

The Value-Added Requirements of the Internal Audit Function and Its Challenges in Islamic Banks: A Theoretical Study

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ABSTRACT

This study is a theoretical literature review that examines the value-added requirements of the internal audit function in Islamic banks and the challenges associated with performing this role. It systematically reviews and synthesizes previous academic studies, professional reports, and regulatory guidelines through a structured process of identifying, selecting, and analyzing relevant literature. The review explores the concept of value-added, the risk-based approach to internal auditing, and the prerequisites for enabling internal audit to add value. The study highlights the internal audit's contributions to governance, internal control, risk management, and stakeholder value creation. To evaluate this contribution, the study references commonly identified indicators in the literature that specifically measure the extent of the internal audit's added value, including auditor competencies, risk mitigation, cost efficiency, and stakeholder satisfaction. At the same time, the review gathers evidence on the key challenges hindering value creation. These include structural constraints, such as limited auditor independence and weak governance frameworks; a shortage of professionals with dual expertise in Shariah and auditing; technological constraints, such as outdated tools and a lack of IT training; and conceptual ambiguity around whether internal audit should operate primarily as a compliance mechanism or as a strategic partner. The study concludes with recommendations drawn from the literature, emphasizing the adoption of unified standards, the development of dual competencies, investment in capacity building, technological advancements, and strategic alignment with financial and Shari'ah objectives. Together, these reforms can enable internal audit to serve as a true value-adding partner for Islamic financial institutions.

Keywords: Internal audit, Risk-based internal audit (RBIA), Value-added, Islamic banks

INTRODUCTION

In the face of increasing regulatory complexity and growing demands for transparency and accountability, the internal audit function has become a cornerstone for ensuring trust and value creation in financial institutions. In Islamic banks, this role is even more critical due to the dual responsibility of complying with both financial regulations and Shari'ah principles. Such dual accountability extends the scope of internal audit beyond traditional oversight to encompass the ethical, legal, and religious dimensions unique to Islamic finance.

The concept of value-added auditing reflects this transformation, as internal audit evolves from a compliance-focused mechanism into a proactive strategic partner. In Islamic banks, fulfilling this role requires adopting risk-based internal audit (RBIA) approaches, strengthening governance, enhancing auditor competencies in both Shari'ah and conventional auditing, and applying effective metrics to measure value creation. However, these demands are challenged by issues such as limited independence, shortages of qualified professionals, and conceptual ambiguity regarding the precise role of internal audit.

This study is a theoretical literature review that systematically examines the value-added requirements of the internal audit function in Islamic banks and the challenges that hinder its effectiveness. The review process involved identifying, selecting, and analyzing relevant academic research, professional reports, and regulatory guidelines.

The study proceeds as follows: it first outlines the concept of value-added internal auditing and its connection with the RBIA approach. It then explores the specific requirements for enabling internal audit to add value in Islamic banks, along with the indicators commonly used to measure this value. Finally, it discusses the structural, operational, and technological challenges facing internal audit in Islamic banks and provides recommendations for strengthening its strategic role in enhancing governance, risk management, and stakeholder trust.

METHODOLOGY

This study is a theoretical literature review that examines the value-added requirements of the internal audit function in Islamic banks and the challenges hindering its effectiveness. The methodology followed a structured approach comprising the following steps:

- **Identification of sources:** Relevant academic journals, books, professional reports, and regulatory guidelines were systematically searched to ensure comprehensive coverage of the topic.
- **Selection criteria:** Sources were selected based on relevance to the study objectives, credibility of the publication, recency, and applicability to the Islamic banking context.
- **Extraction of key themes:** The literature was examined to identify and summarize key concepts and discussions related to the prerequisites for internal audit to create value, the indicators used to assess value addition, the audit's role in governance, control, and risk management, and the operational, structural, and technological challenges faced by Islamic banks.
- **Organization of themes:** Extracted information was thematically organized according to the main areas of interest, ensuring a coherent presentation of concepts, discussions, and identified challenges.
- **Coverage:** To ensure comprehensive coverage, this review analyzed 71 academic and professional sources published between 1985 and 2025. The inclusion of earlier foundational works, such as Porter's (1985) value chain theory, which emphasizes exchange value within organizational strategy, and Teece's (2007) dynamic capabilities theory, which highlights intangible assets like knowledge and innovation, was intentional to establish a solid theoretical grounding. These classical perspectives were combined with more recent contributions, such as the 2024 Global Internal Audit Standards, to capture both the evolution of the concept of value and its contemporary applications in internal auditing. This broad temporal scope enables the study to trace how the notion of "value" has expanded from strategic and marketing contexts into the internal audit function, while highlighting current challenges and opportunities in Islamic banking.

This structured methodology ensures a rigorous, transparent, and focused review of existing knowledge, providing a solid foundation for understanding how internal audit can strategically contribute to governance, risk management, and stakeholder value creation in Islamic financial institutions, while highlighting the challenges that need to be addressed to realize its full potential.

The Concept of Added Value of The Internal Audit Function

The concept of "value" has multiple meanings and uses, most notably the distinction between "value" in the singular form, which refers to the worth of a specific thing, and "values" in the plural form, which are associated with personal beliefs and social behaviors. In the field of management, the term "value" is gaining increasing prominence, especially in the areas of strategy and marketing. Among the most influential theories are Porter's value chain theory (1985), which focuses on exchange value, and Teece's strategic thinking theory (2007), which focuses on non-consumable exchangeable assets, such as knowledge, innovation capabilities, and brands.

