death or life or resurrection. (Al Qur'an 25:3)

From an Islamic perspective, Shariah as a law is considered enforceable for devotional or ritual matters (*'ibadah*), and in any political, social, economic and commercial activities (*mu`amalat*). For ritual matters, the Shariah guidance is clear and is outlined in a rules based manner. On the other hand, for other commercial and economic activity, the principle held by the Islamic bankers that 'every contractual arrangement is permissible, unless expressly prohibited by Shariah' (M. Iqbal, 2012, p. 67), opens a level of reflexivity within the conflicting values. In line with Maurer (2003), gods and demons are mingled, redefined and transformed to preserve stability and legitimacy. The conflicting value spheres encourage people to ignore the irresolvable conflicts of values, and implicitly or explicitly choose which value and 'god' to serve their objective to guide and ground that choice (Friedland, 2013).

F. Research Contribution

This thesis has presented theoretical, empirical and practical contributions that demonstrate the novelty and validity of the underlying research. The underlying frame of religious compliance, explored in Chapter 4, is the primary theoretical contribution of this research and provides a tool to understand the nature of what constitutes Shariah compliance and the dynamics of its implementation. The sensitizing concept of religious compliance helps to explain the empirical consequences of the lack of a clear definition of Shariah compliance in the regulatory frameworks and standards available for the industry, which prevailed to be unavoidable and somehow unsolvable. It also answers the challenge to have a clear reference of what constitute Shariah compliance in proposed in the previous studies (Hayat, et al., 2013; Maurer, 2003, 2012; Pitluck, 2012). Moreover, the sensitising concept of religious compliance provides two directions for this research: firstly, a deeper review of the existing level of religious compliance, and secondly exploring the process of Shariah compliance infusion. The level of compliance in IBF with its operational complexity is a product of the enactment process, and in the course of preserving its legitimacy IBF formalises, maintains, and formalises the

transcendental rules. In the end, I decided to choose to examine the process of Shariah infusion and this has enabled me to provide a balanced picture in portraying the dynamics, discrepancies, and paradoxes in the process.

In addition, through the two case studies, this research provides an empirical contribution that explores the process of religious compliance infusion in the Islamic banking industry in both a Muslim and non-Muslim country. With a juxtaposition of institutional work and a sensemaking perspective as theoretical lenses, this research discovered and defined multilevel rules ambiguities at regulatory, institutional, and individual levels. This also contributes to filling the gap that exists in terms of the lack of a micro foundation in institutional theory/work based research. In line with Suddaby, Seidl, and Lê (2013, p. 338), this research strengthens the discussion at a micro level and shows the 'ongoing interactions and inter-subjective interpretations of the individuals and social groups through which they are constituted'. Thus, the process of formalizing, maintaining and disrupting Islamic banking institutions is very much focused on what the individual members and key actors inside Islamic banks actually do. The methodological and theoretical perspective of this research are unique in the use of multi-level analysis and approaches that blend micro and macro perspectives of the research field, to illuminate and provide a more complete picture of religious compliance infusion and enactment in IBF.

Another contribution can be viewed as a practical one for Islamic banks and the Islamic finance industry, in general. The findings of this research might enable Islamic banks to reflect on their practices and further evaluate the products and services offered through their marketing and banking operations. It would also be useful for the Islamic banking industry to revisit the regulatory framework and regulatory strategic decision making related to Shariah compliance interpretation at both regulatory and institutional levels. The findings have revealed that Islamic banks bear a certifier risk due to the heavy reliance on individual scholars and key actors, and this might endanger the bank in the long run. The ambiguities in the religious rules enactment show that this increasingly important industry needs to reflect on the values selected and maintain its commitment to preserving an enduring reputation and legitimacy.

G. Reflection on the Research Process and Analysis

The process of conducting this research and analysis has been an exciting and rewarding process. The interviews and research observations within the two case studies have enabled me to learn to see phenomena in a more balanced perspective. In the course of research and analysis, however, my limited understanding of the UK's cultural and legal setting, and my background and

attachment to the history and industry development in Indonesia, might have had an impact on the depth of the analysis. Throughout the research process, I tried to equip myself with an understanding of the UK's cultural and legal background to help sharpen my analysis. Nevertheless, I have a limited ability to explore the literature, especially in banking and its embedded culture from the Victorian era to the emergence of the UK's existing system of light touch regulation. The fact that I am not originally a UK citizen might have given me a degree of cultural and historical distance from the case setting.

