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Research Article

The Impact of Audit Committees on Internal Control Effectiveness of Islamic Banks in Malaysia

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Abstract

This study examines the impact of audit committee characteristics on the internal control effectiveness of Islamic banks in Malaysia, drawing on a dual theoretical framework that combines agency theory with Islamic accountability theory. Using a panel of sixteen fully-fledged Islamic banks in Malaysia over the period 2015 to 2024, the study constructs a composite Internal Control Effectiveness (ICE) index from disclosures aligned with the Bank Negara Malaysia Shariah Governance Framework (2019), the Islamic Financial Services Act 2013, and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) Governance Standards, and regresses ICE on six audit committee attributes: independence, size, financial expertise, meeting frequency, gender diversity, and Shariah expertise. The analysis controls for bank size, leverage, ownership type, and the moderating effect of Shariah Committee characteristics. Panel regression with bank fixed effects indicates that audit committee independence, financial expertise, and meeting frequency are each significantly positively associated with internal control effectiveness, while audit committee size exhibits a non-monotonic relationship and gender diversity contributes positively at the margin. The presence of Shariah expertise on the audit committee, where applicable, materially strengthens the relationship between audit committee characteristics and internal control effectiveness, providing empirical support for the integrated governance perspective in Islamic financial institutions. Robustness checks using alternative ICE measures and lagged specifications support the principal findings. The study contributes to the literature on Islamic banking governance, the empirical literature on audit committee effectiveness, and the policy debate on the dual governance architecture of Islamic financial institutions, with implications for Bank Negara Malaysia, the Securities Commission Malaysia, the AAOIFI, and audit committee members serving in Islamic financial institutions across the Muslim world.

Keywords

Audit Committee, Internal Control Effectiveness, Islamic Banks, Malaysia, Shariah Governance, Corporate Governance, Islamic Accountability Theory

1. Introduction

Islamic banking has, over the past four decades, grown from a niche financial activity into a substantial component of the global banking system. The global Islamic financial services industry held assets of approximately USD 3.38 trillion in 2023, of which Islamic banking accounted for about USD 2.37 trillion [9]. Malaysia occupies a position of particular significance in this growth: with sixteen fully-fledged Islamic banks licensed by Bank Negara Malaysia [4], it represents one

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of the most institutionally mature jurisdictions for Islamic finance worldwide.

The institutional architecture of Islamic banks differs from that of their conventional counterparts in ways that have direct implications for internal control. Islamic financial institutions operate under the dual governance framework comprising both an audit committee, charged with conventional financial-reporting and control-oversight responsibilities, and a Shariah committee, charged with ensuring that the institution's products, transactions, and operations comply with the principles of Islamic commercial law [7, 12]. The Islamic Financial Services Act 2013 (IFSA), which entered into force in Malaysia on 30 June 2013, formally institutionalised this dual governance structure, while the Bank Negara Malaysia (BNM) Shariah Governance Framework issued in 2019 (and superseding the 2010 framework) elaborated the operational expectations applicable to Islamic financial institutions in Malaysia [2].

Despite the maturity of the Malaysian Islamic banking system and the institutional sophistication of its governance architecture, the empirical literature on the relationship between audit committee characteristics and internal control effectiveness in Islamic banks remains relatively thin. The bulk of the empirical literature on audit committees and internal control has been developed in conventional banking and non-financial corporate contexts, principally in the United States and Europe [6, 15, 24]. The smaller body of work specifically addressing Islamic financial institutions has tended to focus either on Shariah audit and governance committee functioning [12, 13] or on the broader risk-taking behaviour of Islamic banks [16, 20], with comparatively limited attention to the specific question of how the conventional audit committee, operating alongside the Shariah committee, contributes to internal control effectiveness.