In this context, the Corporate Finance Institute (CFI, 2022) defines "added value" as "the additional value created beyond the initial value of something." Regarding internal auditing, the Institute of Internal Auditors (IIA, 2017) specifies that added value is achieved when internal audit activities enhance the effectiveness of governance,

risk management, and control processes within the organization. This view is reinforced in the updated 2024 Global Internal Audit Standards, which emphasize that internal audit supports organizational success by contributing to ethical behavior, informed decision-making, and improved oversight, ultimately adding value through enhanced governance and institutional resilience (IIA, 2024).

On the other hand, added value is also described as “the positive impact enjoyed by the organization and its stakeholders through internal audits, which improve efficiency, transparency, integrity, and accountability. They offer recommendations based on data analysis and assessment, enabling risk management and governance” (Mohamed & Awad, 2020). Thus, internal auditing can contribute to value creation by generating savings, seizing opportunities, and preventing losses while enhancing the transparency of activities and the effective implementation of policies (Popescu & Vasile, 2011). Faiteh and Aasri (2022) consider internal auditing an essential lever for value creation within organizations. Through its missions and skills, it guides governance bodies with effective recommendations.

Furthermore, Eulerich and Lenz (2020) revealed in their study that the internal audit function’s activities that bring the most value to the organization, specifically regarding the effectiveness of the internal control system, risk management, and governance processes, align with the IIA definition and Standard 2100. The effectiveness of internal auditing in value creation rests on two elements: first, a consensus between internal auditors and stakeholders on how to make auditing a value-added activity; second, examining the internal audit function through the lens of the value chain and beneficiary stakeholders (Al-Kashef, 2000).

Thus, the added value of internal auditing lies in improving the organization’s efficiency and effectiveness through independent and objective assessments, aiming to optimize internal processes, including risk management, while ensuring compliance with laws and regulations. This contributes to increased transparency and reliability of organizational reports and data, and supports the achievement of strategic objectives and competitiveness.

The Relationship Between Risk-Based Internal Audit Approach and Value Creation

The transition from traditional internal auditing methods to the modern Risk-Based Internal Audit (RBIA) approach has significantly transformed the role of internal audit into a value-generating function that serves the interests of all stakeholders (Nawal, 2016). This evolution has shifted the focus of audit activities from compliance and verification to strategic contributions that support performance improvement and risk mitigation. As a result, internal auditors are now more involved in proactive planning, including the formulation of audit objectives, defining the scope, and designing comprehensive audit programs aligned with organizational priorities.

The implementation of RBIA requires forming dedicated audit teams capable of executing risk-focused audit programs while ensuring alignment with the evolving nature of the internal audit function. Furthermore, audit reports are expected to highlight risks that could hinder organizational objectives, offering detailed insights on risk likelihood, potential impact, and corresponding mitigation strategies (Baajjah, 2013; Attaf & Bensbahou, 2021). In this context, Rady (2014) stresses the importance of establishing a general framework to enhance the internal audit’s role in value creation. Key determinants of value-added auditing include the quality of the relationship between auditors and management, the degree of support from leadership, and the audit function’s integration into the organization’s risk management framework.

As internal auditing becomes increasingly embedded in strategic operations, it is now widely recognized as a strategic partner in value creation. It achieves this by anticipating risks, improving processes, and aligning audit outcomes with organizational goals. The risk-based audit approach enhances this role further by concentrating efforts on high-risk areas, thus ensuring that audit outputs are both relevant and impactful. Additionally, the value-added auditing model not only seeks to correct existing deficiencies but also emphasizes the prevention of future issues, the prediction of potential risks, and the preemption of systemic failures (Hutchins, 2018).

Ispas et al. (2023) further affirm that adopting a structured, risk-based approach allows organizations to systematically identify, assess, and prioritize risks. This enables better-informed decision-making and more efficient resource allocation, contributing to improved performance and sustainability. Similarly, Wang et al. (2023) argue that integrated risk-based audit planning strengthens the contribution of the audit function by aligning its activities with strategic objectives and optimizing the deployment of audit resources to achieve multiple value-oriented outcomes.

Supporting this, Zahra (2025) concludes that risk-based internal auditing, when combined with effective risk management, plays a pivotal role in fraud detection and prevention. Through early identification of warning signs and the use of tools such as the Whistleblowing System (WBS), along with updates to risk registers and collaboration with anti-fraud teams, internal audit and risk management together enhance organizational integrity and continuous improvement.

The Institute of Internal Auditors (IIA) has also outlined the core elements through which internal audit adds value, namely, assurance, insight, and objectivity, emphasizing its role in improving operations and enabling the achievement of strategic goals. Internal auditing functions most effectively when it gains organizational support and when its recommendations are adopted in ways that align with board expectations while maintaining reasonable costs (IIA, 2020). The IIA (2018) also underscores the importance of auditor independence by clarifying that internal auditors must avoid any administrative responsibilities to preserve objectivity. Abdul Rahim (2018) complements this view by asserting that the future of internal auditing lies in its ability to deliver foresight and strategic insight, thereby positioning the function as a trusted advisor that adds measurable value to the organization's activities. **Figure 1** below illustrates the potential impact and future outlook of the internal audit function.