Another factor is that the individuals, in this case the Islamic bankers, advisers, and Shariah scholars, mostly come from foreign countries which are dominated by Middle Eastern scholars. In other words I was not generally talking to UK natives. This diversity of cultural background of Islamic bank and Islamic bankers might have widened the gap between my understanding of the UK's history, culture and legal background. In the case of researching Islamic banking in Indonesia, I have similarly tried to separate myself from my previous understanding of the industry, the issues and the cultural and legal background, to enable me to perform a critical reflective interpretation and analysis. To some extent, the close relationship between me as a researcher and my background as an Indonesian might also have impacted the way I have analysed the case data, as well as how I have presented the research findings.

To sum up, this research provides a part of the bigger picture in Islamic banking industry. It presented the process of infusion and enactment of religious compliance principles in the two different regulatory and cultural setting. This is a multi-level studies focusing more on when and how individual agents embedded in organizations, as well as in the field to infuse and enact religious compliance. This research is not intended to provide a generalization of the findings. Instead, I conducted this research to provide a more complete view of reality on the process of Shariah compliance implementation in IBF setting. In the end, it is prevailed that the religious compliance infusion and enactment in IBF is cannot be separated from the identity of the regulators and the IBF's individual members. Future research on the micro perspective of process of Shariah compliance approval as a strategic decision making, how the emotions and values involved within individual's decisions is seen interesting.

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Appendix

Sources: Papers analysed by authors from three selected journals; Accounting Organizations and Society (AOS), Journal of Business Ethics (JBE), and Accounting Auditing & Accountability Journal (AAAJ)

Authors	Year	Published in	Discussion on compliance
Boden & Froud	(1996)	AOS	Regulatory compliance cost assessment and legitimating power
Fogarty	(1996)	AOS	Professional regulatory compliance test using peer review
Pentland & Carlile	(1996)	AOS	Legitimacy based compliance in taxpayer audit
Shah	(1996)	AOS	Creative compliance in accounting for convertible securities issuance
Davis Hammond	(1997)	AOS	Signalling and visible form of compliance with law, public expectation and social norms
Shah	(1997)	AAAJ	Creative compliance & regulatory arbitrage in the case of convertible securities structure
Ferrell, LeClair, & Ferrell	(1998)	JBE	Ethical compliance to the Federal Sentencing Guidelines and prevention of legal violation
Mitchell, Sikka, & Willmott	(1998)	AOS	Regulatory compliance for white collar crime
Neu, Warsame, & Pedwell	(1998)	AOS	Symbolic & legitimacy based compliance in environmental disclosure
Nola	(1998)	AAAJ	Legitimacy based regulator compliance's cost and performance
Ruhnka & Boerstler	(1998)	JBE	Organisational private compliance system within government's incentive of regulation
Hume, Larkins, & Iyer	(1999)	JBE	Compliance with ethical standards in tax return preparation
Parker	(2000)	JBE	Ethical aspect on the process of regulatory compliance advisory
McKendall, DeMarr, & Jones-Rikkers	(2002)	JBE	Ethical compliance program and corporate illegality
Beams, Brown, & Killough	(2003)	JBE	Issues that affecting compliance with insider-trading laws
Trivedi, Shehata, & Lynn	(2003)	JBE	Impact of personal moral reasoning and value orientation on taxpayer compliance
Alvesson & Kärreman	(2004)	AOS	Socio-ideological compliance and control in consulting firm
MacDonald & Richardson	(2004)	AOS	Compliance with accounting practice regulation
Arjoon	(2005)	JBE	Legal versus ethical compliance mechanism in corporate governance failure
Mir & Rahaman	(2005b)	AAAJ	Legitimation based compliance of international accounting standards
Moran	(2005)	JBE	Assessing compliance with ILO labour standards
Mobus	(2005b)	AAAJ	Regulatory non-compliance disclosures threaten organizational legitimacy
O'Donnell, Koch, & Boone	(2005)	AOS	Tax compliance decision and recommendation
Michaelson	(2006)	JBE	Compliance and organization ethical progress
Belal & Owen	(2007)	AAAJ	Passive and legitimacy based compliance strategy of international corporate social reporting standards
Bobek, Roberts, & Sweeney	(2007)	JBE	Social norms in tax compliance
Egels-Zandén & Wahlqvist	(2007)	JBE	Business social compliance initiative and post partnership strategies
Egels-Zandén	(2007)	JBE	Supplier's compliance in the multinational corporation
McKernan & Kosmala	(2007)	AAAJ	Creative accounting compliance and future direction into truth and religious based compliance
Sacconi	(2007)	JBE	Compliance with CSR corporate governance structure in the domain of reputation games of socially responsible organisations