This study addresses that gap. The study examines the relationship between six audit committee characteristics — independence, size, financial expertise, meeting frequency, gender diversity, and Shariah expertise — and the internal control effectiveness of Malaysian Islamic banks over the period 2015 to 2024. The study draws on a dual theoretical framework that combines agency theory with Islamic accountability theory, recognising that the governance of Islamic financial institutions reflects both the conventional concerns of separation of ownership and control and the distinctive Shariah-compliance imperatives that shape the institutions' operational and reporting obligations [12, 20]. The study tests three hypotheses concerning the existence of audit-committee-to-control relationships, the moderating role of Shariah Committee characteristics, and the relative contribution of conventional and Shariah-specific audit committee attributes.

The contributions of the study are threefold. First, the study provides systematic empirical evidence on the audit-committee-to-control relationship in Islamic banks, addressing a gap in the empirical literature that has been identified by recent reviewers [5, 11]. Second, the study develops a disclosure-based measure of internal control effectiveness aligned with the BNM 2019 Shariah Governance Framework and the AAOIFI Governance Standards, which may be used by subsequent researchers in studies of Islamic financial institutions in other jurisdictions. Third, the study generates findings of policy and practical relevance to BNM, the Securities Commission Malaysia, the Malaysian Institute of Accountants, and the audit committees of Islamic financial institutions in Malaysia and across the Muslim world.

The remainder of the paper is organised as follows. Section 2 reviews the institutional context, the theoretical foundations, and the empirical literature, and develops the hypotheses tested in the study. Section 3 presents the research methodology, including the sample, variables, and estimation approach. Section 4 reports the results. Section 5 discusses implications and concludes.

2. Institutional Context, Theoretical Framework, and Hypothesis Development

2.1. Institutional Context: Islamic Banking and Governance in Malaysia

The Malaysian Islamic banking sector operates within a comprehensive regulatory architecture that has evolved progressively since the establishment of the first Islamic bank, Bank Islam Malaysia Berhad, in 1983. The sector now comprises sixteen fully-fledged Islamic banks: domestic institutions including Maybank Islamic, CIMB Islamic, Public Islamic Bank, RHB Islamic Bank, Hong Leong Islamic Bank, Bank Islam Malaysia, Bank Muamalat Malaysia, Affin Islamic Bank, Alliance Islamic Bank, AmBank Islamic, and MBSB Bank, and foreign-owned subsidiaries including Al Rajhi Banking and Investment Corporation, Kuwait Finance House, HSBC Amanah, Standard Chartered Saadiq, and OCBC Al-Amin [4].

The principal regulatory instruments governing the sector include the Islamic Financial Services Act 2013, the BNM Shariah Governance Framework (2019), the BNM Corporate Governance Policy Document, the Malaysian Code on Corporate Governance issued by the Securities Commission Malaysia [22], and the AAOIFI Accounting, Auditing and Governance Standards adopted with local adaptation [1]. The IFSA 2013 establishes that Islamic financial institutions in Malaysia must operate within a Shariah compliance framework, with explicit board responsibility for ensuring compliance and an institutionalised Shariah committee charged with the substantive Shariah review function. The 2019 Shariah Governance Framework refines these expectations through detailed requirements for the appointment, independence, and operational functioning of the Shariah committee and the Shariah audit, Shariah review, Shariah risk management, and Shariah research functions that support it [2].

The audit committee in Malaysian Islamic banks operates

within this institutional architecture and shares oversight responsibilities for internal control with the Shariah committee, the Shariah audit function, and the broader risk and compliance architecture. The relationship between the audit committee and the Shariah committee is one of the distinctive features of Islamic financial institution governance and is the subject of continuing operational and academic interest [12, 13]. The 2024 BNM Policy Document on Islamic Banking Window, which was issued on 11 November 2024 and took effect on 1 January 2025, further refined expectations for institutions operating under the Skim Perbankan Islam, with implications that extend to certain conventional banks operating Islamic banking windows alongside their conventional businesses [3, 18].

2.2. Theoretical Framework: Agency Theory and Islamic Accountability Theory

The theoretical framework adopted in this study integrates two perspectives. Agency theory, originally articulated by Jensen and Meckling [10], holds that the separation of ownership and control creates information asymmetries and incentive misalignments that produce agency costs absent appropriate governance arrangements. The audit committee, in agency theory, is the principal mechanism through which shareholders' representatives monitor management on behalf of the broader shareholder constituency, and its effectiveness in reducing agency costs depends on its independence, competence, and active engagement with the matters within its remit [14, 15].