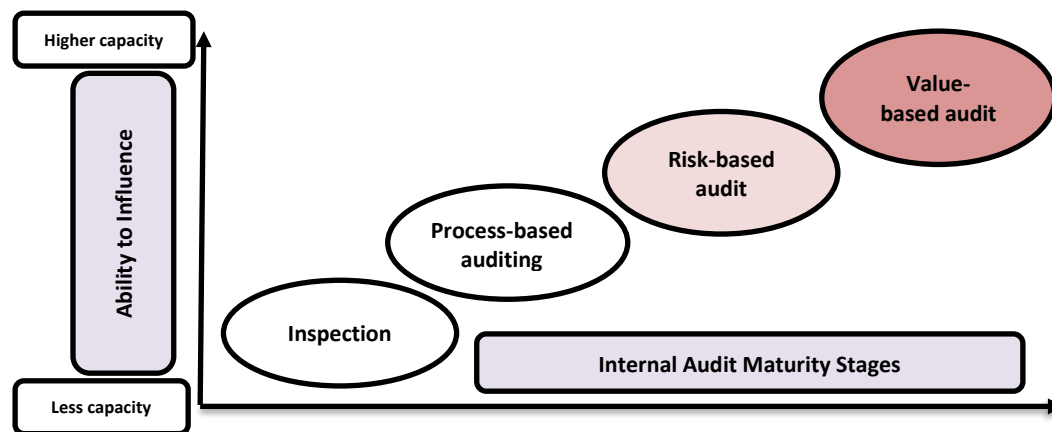


Figure 1. The level of impact of internal audit and prospects.

Source: (Abdul Rahim, 2018).

Based on the above, it can be affirmed that internal auditing is now regarded as a value-creating function. The added value of internal auditing is demonstrated through its stages and activities, from developing a risk-based internal audit plan to submitting the final report. In this report, internal auditing provides assurances on the effectiveness and performance of key risk management processes and offers the necessary recommendations. The value-creating activities of internal auditing do not stop there but extend to the follow-up and monitoring of items identified during the audit, as well as proposing improvements or solutions. This process allows governance bodies of the organization to remain continuously informed.

Value Added Requirements for The Internal Audit Function in Islamic Banks

The value-added approach to internal auditing emphasizes two key objectives. The first (protection) is achieved through internal audit practices aimed at review, compliance, verification, and building trust in the organization's activities, data, and informational lists. The second (support) is realized through internal audit support for various administrative levels within the organization, persuading them that these services will help them assume their responsibilities, address challenges, and leverage opportunities (Abdel Razzaq, 2017; Newman & Comfort, 2018). Here is a set of requirements that enable internal auditing to generate added value:

Scientific and Practical Qualification of the Internal Auditor: Providing a professionally qualified internal audit staff with adequate resources is crucial for effective management and is one of the best services rendered to the organization. This ensures the analysis of opportunities, assessment of quality and efficiency, and timely, accurate communications, making internal auditing a valuable resource for management and the board in achieving objectives and adding value to the organization (IIA, 2019). For internal audit staff to contribute to value creation, their skills must be strengthened in at least four areas (Al-Kashef, 2000):

- Enhancing their knowledge of modern technologies to stay prepared for updates related to the communication revolution, the emergence of e-commerce, and the development of computing applications.
- Improving their knowledge of environmental quality standards, such as ISO 14001.
- Understanding modern business management trends, such as total quality management, business process reengineering, and strategic planning, along with modern accounting approaches.
- Developing their skills in change management, flexibility, listening, negotiation, and understanding personalities, which improves communication and relationships with stakeholders related to their activities.

Independence and Objectivity: Independence and objectivity are crucial for internal auditing to add value to the organization. A lack of independence and objectivity among internal auditors results in a loss of trust from management and the board in their reports, assertions, and recommendations. Thus, weaknesses in objectivity and independence naturally limit the usefulness of the internal audit's assurances and recommendations (IPPF, 2019).

Understanding of the Organization's Activities by Internal Auditing: An essential requirement for internal auditing to add value is the auditor's understanding and familiarity with the nature of the organization's operations and activities. This understanding is reflected in the effectiveness of the internal auditor's recommendations, as it addresses the core improvements needed and clarifies how to enhance performance levels.

Implementing Advisory Programs Across Organizational Levels: This is an important requirement that internal audit departments can use to create real value through comprehensive advisory programs for all organizational departments, in coordination with the accounting sector, to enhance organizational performance effectiveness.

Adopting Programs that Seek New Profit Sources for the Institution: This involves adopting, following, and monitoring continuous improvement programs developed by management, assessing the extent to which these projects add real value to the institution, and evaluating whether resources are adequate for their completion (Hassan, 2012).

Strengthening Communication with Internal Audit Service Beneficiaries: Especially with key parties influencing corporate governance activation, namely the board of directors, the audit committee, and the external auditor.

Expanding Internal Audit's Advisory Role Across All Management Levels: This helps improve organizational efficiency in achieving objectives while providing recommendations to enhance performance and create added value.

Adopting a Total Quality Approach: This applies to both internal auditing activities and the performance of various organizational functions, ensuring new competitive advantages (Khalil, 2011).

Top Management Support for Internal Audit's Work: Top management support is essential for internal auditing to add value, as the alignment between top management and internal auditing reduces conflicts and ensures necessary safeguards during audit procedures, adding value to the organization.

Meeting Beneficiaries' Needs: Addressing the needs of audit beneficiaries is vital for value creation in internal auditing. This includes ensuring precision and objectivity, evaluating satisfaction, and continuously enhancing audit services to maximize institutional value (Baajjah, 2013).