Burnett & Hansen	(2008)	AOS	Environmental compliance and ecoefficiency
Blanthorne & Kaplan	(2008)	AOS	Taxpayer compliance and underreporting behaviour
Cools, Emmanuel, & Jorissen	(2008)	AOS	Transfer pricing tax compliance
Francés-Gómez & del Rio	(2008)	JBE	Stakeholder's preference and rational compliance in the normative nature of CSR
Hechter	(2008)	AOS	Compliance to obligatory norms
Criado-Jiménez, Fernández-Chulián, Larrinaga-González, & Husillos-Carqués	(2008)	JBE	Impression management and legitimacy based corporate social ethical environmental reporting compliance
Watson & Berkley	(2009)	JBE	Value-pragmatics hypotheses in unethical compliance
Mennicken	(2008)	AOS	Compliance with international auditing standards
McCracken, Salterio, & Gibbins	(2008)	AOS	Compliance with GAAP in auditor-client negotiation
Aerts & Cormier	(2009)	AOS	Media of legitimacy in the form of environmental law and regulatory compliance
Bajo, Bigelli, Hillier, & Petracci	(2009)	JBE	Determinants of regulatory compliance in the case of Italian insider trading regulation
Darnall, Seol, & Sarkis	(2009)	AOS	Regulatory compliance in environmental audit and perceived stakeholder's influences
Houghton, Gabel, & Williams	(2009)	JBE	Connection gap between external CSR behaviour and internal ethics and legal compliance programs
Humphrey, Loft, & Woods	(2009)	AOS	Standard-surveillance-compliance system and international financial architecture
Karjalainen, Kempainen, & Raaij	(2009)	JBE	Contract non-compliance behaviour on maverick buying
Tullberg	(2009)	JBE	Moral compliance, rationality and punishment
Arena, Arnaboldi, & Azone	(2010)	AOS	Formal regulatory and legal compliance in Enterprise Risk Management (ERM)
Carmona, Donoso, & Walker	(2010)	AOS	Treaty compliance within the dynamic relationship of accounting and law
Henri & Journeault	(2010)	AOS	Compliance with environmental policies and regulations
Lund-Thomsen & Nadvi	(2010)	JBE	CSR compliance with global and local value chain governance
Verhezen	(2010)	JBE	Shifting & transformation strategy from compliance-oriented to integrity-based organisation culture
Alm & Torgler	(2011)	JBE	Tax compliance, morality and ethical dimension
Majluf & Navarrete	(2011)	JBE	Compliance and ethics program and the impact to the ethical behaviour and economic result
Mikes	(2011)	AOS	Compliance risk and legitimacy requirement to expand the boundary of risk management
Lodhia & Martin	(2011)	AAAJ	Regulatory compliance with National Greenhouse and Energy Reporting Act
Norman	(2011)	JBE	Self-regulation in ethic and moral compliance
Alon & Hageman	(2012)	JBE	Level of tax compliance, institutional factors, trust and corruption
Arnold	(2012)	AOS	Standards-surveillance-compliance system and the political economy of accounting harmonization
Bobek, Hageman, & Kelliher	(2012)	JBE	Role of social norms in tax compliance
Bebbington, Kirk, &	(2012)	AOS	Regulatory compliance within corporate reporting context

Larrinaga			
Bozanic, Dirsmith, & Huddart	(2012)	AOS	Symbolic regulatory compliance in insider trading law
Braithwaite	(2012)	AOS	Tax & regulatory compliance in free capitalism market
Church, Hannan, & Kuang	(2012)	AOS	Shared ethical compliance approach in budget reporting
Dhanani & Connolly	(2012)	AAAJ	Legitimacy based compliance in UK's charity organisations
Fasterling	(2012)	JBE	Symbolic of legitimacy through compliance disclosure
Frechtling & Boo	(2012)	JBE	Compliance to the code of ethics of management research
Gracia & Oats	(2012)	AOS	Boundary of tax compliance and regulation
Guerreiro, Rodrigues, & Craig	(2012)	AOS	Social and legitimacy based compliance in voluntary IFRS adoption
Maciejovsky, Schwarzenberger, & Kirchler	(2012)	JBE	Rationality and emotion in the tax ethics and compliance
Power	(2012)	AOS	Regulatory compliance and fraud risk
Spence & Rinaldi	(2012)	AOS	Legal/Regulatory compliance as a form of sustainability accounting embeddedness in organisation