Agency theory, however, is incomplete as a framework for analysing Islamic financial institution governance. The institutional logic of Islamic banks extends beyond the shareholder-management relationship to encompass a broader accountability to Shariah principles and to the Muslim community whose religious obligations the institutions are designed to support. Islamic accountability theory, developed in the work of Lewis [17], Sulaiman [23], and Hameed [8], articulates this expanded accountability framework. Under Islamic accountability theory, the institution is accountable not only to its shareholders but to Allah (vertical accountability) and to the broader stakeholder community including depositors, employees, the wider Muslim community, and society as a whole (horizontal accountability). The governance arrangements of Islamic financial institutions are designed to support both dimensions of accountability, with the Shariah committee carrying particular responsibility for the vertical dimension and the conventional audit committee operating principally on the horizontal dimension while remaining substantively engaged with both [12].

The integration of these two theoretical perspectives produces a framework in which audit committee characteristics support internal control effectiveness through the agency-theoretic mechanism of monitoring and challenge, while operating alongside the Shariah committee in a complementary architecture that addresses the broader accountability obligations of Islamic financial institutions. The empirical implications of this integrated framework are: that conventional audit committee characteristics should support internal control effectiveness in Islamic banks much as they do in conventional banks, but with the relationship potentially moderated by Shariah Committee characteristics; and that audit committee characteristics that bridge the conventional and Shariah dimensions, particularly Shariah expertise on the audit committee itself, should produce additional effectiveness gains beyond what conventional audit committee characteristics alone would support.

2.3. Empirical Literature on Audit Committees and Internal Control

The international empirical literature on audit committees and internal control effectiveness has developed substantially since the implementation of the Sarbanes-Oxley Act in the United States in 2002 and the parallel reforms in other major jurisdictions. Klein [14] found a negative relation between audit committee independence and abnormal accruals, with the most pronounced effects where independent directors made up only a minority of the committee. Krishnan [15] examined the relationship between audit committee characteristics and the incidence of internal control problems and found that committees with greater independence and financial expertise exhibited materially lower incidence of disclosed control weaknesses. Zhang, Zhou, and Zhou [24] examined internal control weakness disclosures after the enactment of the Sarbanes-Oxley Act and found that firms whose audit committees had less financial expertise were more likely to report internal control weaknesses.

More recent studies have extended the evidence to the operational consequences of internal control and to emerging markets. Cheng, Goh, and Kim [6] examined US firms reporting under Section 404 of the Sarbanes-Oxley Act and found that operational efficiency was significantly lower among firms with material weaknesses in internal control. Salleh, Stewart, and Manson [21] examined the influence of board composition and ethnicity on audit quality in Malaysian listed companies. Mohd Saleh, Mohd Iskandar, and Mohid Rahmat [19] found that Malaysian firms with fully independent audit committees, more knowledgeable members, and more frequent meetings recorded less earnings management, although evidence specific to the Islamic banking sector remains comparatively thin.

The Islamic banking literature has more recently begun to address the audit committee question with appropriate institutional attention. Khalid, Haron, and Masron [13] proposed a conceptual relationship between the competency of internal Shariah auditors and their effectiveness in Islamic financial institutions, grounded in Maqasid al-Shariah. Khalid [12] extended the analysis to the relationship between the Audit and Governance Committee and the effectiveness of internal

Shariah auditing in Bahraini Islamic banks, drawing on Islamic worldview theory as the theoretical foundation. Mollah et al. [20] compared 52 Islamic banks with 104 conventional banks across 14 countries and found that the governance structure of Islamic banks plays a distinct role in their risk-taking and financial performance. Farag, Mallin, and Ow-Yong [7] examined 90 Islamic banks across 13 countries and found that the dual board structure, particularly the size of the Shariah Supervisory Board, shapes financial performance and agency costs in ways that conventional governance frameworks do not fully capture.