To summarize, the value-added role of the internal audit function in Islamic banks is not realized through isolated practices but rather through a comprehensive framework that integrates technical proficiency, strategic alignment, organizational insight, and strong communication with stakeholders. Each of the outlined requirements, ranging from the auditor's professional qualifications and independence to the adoption of total quality management and responsiveness to beneficiaries' needs, collectively forms the foundation for a high-impact internal audit function. Moreover, value creation is enhanced when internal audit is positioned not merely as a control mechanism but as a strategic partner that contributes to organizational resilience, innovation, and sustainable performance. This holistic perspective ensures that internal auditing moves beyond compliance to become a key driver of institutional value and continuous improvement.

Indicators for Measuring the Added Value of The Internal Audit Function

The internal audit function is widely recognized as a fundamental pillar of good governance, having progressed from a traditional oversight role to a strategic function focused on delivering measurable value to the organization (IIA, 2024). To achieve this value-adding role, internal audit must adopt performance measurement systems that are closely aligned with the organization's strategic objectives and operational priorities. This entails the application of a comprehensive set of indicators that emphasize outcomes over inputs, ensuring that audit activities contribute concretely to organizational success (ADAA, 2010).

The evaluation of internal audit effectiveness, therefore, relies on performance indicators that reflect both the nature of the services rendered and the perceptions of key stakeholders who benefit from these services. These indicators are also shaped by the auditors' professional qualifications and the overall quality of their performance (Baajjah, 2013). In practice, performance metrics are generally classified into two broad categories: tangible (or direct) indicators, often measured through financial data, and intangible (or indirect) indicators, assessed using non-financial criteria. As such, the framework for evaluating the value added by internal audit must integrate both quantitative and qualitative dimensions (Hilmi & Fatine, 2022).

Table 1 below presents a structured classification of these performance indicators, capturing the dual functional and strategic contributions of internal audit.

Table 1. Indicators for measuring the added value of the internal audit function

Category	Performance Indicators
Qualifications and development of internal auditors	Ratio of auditors with extensive experience to total auditors
	Ratio of certified auditors to total auditors
	Ratio of audit-related training sessions
	Ratio of audit training hours to total training hours
Internal Audit Activities	Ratio of risk-prevention procedures to total procedures
	Ratio of risk-mitigation procedures to total procedures
	Number of training programs on internal control and risk systems
Beneficiaries of the internal audit	Satisfaction level of internal and external beneficiaries
	Number of submitted reports vs. planned reports
	Number of services delivered vs. requested services
Financial savings from the internal audit	Savings realized vs. projected audit cost
	Improvement in external audit cost
	Avoidance of risk-related losses
	Reduction in risk-incurred costs
Services Provided	Minimization of revenue losses due to risk
	Completed audit tasks compared to planned tasks
	Percentage of implemented recommendations from current and previous reports
Cost Control	Average number of days from audit completion to report issuance
	Actual cost versus allocated internal audit budget
	Ratio of actual audit hours (excluding management time) versus available hours
	Percentage of tasks completed on time and within budget

Source: (Baajjah, 2013; ADAA, 2010).

It is important to recognize the interdependence among the various indicators used to measure the added value of the internal audit function. For instance, the development and qualification of internal auditors are directly linked to the quality and effectiveness of audit activities, as well as to the satisfaction of both internal and external beneficiaries. The greater the investment in building the capabilities of audit professionals, the more significant the improvements in audit outputs and stakeholder confidence.

Among the most prominent indicators confirming that internal auditing contributes real value to the organization are:

- The extent to which internal and external beneficiaries approve the reports and insights provided by the internal audit.
- A consistent year-over-year reduction in the organization's risk exposure due to enhanced audit practices.
- High satisfaction levels among key governance bodies, including the board of directors, senior management, and the audit committee, regarding the quality of internal audit services.
- Reduced operational costs resulting from fewer errors, minimized losses, and effective risk mitigation.

- Progressive decreases in the cost of external audit engagements, attributable to the strength of internal audit controls.
- Improved profitability and cost savings driven by audit-based operational improvements, which in turn enhance customer satisfaction, institutional reputation, and competitive positioning.

In the context of Islamic banking, these indicators acquire additional significance, as the internal audit function must also ensure that all operations are fully compliant with Sharia principles. This includes verifying the absence of *riba* (usury), *gharar* (excessive uncertainty), and other prohibited elements from financial products and services. Internal audit in Islamic banks is further entrusted with safeguarding the principle of *amanah* (trust), especially in dealing with depositors' funds, who are treated as partners rather than creditors.

Therefore, the framework for measuring the added value of internal audit in Islamic banks must incorporate Sharia-related indicators alongside operational and financial ones. These may include:

- The extent of compliance with Fatwas and Sharia board rulings.
- The degree to which Sharia audit findings are addressed and rectified.
- Stakeholder confidence in the Islamic identity and ethical soundness of banking operations (Abdullah & Hassan, 2022).

Together, these indicators reflect both the functional and strategic dimensions of internal auditing and illustrate its role in enhancing resilience, transparency, and long-term value creation within a framework that respects Islamic financial ethics and societal responsibility.

The Role of Internal Audit Governance in Adding Value to Islamic Banks

In recent years, governance has emerged as a critical concept in the organizational and economic landscape, gaining increasing prominence as institutions pursue competitiveness, expansion, and profitability (Amoura, 2021). According to the Organization for Economic Co-operation and Development (OECD, 2004), governance constitutes a fundamental pillar for enhancing economic efficiency, sustaining growth, and fostering investor confidence. It encompasses a framework of relationships among the organization's management, board of directors, shareholders, and other stakeholders, and outlines the structure through which organizational objectives are defined and performance is monitored.

