

## Regulations of Shariah Audit for Islamic Financial Institutions

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<https://doi.org/10.58458/ipnj.v06.01.04.0043>

### Abstract

Malaysia is well known for its Islamic capital market and is leading in the Islamic banking industry. Being an Islamic country, Malaysia emphasizes on the purification of its money market to provide Muslims society with *halal* source of finance. Although Malaysia is leading the industry, *shariah* auditing is still in need of good governance and direction to best achieve its potential. The Central Bank of Malaysia (BNM) is the key regulator of Malaysian IFIs and *shariah* auditing practices besides several other institutions which their rules and regulations have been adapted to suit *shariah* requirement. Thus, this article is written with an aim to provide readers on the extant of regulations surrounding *shariah* auditing practices in Malaysia, issues arises and opportunity for improvements. Utilizing archival/ historical search, various documents have been reviewed comprises diverse literatures and scholarly discussion on *shariah* auditing issues. Three main issues have been identified for attention (i) competency and skills requirements of internal auditor conducting *shariah* audit and ambiguous guidelines to specify the competency level; (ii) absent of a structured *shariah* auditing framework; and (iii) roles perception gap, where *shariah* audit and review were reported to be conducted only by *shariah* committee and external auditors. In conclusion,

this study raised awareness on the importance of shariah auditing education to overcome most of the issues highlighted.

### Introduction

The development of Islamic economics and emergence of Islamic financial institutions (IFIs) has created a new phenomenon within the global finance arena. Not surprisingly, considerable attention has been given to the area of Islamic business and finance. Alongside the development and the desire to sell and buy products while complying with *shariah* requirements, an area worth probing is auditing. Auditing is important in assuring investors and customers on the accountability and truthfulness of the economies in delivering *shariah* compliance products. Nevertheless, as the Islamic economics are new, the rules and principles governing it are also minute. Although many assumed the International Financial Reporting Standards (IFRS) as basic guidelines, significant effort has to be allocated to ensure that transactions are complying with *shariah* and the IFIs are serious in upholding the Islamic principles which set them apart from the conventional products and financial institutions.

The main objective of the establishment of IFIs is to provide Muslims societies with an economy and investment opportunities that protect them from being sinful, an economy which abide by *shariah* principles. The *shariah* complied economy existed on several premises particularly the prohibition of interest, fair profit sharing, avoidance of *haram* activities and to safeguard the interest of societies (Dusuki, Ali, and Hussain, 2012). The function of Islamic banks is different from those of traditional banks which emulate the Western model. *Shariah* complied IFIs relationship with investors/depositors are not similar to the traditional banks and so does the financial reporting where principles and rules are clearly different.

Customers and shareholders of IFIs may not gain confidence without the IFIs effort to several aspects: (i) communicate all relevant information in order to assist users in evaluating their companies' financial compliance with the *shariah* principles, and (ii) provide attestation and assurance that their financial business or operations are in compliance with all the relevant *shariah* principles. To provide the attestation and assurance, IFIs have to undertake Islamic auditing (*shariah* auditing) and *shariah* review (compliance process). The *shariah* auditing process, which is unique compared to conventional banking process, helps IFIs establish credibility and reputation from the Islamic financial standpoint. A survey by PwC Malaysia, which appears in *Shariah Audit: Industry's Insight* (2011), indicates that a key pillar of the *shariah* governance framework (SGF) is the *shariah* audit due to its important role in providing public assurance on the governance of *shariah* products and services. In fact, through *shariah* auditing process, IFIs can reduce the risk of *shariah* non-compliant that may be damaging to reputation, causing legal actions if not addressed properly or lessening the confidence of depositors, investors, customers, and other stakeholders (Dusuki et al., 2012; Shafii, Supiah, and Syahidawati, 2010). Furthermore, any proceeds from non-*shariah* compliance activities is *haram* for the company, cannot be considered as profit and should be bequeath to the poor and needy Dusuki et al., 2012).