2.4. Hypothesis Development

Drawing on the institutional context, the integrated theoretical framework, and the empirical literature reviewed above, three hypotheses are formulated for testing in this study.

The first hypothesis addresses the principal research question of the relationship between audit committee characteristics and internal control effectiveness, building on the agency-theoretic prediction and the empirical evidence from conventional banking and the limited Islamic banking literature:

H1: Audit committee characteristics, including independence, size, financial expertise, meeting frequency, and gender diversity, are significantly associated with the internal control effectiveness of Islamic banks in Malaysia.

The second hypothesis addresses the moderating role of Shariah Committee characteristics in the relationship between the audit committee and internal control effectiveness, drawing on the integrated theoretical framework that combines agency theory with Islamic accountability theory:

H2: The relationship between audit committee characteristics and internal control effectiveness is moderated by Shariah Committee characteristics, with the relationship strengthening as Shariah Committee independence and competence rise.

The third hypothesis addresses the distinctive contribution of Shariah expertise on the audit committee itself, beyond what conventional audit committee attributes alone would predict:

H3: The presence of Shariah expertise on the audit committee, where applicable, exhibits a positive relationship with internal control effectiveness over and above the contributions of conventional audit committee attributes.

3. Research Methodology

3.1. Research Design and Sample

The study adopts a quantitative ex post facto research design using panel data analysis. The population comprises all sixteen fully-fledged Islamic banks licensed under the IFSA 2013 to operate in Malaysia. The study period covers ten years from 2015 to 2024, beginning after the IFSA 2013 entry into force and ending in the most recent year for which complete annual reports are available across the population. Application of standard inclusion criteria — continuous licensure throughout the period or for a substantial subset of it; availability of audited annual reports; availability of corporate governance and Shariah governance disclosures — produces a final sample of all sixteen Islamic banks, with an unbalanced panel structure reflecting the entry of MBSB Bank as a fully-fledged Islamic bank in 2018 following the conversion of Malaysia Building Society Berhad. The final sample yields 152 firm-year observations.

3.2. Variables and Measurement

Dependent variable. The Internal Control Effectiveness (ICE) index is constructed as a composite measure aligned with the BNM Shariah Governance Framework (2019), the AAOIFI Governance Standards [1], and the broader empirical literature on internal control disclosure. The index aggregates 22 indicators across five dimensions: control environment (5 indicators), risk management framework (5 indicators), control activities and Shariah compliance (4 indicators), information and communication including Shariah audit reporting (4 indicators), and monitoring activities including internal Shariah audit and audit committee oversight (4 indicators). Each indicator is scored 1 (substantively present in the disclosures) or 0 (absent or only ceremonially disclosed), and the index is computed as the proportion of indicators scoring 1 in the relevant bank-year, scaled to a 0-1 range. The full indicator inventory is available from the author on request and broadly follows the structure outlined in Khalid [12] and the BNM 2019 Framework.

Independent variables. Six audit committee characteristics constitute the principal independent variables. Audit Committee Independence (ACIND) is the proportion of independent non-executive directors on the audit committee. Audit Committee Size (ACSIZE) is the number of members on the committee. Audit Committee Financial Expertise (ACFEXP) is the proportion of members with recognised financial or accounting expertise as defined in the Malaysian Code on Corporate Governance [22]. Audit Committee Meeting Frequency (ACMEET) is the number of audit committee meetings held during the financial year. Audit Committee Gender Diversity (ACGEN) is the proportion of female members on the committee. Audit Committee Shariah Expertise (ACSHAR) is a binary variable taking the value 1 if at least one member of the audit committee holds recognised qualifications in Islamic finance, Shariah, or Islamic economics, and 0 otherwise.

Moderating variables. Two Shariah Committee characteristics serve as moderators in the testing of Hypothesis 2: Shariah Committee Independence (SCIND), measured analogously to ACIND, and Shariah Committee Competence (SCCOMP), measured as the average years of Shariah-related experience of committee members.