Governance operates through a set of formal mechanisms designed to safeguard the rights of shareholders and various stakeholders by reinforcing managerial accountability and enhancing oversight processes. These mechanisms play a central role in evaluating management performance and ensuring transparency in financial reporting. As outlined by Mohammed (2016), governance mechanisms can be broadly classified into two main categories as follows:

- **Internal mechanisms (internal control mechanisms):** These include mechanisms for monitoring the performance of the organization's management, taking into account the strength of its internal audit department, the extent of the management's commitment to applying the applicable accounting standards, the strength of the independence of the audit committee, and the degree of the organization's reliance on advanced information technologies.
- **External mechanisms (external control mechanisms):** These are related to the institution's auditor, who is responsible for examining the financial statements, preparing financial reports, and expressing their neutral technical opinion on them. Therefore, monitoring their performance must be ensured, which is mandatory. Changing the auditor periodically, ensuring his independence and the extent of his commitment to applying the applicable auditing standards, and the extent of his provision of advisory services to the institution.

Furthermore, Internal audit serves as a foundational pillar of corporate governance, playing a vital role in enhancing regulatory oversight and establishing effective risk mitigation frameworks (Alwardat, 2017). Beyond its traditional assurance function, internal audit acts as a strategic partner by offering insights that empower both management and the board to better understand and improve governance structures and processes. A well-developed and mature internal audit function can proactively identify trends, anticipate risks, and highlight emerging issues before they escalate into organizational crises (Amoura, 2021).

In today's increasingly complex risk environment, the scope of internal auditing is expected to broaden significantly. Its responsibilities now extend to areas such as risk governance, organizational culture and behavior, sustainability, and non-financial reporting practices (IIA, 2018). According to the new 2024 Internal Auditing Standards, internal audit is now required to help organizations improve governance by supporting decision-making, encouraging ethical behavior, facilitating risk communication, and coordinating among the organization's various oversight bodies. These standards focus on operating in a flexible manner based on general principles, rather than fixed steps, to suit different types of organizations (IIA, 2024).

In contrast, internal audit plays a pivotal role in strengthening governance practices by contributing to a range of organizational benefits. As noted by Madhani (2020), enhanced governance, fostered by internal audit, leads to better organizational management, improved credibility of executive leadership, increased attraction of long-term investors, greater access to low-cost capital, and ultimately, enhanced organizational value.

These visions are supported by Yazid (2016), who highlights the impact of internal auditing in improving performance and enhancing the competitiveness of the organization within a strong governance framework, through:

- Promoting transparency and fairness to attract investment and support global expansion.
- Enhancing long-term competitiveness through technology and investor awareness.
- Building trust in the national economy by strengthening financial markets and increasing investment.
- Supporting strategic management and decision-making to improve institutional development and positioning.

In conclusion, internal audit governance plays a pivotal role in adding value to Islamic banks by reinforcing accountability, transparency, and adherence to ethical and regulatory frameworks. Through its independent evaluation of governance structures, internal controls, and risk management practices, internal audit enhances stakeholder confidence, protects rights, and ensures the integrity of financial reporting. These contributions not only align with the unique principles of Islamic banking but also strengthen institutional reputation and competitive positioning in the financial sector.

The Control Role of Internal Audit in Adding Value to Islamic Banks

Achieving sustainable organizational value requires robust oversight and control of internal activities and operations, primarily through comprehensive internal control systems in which internal auditing plays a central role. Internal audit supports management in attaining business objectives and contributes to the enhancement of operational performance by identifying inefficiencies, minimizing risks, and promoting accountability (Attaf & Bensbahou, 2023).

Internal control functions as an essential component of both corporate governance and risk management frameworks. It is shaped, understood, and monitored by the board of directors, senior management, and relevant personnel within the organization. Its purpose is to help the organization seize opportunities and mitigate risks in accordance with the risk management strategy and internal control policies established by the board. According to IFAC (2012), internal control enables the achievement of organizational objectives through the following:

- Implement effective and successful strategic and operational processes.
- Provide useful information to users to make rational decisions promptly.
- Ensure compliance with applicable laws and regulations, as well as the organization's policies and guidelines.
- Protect the organization's resources from loss, fraud, misuse, and damage.
- Protect information systems, including information technology, in a manner that ensures the existence, integrity, and confidentiality of such systems.

Internal control has been the subject of various definitions by international professional bodies. The Committee of Sponsoring Organizations (COSO, 2013) defines internal control as "a process implemented by an organization's board of directors, management, and other personnel to provide reasonable assurance regarding the achievement of operational, reporting, and compliance objectives (compliance with laws)." Similarly, the International

Federation of Accountants (IFAC, 2010), in its International Standard on Auditing (ISA) No. 315, describes internal control as “the process designed, implemented, and maintained by those charged with governance, management, and other personnel, to provide reasonable assurance regarding the achievement of the organization’s objectives for the reliability of financial reporting, the effectiveness and efficiency of operations, and compliance with applicable laws and regulations.”

Beyond these definitions, a strong interrelationship exists between internal control and internal audit. Internal control encompasses the systems, policies, procedures, and processes established by the board of directors, executive management, and employees to protect organizational assets, mitigate risks, and facilitate the achievement of strategic objectives. In contrast, internal audit serves as an independent and objective function that evaluates the adequacy and effectiveness of these internal control systems. By reviewing the organization’s activities, control mechanisms, and management information systems, internal audit supports both the board of directors and management in overseeing and enhancing the internal control framework (OCC, 2001).