### **Definition and Regulatory Requirements of Shariah Auditing Practices**

In the Malaysian context, *shariah* auditing is unambiguously spelt out in a set of guidelines in SGF (2010) issued by BNM on 20 May 2010. This set of guideline stipulates that the internal auditors from the internal audit department should conduct *shariah* auditing, and the internal auditors should be

competent in the *shariah* knowledge and understanding of the *shariah* issues related to Islamic banking products and operations. On the other hand, Part IV, Division 3, Section 37 (1) of IFSA's act (2013) states that IFIs are required to appoint any person to carry out audit on *shariah* compliance by the institutions. *Shariah* auditing is defined based on the *Shariah Governance Framework for Islamic Financial Institutions* (2010) - (SGF, 2010), which was issued by Central Bank Malaysia (BNM), as follows;

*“Shariah audit refers to the periodical assessment conducted from time to time, to provide an independent assessment and objective assurance designed to add value and improve the degree of compliance in relation to the IFI's business operations, with the main objective of ensuring a sound and effective internal control system for Shariah compliance”. Section IV, Principle 7 (ii); 7.7 (SGF, 2010, p 28.).*

Greater understanding of *shariah* audit is entailed before such efforts can be implemented effectively. To begin with, a proper definition of *shariah* audit is required, and the literature is quite replete with definitions of *shariah* audit, which to a certain extent have confused readers. For example, Abdul Rahman (2008b, p.9) defines *shariah* audit as *“the accumulation and evaluation of evidence to determine and report on the degree of correspondence between information and established criteria for shari'ah compliance purposes.”* On the other hand, Alwi (2007) and Shafii et al.(2010) assert that *shariah* audit is a process to check whether IFIs' services, products, and procedures comply with *shariah* principles in all their business operation, particularly their financial statements and other operational components. The *shariah* auditing process should include the products, technology supporting operations,

operational processes, the people involved in the key areas of risk, documentations and contracts, the policies and procedures, and other activities that require adherence to *shariah* principle. (Alwi, 2007).

Alternatively, Haniffa (2010, p.1 ) provides a compelling definition of *shariah* auditing, which states that *shariah* audit is:

*“a systematic process of objectively obtaining and evaluating evidence regarding assertions about religious and socioeconomic actions and events, in order to ascertain the degree of correspondence between those assertions and the applicable financial reporting framework, including the criteria specified based on shariah principles as recommended by the Shariah Supervisory Board (SSB), and communicating the results to all interested parties”.*

In essence, Haniffa's (2010) definition highlights the importance of religious and social economics events practiced by IFIs that have to adhere to *shariah* principles as prescribed in the Islamic teaching.

Realizing the importance of *shariah* principles in Islamic finance and banking, in 2010, Bank Negara Malaysia (BNM) issued *Shariah* Governance Framework (SGF), which contains a guideline for the establishment of the *shariah* governance in IFIs. Specifically, this guideline stipulates that all IFIs in Malaysia are required to comply with all the requirements as outlined in the guidelines. In particular, one of the salient requirements is that all IFIs must establish a *shariah* committee to ensure that their business operations are in line with the *shariah* rules. Later, a new regulation called Islamic Financial Services Act, 2013 (IFSA, 2013) was issued by the government of Malaysia to address new developments in the Islamic banking.

In fact, from the regulators' point of view, *shariah* compliance in the IFIs is the utmost and ultimate requirement that should be adhered to and preserved. In this regard, the new regulations issued by the government of Malaysia under the Islamic Financial Services Act (2013) (IFSA, 2013) clearly prescribes the importance of *shariah* compliance in all IFIs operations and business. In particular, IFSA's regulatory objective as spelt in Section 6 emphasizes the imperative of promoting financial stability and compliance with *shariah*. As such, according to Section 28 (1) IFSA (2013), IFIs at all times must ensure that their aims, operations, business, affairs, and activities comply with *shariah*. More importantly, IFIs are obligated to make sure that their internal policies and procedures are consistent with the standards issued by BNM to manage their business, affairs, and activities in accordance with the *shariah* principles.

Collectively, the Board of Directors (BOD), Chief Internal Officer (CEO), senior officer, and *shariah* committee (SC) are all responsible to make sure that IFIs comply with the standards specified by BNM at all time, including carrying out audit on *shariah* compliance. To ensure such undertaking, IFSA (2013) under Division 3, Section 37 states that IFIs may engage certified institutions to appoint any person to carry out such an audit on *shariah* compliance by the institutions. In addition, auditing allows auditors to express their opinions based on truthful, fair judgment on whether the financial statements and materials that have been prepared are in accordance with the *shariah* rules and principles as well with relevant accounting standards (Abdul Rahman, 2008b).