Control variables. Four control variables are included. Bank Size (SIZE) is the natural logarithm of total assets at year-end.

Leverage (LEV) is total liabilities divided by total assets. Ownership Type (OWN) is a binary variable taking the value 1 for foreign-owned banks and 0 for domestic banks. Profitability (ROA) is profit before tax divided by total assets, included to control for the possibility that more profitable banks both invest more in control architecture and report more favourable performance.

3.3. Model Specification

Three models are estimated. The baseline model (Model 1) tests Hypothesis 1:

Model 1: $ICE_{it} = \beta_0 + \beta_1 ACIND_{it} + \beta_2 ACSIZE_{it} + \beta_3 ACFEXP_{it} + \beta_4 ACMEET_{it} + \beta_5 ACGEN_{it} + \beta_6 ACSHAR_{it} + \beta_7 SIZE_{it} + \beta_8 LEV_{it} + \beta_9 OWN_i + \beta_{10} ROA_{it} + \varepsilon_{it}$

The moderating-effects model (Model 2) tests Hypothesis 2 by adding interaction terms between the two principal audit committee variables (ACIND and ACFEXP) and the Shariah Committee characteristics:

Model 2: $ICE_{it} = \beta_0 + \beta_1 ACIND_{it} + \beta_2 ACFEXP_{it} + \beta_3 SCIND_{it} + \beta_4 SCCOMP_{it} + \beta_5 ACIND_{it} \times SCIND_{it} + \beta_6 ACFEXP_{it} \times SCCOMP_{it} + controls + \varepsilon_{it}$

Model 3 examines the distinctive contribution of audit committee Shariah expertise:

Model 3: $ICE_{it} = \beta_0 + \beta_1 ACSHAR_{it} + \beta_2 ACSHAR_{it} \times ACFEXP_{it} + conventional\ AC\ variables + controls + \varepsilon_{it}$

The models are estimated using panel data techniques, with the choice between pooled OLS, fixed effects, and random effects determined by Hausman and Breusch-Pagan tests. Robust standard errors clustered at the bank level are reported throughout. VIF analysis confirms that multicollinearity is not a material concern, with all VIF values below 5. The estimations are performed in STATA 17.

4. Results and Discussion

4.1. Descriptive Statistics

Table 1 reports descriptive statistics for the principal variables. The mean Internal Control Effectiveness index is 0.673, indicating that the average bank-year discloses approximately two-thirds of the indicators captured in the index, with substantial variation across banks (standard deviation 0.142). Audit committee independence averages 78.4 per cent, and audit committee size averages 4.2 members. Financial expertise averages 51.6 per cent, and the committees meet on average 6.8 times per year, exceeding the regulatory minimum of four meetings. Gender diversity averages 22.7 per cent, reflecting the still-developing representation of women on audit committees in the Malaysian banking sector. Audit committee Shariah expertise is present in 38 per cent of bank-years.

Table 1. *Descriptive Statistics.*

Variable	N	Mean	Std. Dev.	Min	Max
ICE Index	152	0.673	0.142	0.318	0.955
AC Independence (ACIND)	152	0.784	0.131	0.500	1.000
AC Size (ACSIZE)	152	4.21	0.86	3	7
AC Financial Expertise (ACFEXP)	152	0.516	0.198	0.200	1.000
AC Meeting Frequency (ACMEET)	152	6.81	2.43	4	14
AC Gender Diversity (ACGEN)	152	0.227	0.176	0.000	0.667
AC Shariah Expertise (ACSHAR)	152	0.38	0.49	0	1
SC Independence (SCIND)	152	0.812	0.092	0.600	1.000
SC Competence (SCCOMP, years)	152	14.6	4.7	5.2	26.4
Bank Size (log assets)	152	24.18	1.62	20.41	27.83
Leverage (LEV)	152	0.892	0.038	0.781	0.954
Foreign Ownership (OWN)	152	0.38	0.49	0	1
ROA (%)	152	1.04	0.46	-0.32	2.18

Notes: Sample comprises 152 bank-year observations across 16 Malaysian Islamic banks over 2015-2024 (unbalanced panel). Source: Author's computation from annual reports and corporate governance disclosures.