In light of evolving business environments and the growing complexity of managerial responsibilities, particularly with regard to governance compliance and risk management, the role of internal audit has become increasingly central to supporting management in fulfilling these duties (Saleh & Al-Sayed, 2019). The need for internal auditing stems primarily from its control-oriented function, which enables organizations to maintain oversight over internal processes and ensure alignment with strategic goals.

Internal auditors contribute significantly to strengthening internal controls by facilitating self-assessments and promoting the adoption of best practices. They serve as key references in risk and control assessments, offering essential tools such as centralized risk databases and producing periodic risk and control reports that are critical to effective risk management (Susilawati, 2023).

Moreover, internal auditing plays a fundamental role in the financial information process. In accordance with corporate governance codes, internal auditors supervise control activities and support the evaluation of internal control system effectiveness and efficiency (Ismail et al., 2022). Their responsibilities now extend to identifying emerging risks and offering consultative guidance on appropriate mitigation strategies (Gali & Sami, 2013).

The Institute of Internal Auditors (IIA, 2019) underscores that every organization, regardless of size, should maintain a robust internal control system. To maximize its benefits, this system should be supported by a professionally qualified and well-resourced internal audit team capable of delivering value-added services. The primary responsibility of the internal audit is to assess the adequacy and effectiveness of internal controls. Internal auditors evaluate organizational activities against three key objectives: operations, reporting, and compliance, while also assessing how well internal control components interact and contribute to achieving the organization's goals (IFC, 2021).

According to the 2024 Global Internal Audit Standards, the internal audit function assumes a dual role, providing both assurance and advisory services, in enhancing the organization's internal control systems. This includes evaluating the adequacy, efficiency, and effectiveness of control mechanisms, as well as supporting their ongoing development (IIA, 2024). As part of this dual role, internal audit provides independent assurance on the reliability of internal controls and offers advisory support to management in the design, implementation, and assessment of these structures. Such contributions enable management to rely on audit reports for achieving financial accuracy, ensuring regulatory compliance, and improving operational efficiency (Saleh & Al-Sayed, 2019).

Based on the foregoing, the control role of internal audit is essential to adding value in Islamic banks. By independently assessing the adequacy and effectiveness of internal controls, it enhances oversight, supports informed decision-making, and ensures alignment with Sharia-compliant governance and operational objectives. This role not only mitigates risks and safeguards assets but also promotes continuous improvement in compliance and efficiency, reinforcing the bank’s competitiveness and its ability to meet stakeholder expectations in a dynamic financial environment.

The Role of Internal Audit in Risk Management to Add Value to Islamic Banks

Following the financial collapses of several major global institutions, risk management has emerged as a critical component of corporate strategy and a fundamental pillar of governance frameworks. It is now considered an

essential element within the internal control systems outlined in COSO publications (Al-Qudah, 2023). As an intangible yet strategically valuable organizational resource, difficult to replicate, effective risk management contributes directly to achieving a sustainable competitive advantage (Teoh et al., 2017). To maximize its effectiveness, risk management must be integrated at all levels of the organization. This integration enables the achievement of strategic goals, ensures operational efficiency, and facilitates the delivery of competitively priced products and services (Angeline & Teng, 2016).

Within this context, Internal auditors play a key role in evaluating the effectiveness of risk management systems and providing actionable recommendations. According to the Global Internal Audit Standards (IIA, 2024), the internal audit is responsible for assessing the adequacy of governance, risk management, and control processes. By delivering independent assurance and strategic insights, internal auditors help management and the board strengthen risk frameworks and support the achievement of organizational objectives.

In addition, internal auditors leverage their deep understanding of organizational processes to provide valuable insights through reports, consultations, and guidance to senior and operational management (Munteanu & Zaharia, 2014). Although they do not manage risks directly, they play a critical oversight role by offering independent assurance and advisory services that support informed decision-making. As noted by IIA Australia (2023), internal audit complements second-line risk functions, with both focusing on strengthening the organization's risk profile and management capabilities.

Value-added internal audit activities are characterized by their ability to reduce risk exposure, lower operational costs, increase efficiency, and promote transparency. One of the indirect outcomes of such activities is the improvement of employee performance across the organization (IIA Ukraine, 2023). In this context, risk management is embedded within the internal control structure and is essential for identifying, mitigating, or capitalizing on potential risks to protect organizational assets and create value for stakeholders. The enactment of the Sarbanes-Oxley Act of 2002 marked a pivotal expansion in internal audit responsibilities, particularly by reinforcing the alignment of audit objectives with the broader risk profile of the organization (Abu Jabal, 2021).

The core mandate of internal audit in risk management lies in its capacity to assess the quality of risk mitigation strategies and operational practices, assuring senior management and the board of directors. Internal auditors are thus required to focus on high-risk processes, often positioned within the core value chain, to maximize the value contributed through their assessments (Karagiorgos et al., 2009).

Empirical research conducted by the Institute of Internal Auditors (IIA, 2009) confirms that internal audit contributes to value creation through effective risk management by delivering objective assurance that critical risks are being appropriately addressed and that internal controls are functioning as intended. As a strategic management tool, internal audit plays a proactive role in detecting potential risks before they materialize. It contributes by offering a comprehensive view of the risk landscape, recommending appropriate responses, and advising on control procedures. Ultimately, it provides reasonable assurance to the board and audit committee regarding the adequacy of the risk control framework (Ghali & Sami, 2013).

Moreover, Schulien & Bates (2006) highlight that internal auditing enhances organizational value by prioritizing high-risk and high-impact areas, improving compliance mechanisms, and strengthening both operational understanding and control frameworks. However, audit activities that are misaligned with the organization's goals and risk profile fail to deliver such value (IPPF, 2019).