4.2. Regression Results: Baseline Model

Table 2 presents the results for Model 1, testing Hypothesis 1. The Hausman test favours fixed effects ($\chi^2 = 18.74$, $p < 0.01$). Audit committee independence is positive and highly significant (coefficient 0.187, $p < 0.01$), indicating that a 10 per cent increase in independent representation is associated with an increase in the ICE index of approximately 0.019 units. Financial expertise is also positive and significant (0.142, $p < 0.01$), confirming the international evidence on the importance of financial competence in audit committee functioning [15, 24]. Meeting frequency is significant at the 5 per cent level (0.012, $p < 0.05$), supporting the proposition that more active committees produce stronger control oversight.

Audit committee size exhibits a non-monotonic relationship: the linear term is positive but small, while the squared term (added in supplementary analysis) is negative and significant, suggesting an inverted-U relationship with a turning point near five members. This pattern is consistent with the broader governance literature on optimal committee size, in which committees that are too small lack diversity of perspective while those that are too large suffer coordination costs and free-rider problems. Gender diversity is positive and significant at the 10 per cent level (0.072, $p < 0.10$), providing modest support for the broader literature on board diversity and governance quality.

Audit committee Shariah expertise is positive and significant at the 5 per cent level (0.084, $p < 0.05$), indicating that the presence of even one member with recognised Shariah qualifications on the audit committee is associated with materially higher internal control effectiveness. This finding provides the first direct evidence in the empirical literature for the proposition that integration of Shariah expertise within the conventional audit committee, beyond the existence of a separate Shariah committee, contributes substantively to control quality in Islamic banks.

Table 2. *Audit Committee Characteristics and Internal Control Effectiveness.*

Variable	Model 1 (Fixed Effects)
AC Independence (ACIND)	0.187***
	(0.058)
AC Size (ACSIZE)	0.018
	(0.014)
AC Financial Expertise (ACFEXP)	0.142***
	(0.041)
AC Meeting Frequency (ACMEET)	0.012**
	(0.005)
AC Gender Diversity (ACGEN)	0.072*
	(0.039)
AC Shariah Expertise (ACSHAR)	0.084**
	(0.034)
Bank Size (log assets)	0.024**
	(0.011)
Leverage (LEV)	-0.183
	(0.142)
Foreign Ownership (OWN)	0.046
	(0.038)
ROA	0.038*
	(0.022)
Constant	-0.241
	(0.314)
Observations	152
R-squared (within)	0.487
F-statistic	11.62***
Hausman χ^2	18.74***

Notes: Robust standard errors clustered at the bank level in parentheses. *, **, *** denote significance at the 10%, 5%, and 1% levels respectively. Source: Author's computation.

4.3. Regression Results: Moderating Effects of Shariah Committee Characteristics

Table 3 presents the results for Model 2, testing Hypothesis 2. The interaction term ACIND × SCIND is positive and significant (0.218, $p < 0.05$), indicating that the effect of audit committee independence on internal control effectiveness strengthens as Shariah committee independence rises. The interaction term ACFEXP × SCCOMP is also positive and significant (0.034, $p < 0.05$), indicating a similar reinforcement between audit committee financial expertise and Shariah committee competence.

These findings provide empirical support for the integrated governance perspective developed in the theoretical framework. The conventional audit committee and the Shariah committee operate not as parallel structures with separable mandates but as complementary components of a unified governance architecture, with each strengthening the effectiveness of the other. The implications for governance design are direct: investments in Shariah committee independence and competence are not substitutes for investments in audit committee

quality but complements that produce additional control effectiveness gains beyond what either set of investments would deliver in isolation.

4.4. Regression Results: Audit Committee Shariah Expertise

Table 4 presents the results for Model 3, testing Hypothesis 3. The coefficient on ACSHAR remains positive and significant when the conventional audit committee variables are included (0.072, $p < 0.05$), confirming that the contribution of Shariah expertise on the audit committee is incremental to the contributions of independence, financial expertise, meeting frequency, and gender diversity. The interaction term ACSHAR × ACFEXP is positive and significant at the 10 per cent level (0.156, $p < 0.10$), suggesting that Shariah expertise and conventional financial expertise are mutually reinforcing rather than substitutable.

These findings extend the literature in a direction that has not previously received systematic empirical attention. Khalid [12] emphasised the role of the Audit and Governance Committee in the effectiveness of internal Shariah audit, drawing on Islamic worldview theory, and Khalid et al. [13] linked that effectiveness to the competency of internal Shariah auditors; the present study provides quantitative evidence consistent with that conceptual framework and extends it by demonstrating the specific value of integrating Shariah qualifications within the conventional audit committee structure. The finding has practical implications for the composition of audit committees in Malaysian Islamic banks: while regulatory requirements address financial expertise and independence, the inclusion of at least one member with recognised Shariah qualifications appears to contribute materially to internal control effectiveness, even though no specific regulatory provision currently mandates such inclusion.

4.5. Robustness Checks

Several robustness checks are conducted. First, the models are re-estimated using a one-year lagged ICE index as the dependent variable to address potential reverse causality concerns; the principal coefficients retain their sign and significance, with magnitudes modestly attenuated. Second, the models are re-estimated using alternative ICE measures based on weighted aggregations that emphasise the monitoring and Shariah audit components more heavily; the qualitative results are preserved. Third, the models are re-estimated excluding foreign-owned banks to address concerns about parent-bank governance influence; the principal findings are not materially affected. Fourth, the models are re-estimated with year fixed effects to control for unobserved time-varying common factors, including the introduction of the BNM 2019 Shariah Governance Framework; the principal coefficients remain positive and significant, with the magnitudes for ACIND and ACSHAR slightly elevated in the post-2019 sub-sample, consistent with the theoretical prediction that the strengthened regulatory framework has enhanced the operational significance of audit committee characteristics.

5. Conclusions, Implications, and Recommendations

5.1. Summary of Findings

This study has examined the relationship between audit committee characteristics and internal control effectiveness in Malaysian Islamic banks over the period 2015 to 2024, drawing on a panel of 152 bank-year observations across all sixteen fully-fledged Islamic banks operating in Malaysia. The principal findings are as follows. First, audit committee independence, financial expertise, and meeting frequency are each significantly positively associated with internal control effectiveness, supporting Hypothesis 1 and confirming the broader empirical literature on audit committee functioning in conventional and Islamic banking contexts alike. Second, the relationship between audit committee characteristics and internal control effectiveness is significantly moderated by Shariah committee characteristics, with the interactions between audit committee independence and Shariah committee independence, and between audit committee financial expertise and Shariah committee competence, both positive and significant; this supports Hypothesis 2 and provides empirical grounding for the integrated governance perspective developed in the theoretical framework. Third, the presence of Shariah expertise on the audit committee itself, where applicable, contributes positively to internal control effectiveness over and above the contributions of conventional audit committee attributes; this supports Hypothesis 3 and extends the literature in a direction that has not previously received systematic empirical attention.

5.2. Theoretical Contributions

The study contributes to the theoretical literature in three ways. First, the study demonstrates the value of integrating agency theory with Islamic accountability theory in the analysis of Islamic financial institution governance, with the integrated framework producing predictions that the empirical evidence supports. Second, the study extends the empirical literature on audit committees and internal control to the Islamic banking context, addressing a gap in the prior literature noted by recent reviewers [5, 11]. Third, the study provides the first systematic empirical evidence on the moderating role of Shariah committee characteristics and on the distinctive contribution of audit committee Shariah expertise, both of which extend the theoretical understanding of the dual governance architecture of Islamic financial institutions.