Empirical findings from Islamic banks in Yemen further reinforce the theoretical perspectives on the role of internal audit in enhancing risk management. The study conducted by Attaf & Bensbahou (2025) identified four core functions through which internal auditing contributes to the effectiveness of risk management:

- Early risk identification through proactive monitoring and assessment procedures.
- Accurate risk assessment by evaluating the nature, scope, and potential impact of various financial and operational risks.
- Control evaluation, ensuring that existing control systems are both adequate and effective in mitigating identified risks.
- Ongoing monitoring and reporting, which includes delivering timely and reliable information to support management's decisions and strategic planning.

These findings suggest that when internal audit units are empowered with professional independence,

sufficient resources, and institutional support, they serve as a pivotal component in strengthening the organization's risk governance framework and enhancing its overall strategic agility.

In conclusion, internal audit plays a dynamic and strategic role in strengthening risk management within Islamic banks, thereby contributing significantly to value addition. By conducting independent and forward-looking evaluations, internal audit enhances the organization's ability to identify, assess, and respond to risks in a timely and effective manner. This function supports better decision-making, reinforces operational resilience, and aligns risk responses with the bank's long-term strategic and Sharia-compliant objectives. When internal audit is effectively integrated within governance structures and risk management frameworks, it becomes a vital driver of transparency, accountability, and sustainability, empowering Islamic banks to navigate uncertainties, protect stakeholder interests, and maintain a competitive edge in a constantly evolving financial environment.

The Role of Internal Audit in Creating Value for Stakeholders in Islamic Banks

Internal audit in Islamic banks goes beyond internal control and risk monitoring by contributing to the creation of added value for various stakeholders in line with the principles of Sharia-compliant governance. This value emerges through enhanced trust, transparency, and operational integrity. The contribution is evident in the following areas:

- **Adding Value to Customers:** In Islamic banks, customer value extends beyond profitability to encompass quality, ethical service, and sustainability, core aspects that align with Sharia principles such as fairness, transparency, and public benefit. Value is reflected in how effectively products and services meet customer needs through pricing, quality, and market responsiveness (Jado, 2007). Internal audit contributes indirectly to this by evaluating internal controls, identifying weaknesses, and recommending improvements that enhance performance, profitability, and compliance (Al-Jabali, 2020). These efforts support the delivery of high-quality, timely, and Sharia-compliant services, reinforcing customer satisfaction, loyalty, and the bank's competitive position.
- **Adding Value to Shareholders and Stakeholders:** In Islamic banks, the Board of Directors bears a fiduciary responsibility to manage shareholders' capital efficiently, in line with Sharia principles that emphasize ethical investment, profit-sharing, and risk minimization (Al-Kashif, 2000). Value creation for shareholders and stakeholders includes generating returns above the cost of capital, delivering superior customer value, and fulfilling social responsibilities (Jado, 2007). As Suroso (2022) affirms, organizations that consistently create stakeholder value achieve a competitive edge, with the value-added approach serving as a key performance metric linked to shareholder wealth.

Internal audit contributes strategically to this process by enhancing financial transparency, improving risk management, and supporting informed decisions. Its independence and operational insight enable it to uncover control weaknesses and improve reporting accuracy, thereby strengthening investor confidence (Al-Gabali, 2020; Abu Jabal, 2021). Moreover, stakeholders value audit functions that anticipate risks and propose tailored control measures (Eulerich & Lenz, 2020). To meet rising expectations, internal audit must evolve beyond compliance, playing a broader role in governance, performance evaluation, and strategic support (Lakhdar & Salmi, 2021).

- **Adding Value to Other Beneficiaries:** In Islamic banks, other beneficiaries, such as senior management, employees, suppliers, unions, and the surrounding environment, have a vested interest in the bank's sustainability, which aligns with the Sharia principles of justice, partnership, and social responsibility. Like shareholders, they depend on operational continuity driven by efficient and ethically sound processes. Internal audit supports this by assessing the effectiveness of internal controls and risk management, thereby enhancing efficiency and value creation for all parties (Al-Kashef, 2000).

Moreover, value-oriented audit reports help build employee trust in management and encourage engagement with the bank's mission (Abou Jabal, 2021). By reviewing policies and ensuring adherence to Sharia-compliant and regulatory standards, internal audit contributes to a supportive work environment, higher employee satisfaction, and improved productivity.

In conclusion, internal audit in Islamic banks plays a vital role in adding value for all stakeholders by reinforcing Sharia-compliant governance, promoting ethical transparency, and supporting balanced decision-making. Through its assurance and advisory functions, internal audit helps protect the rights of customers, shareholders, employees, and society at large. It strengthens confidence in the bank's operations, ensures

alignment with Islamic financial principles, and contributes to sustainable value and social responsibility following the objectives of Islamic finance.

Challenges of Creating Added Value Through Internal Audit in Islamic Banks

Creating added value through internal audit in Islamic banks involves navigating a complex set of structural, operational, technological, and conceptual challenges. The internal audit function in these banks is expected to go beyond traditional roles, such as risk mitigation and control assessment, to also ensure Shari'ah compliance, making the responsibilities of internal auditors broader and more intricate.

Structurally, many Islamic financial institutions suffer from limited auditor independence and underdeveloped governance frameworks (Shakarboyevich, 2025). Reporting lines often place internal auditors under direct management supervision, which may compromise the objectivity of their assessments. Furthermore, some institutions lack clearly defined audit charters and oversight structures that empower auditors to contribute strategically.