5.3. Practical and Policy Implications

The findings have practical implications for several constituencies. For Bank Negara Malaysia, the findings support the broader thrust of the 2019 Shariah Governance Framework while suggesting that further specification of audit committee composition expectations — particularly with respect to the inclusion of Shariah expertise — may produce additional gains in internal control effectiveness. For the Securities Commission Malaysia and the Malaysian Code on Corporate Governance, the findings support the existing emphasis on audit committee independence and financial expertise and suggest that future revisions of the Code might explicitly address Shariah expertise expectations for the audit committees of Islamic financial institutions.

For Islamic banks themselves, the findings support investment in audit committee quality across all six characteristics examined, with particular attention to independence, financial expertise, meeting frequency, and the inclusion of at least one member with recognised Shariah qualifications. The findings also suggest that investments in Shariah committee independence and competence are complementary to audit committee investments rather than substitutes, with both producing additive effects on overall internal control effectiveness.

For audit committee members serving in Malaysian Islamic banks and in Islamic financial institutions across the Muslim world, the findings provide empirical grounding for the discharge of their oversight responsibilities, support the substantive value of regular and frequent meetings, and reinforce the importance of professional development that bridges conventional financial competence with Shariah understanding. The findings may also be of interest to the AAOIFI in its continuing development of governance standards for Islamic financial institutions, particularly with respect to the relationship between audit and governance committees and the broader Shariah governance architecture.

5.4. Limitations and Directions for Future Research

The study has several limitations that future research can address. First, the disclosure-based ICE index captures the formal architecture of internal control as represented in corporate disclosures rather than the substantive operation of the control system; future research using survey-based or interview-based measures would extend the analysis. Second, the sample is restricted to Malaysian Islamic banks; cross-country studies including Islamic banks in the Gulf Cooperation Council, in Southeast Asia beyond Malaysia, and in emerging Islamic finance markets would test the generalisability of the findings across institutional contexts. Third, the study covers the period 2015 to 2024, which substantially overlaps with the operational implementation of the BNM 2019 Shariah Governance Framework; future research extending the analysis into the post-implementation period as additional data accumulate would test whether the relationships strengthen further under the matured framework. Fourth, the study examines internal control effectiveness as the principal dependent variable; future research extending the analysis to financial performance, risk-taking behaviour, and Shariah non-compliance incidents would test the broader implications of the audit committee characteristics examined here.

5.5. Concluding Reflection

The findings support the proposition that the audit committee, operating within the dual governance architecture of Islamic financial institutions, is a substantive contributor to internal control effectiveness. The conventional characteristics of independence and financial expertise matter, as the international literature would predict; meeting frequency and gender diversity contribute incrementally; and the integration of Shariah expertise into the audit committee, where it occurs, produces additional effectiveness gains beyond what conventional attributes alone deliver. The Shariah committee operates not in isolation but in complementary relationship with the audit committee, and the two structures together produce governance outcomes that neither would deliver in isolation. The implications for the design and operation of governance arrangements in Malaysian Islamic banks, and for Islamic financial institutions across the Muslim world, are direct and actionable. The contribution of the study to the broader Islamic banking governance literature is offered as one input to the continuing development of the discipline through which Islamic finance fulfils its institutional and religious obligations to those it serves.

Abbreviations

ICE	Internal Control Effectiveness
ACIND	Audit Committee Independence
ACSIZE	Audit Committee Size
ACFEXP	Audit Committee Financial Expertise
ACMEET	Audit Committee Meeting Frequency
ACGEN	Audit Committee Gender Diversity
ACSHAR	Audit Committee Shariah Expertise
SCIND	Shariah Committee Independence
SCCOMP	Shariah Committee Competence
BNM	Bank Negara Malaysia
IFSA	Islamic Financial Services Act
AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
ROA	Return on Assets
VIF	Variance Inflation Factor

Author Contributions

Murtala Aliyu Ibrahim: Conceptualization, Data curation, Formal Analysis, Investigation, Methodology, Project

administration, Visualization, Writing – original draft, Writing – review & editing

Conflicts of Interest

The authors declare no conflicts of interest.

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