Operationally, there is a persistent shortage of auditors qualified in both conventional auditing and Shari'ah law. Recruitment practices tend to favor candidates with traditional accounting backgrounds, due to the absence of standardized qualification frameworks (Ali, 2018; Mohd et al., 2020). This competency gap limits the audit function's ability to assess complex Islamic financial products and Shari'ah compliance. Resistance from management toward audit findings and inadequate investment in capacity-building programs also constrain the effectiveness of internal audit teams.

From the Shari'ah audit perspective, various studies have emphasized the fragmented implementation of Shari'ah governance. Internal Shari'ah audits are often conducted without comprehensive manuals or standardized plans, leading to subjective judgments that vary between institutions (Algabry et al., 2021). The absence of national regulatory clarity and overlap between the roles of Shari'ah reviewers, supervisors, and auditors further hinders the effectiveness of these processes. Additionally, the shortage of qualified Shari'ah auditors and the lack of integration of Shari'ah audit into formal academic curricula exacerbate this situation (Shahid et al., 2023).

Technologically, many internal audit departments still rely on outdated methods, lacking advanced digital tools such as data analytics and automated risk detection systems. Furthermore, Shari'ah auditors in particular often lack adequate training in core banking systems and cybersecurity, exposing institutions to operational and compliance risks (Umar, 2024; Newman & Comfort, 2018).

Conceptual issues add another layer of complexity. There remains confusion in some institutions over whether internal audit is primarily a compliance function or a strategic partner. This ambiguity affects the allocation of resources, authority, and the integration of audit findings into executive decision-making (Faiteh & Aasri, 2022; Abbood & Maeni, 2022). Moreover, the lack of standardized performance measures, such as value-based metrics, makes it difficult to demonstrate the actual added value created by internal audit.

Furthermore, weak coordination between internal audit units, Shari'ah committees, and external auditors often leads to inefficiencies and duplication of efforts (Shahid et al., 2022). The internal audit function also plays a critical role in preventing creative accounting practices that may distort financial statements. However, its effectiveness is often limited by insufficient authority and technical capacity, undermining internal control systems and stakeholder confidence (Jarrah et al., 2022).

Finally, it is important to recognize that Shari'ah auditing is not a separate activity, but rather an integral part of the broader internal audit framework in Islamic banks. Therefore, internal auditors must possess both conventional auditing competencies and basic Shari'ah knowledge to perform their duties effectively. Building dual expertise is essential to realizing the full strategic potential of internal auditing in Islamic financial institutions (Attaf & Bensbahou, 2024).

These overlapping challenges reflect the complexity of the internal audit environment in Islamic banks, where traditional auditing functions must be integrated with religious, ethical, and strategic dimensions. Overcoming such difficulties requires a comprehensive rethinking of the internal audit's role, one that recognizes its potential not only as a compliance mechanism but as a key driver of organizational integrity, resilience, and long-term value. Ultimately, strengthening internal audit within this context depends on building a robust infrastructure that

supports independence, dual expertise, technological competence, and alignment with both regulatory and Shari'ah principles.

CONCLUSION

This study confirms that the internal audit function plays a strategic role in enhancing governance, risk management, and internal control processes in Islamic banks. Beyond its traditional assurance and compliance roles, internal audit in Islamic financial institutions contributes directly to value creation by aligning with Shari'ah principles and supporting ethical, transparent, and accountable operations. Its integration with institutional objectives enables it to act not only as a control mechanism but also as a strategic partner that supports sustainability, innovation, and competitiveness.

However, creating added value through internal audit in Islamic banks is hindered by several challenges. Structurally, the lack of auditor independence and weak governance frameworks limits the audit's objectivity and strategic influence. Operationally, the shortage of professionals with dual expertise in Shari'ah and auditing, alongside inadequate investment in training and development, impairs audit effectiveness. Technological limitations, such as the reliance on outdated tools and insufficient IT and cybersecurity capabilities, further weaken internal audit functions. Conceptual ambiguity regarding whether internal audit is viewed as a compliance enforcer or a value-adding partner also contributes to misalignment of expectations and resource allocation. Additionally, poor coordination between internal audit units, Shari'ah committees, and external auditors reduces the overall effectiveness of the audit process.

To address these challenges and enhance the strategic role of internal audit in Islamic banks, the following measures are recommended:

- Establish unified standards for internal and Shari'ah auditing in line with AAOIFI and IIA frameworks.
- Develop clear competency models that require dual qualifications in finance and Shari'ah for internal audit professionals in Islamic banks.
- Invest in capacity building, including structured training programs, continuing professional development (CPD), and academic integration of Shari'ah audit subjects.
- Enhance technological capabilities by adopting digital audit tools and ensuring auditors are trained in IT systems and cybersecurity.
- Strengthen governance structures by clarifying audit charters, ensuring functional independence, and creating centralized Shari'ah advisory councils where appropriate.
- Promote a strategic audit culture within institutions, positioning internal audit as a value-adding partner rather than a compliance enforcer.

Finally, it should be noted that this study is based entirely on a theoretical literature review and relies on secondary sources. Future research could empirically validate these findings through case studies, surveys, or interviews with internal auditors and Shari'ah committees in Islamic financial institutions. It could also focus on developing and empirically testing indicators derived from the literature to measure the added value of internal audit in practice. Such efforts would enhance the practical relevance of this study's recommendations and further underscore the importance of repositioning internal audit as a strategic, value-adding function capable of enhancing governance, managing risk, and upholding Shari'ah compliance in an increasingly competitive financial environment.

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