If any findings of such an audit indicate a breach of provisions has been committed, the guilty IFIs would be liable to appropriate penalty. Specifically, Section 28 (5) of the IFSA it mandates that any person who contravenes this Act shall be liable to imprisonment for a term not exceeding eight years or to be fined not exceeding 25 million or both. Clearly, the act highlights the duty and the importance of the IFIs to ensure their business activities are in compliance with the relevant *shariah* precepts of which it becomes an offence under the law for the Islamic financial institutions to breach this conformance. Given the severity of such punitive measures, it is crucial for IFIs to ensure their activities and operations must comply with all the *shariah* principles.

The mechanics of SGF (2010) framework comprises three main working groups, namely the board, management, and *shariah* committee. These three working groups are interdependent to enable IFIs in supplying their customers with *shariah*-compliant services at all times. The roles assumed in SGF mechanics include *shariah risk management control*, *shariah review*, and *shariah audit*. The *shariah risk management control* helps identify all possible risks of *shariah* non-compliance and,

where appropriate, suggests counteractive measures in handling risks. The *shariah* review function will continuously evaluates and oversee *shariah* compliance of all activities. The *shariah* audit conducts annual investigations to provide independent assessments of the adequacy and compliance of IFIs with established policies, procedures as well as the internal control. Table 1.1 summarizes the definitions of the three organs based on the SGF (2010) guideline.

Under Section VI (*Shariah* Compliance and Research Function), Principle 7, the objective of *shariah* review function is to ensure that activities and operations carried out by the IFIs covering IFI's overall business operations, including end-to-end product development process from the pre-product approval to post-product approval process, do not contravene with *shariah*. The pre-product approval process refers to the process of product structuring prior to the introduction of product to the market, while post-product approval process refers to the product offering process. Then, qualified *shariah* officers, who normally have relevant academic background in *shariah* such as *Usul Al-fiqh* (the origin of Islamic Law) and *Fiqh Muamalat* (Islamic transaction), shall perform the *shariah* review function. In conducting the *shariah*

Table 1.1: Definition of *Shariah* Review, Audit, and Risk Management based on SGF (2010)

<p><b><i>Shariah Review</i></b> - refers to regular assessment on <i>Shariah</i> compliance in the activities and operations of the IFI by qualified <i>Shariah</i> officer(s)<sup>12</sup>, with the objective of ensuring that the activities and operations carried out by the IFI do not contravene with the <i>Shariah</i> [Section IV, Principle 7 (i); 7.3]</p>
<p><b><i>Shariah Risk Management</i></b> - refers to systematically identify, measure, monitor and control of <i>Shariah</i> non-compliance risks to mitigate any possible of non-compliance events. The systematic approach of managing <i>Shariah</i> non-compliance risks will enable the IFI to continue its operations and activities effectively without exposing the IFI to unacceptable levels of risk. [Section IV, Principle 7 (iii); 7.15]</p>
<p><b><i>Shariah Audit</i></b> - refers to the periodical assessment conducted from time to time, to provide an independent assessment and objective assurance designed to add value and improve the degree of compliance in relation to the IFI's business operations, with the main objective of ensuring a sound and effective internal control system for <i>Shariah</i> compliance. [Section IV, Principle 7 (ii); 7.7]</p>

review process, these officers need to adhere to the guideline as follows:

- (i) To planning the review program encompassing the objectives, scope, reporting, rectification, and follow-up actions;
- (ii) To document the processes involved in the review;
- (iii) To communicate the outcome of the review and to highlight any non-compliance to the *shariah* committee and management;
- (iv) To rectify any instances of non-compliance with the *shariah* so as to prevent such events from recurring.

Following the review function, internal auditors of the IFIs, who are well-trained and knowledgeable in *shariah*, will then perform the *shariah* audit function. The main objective of the *shariah* audit function is to establish a sound, effective internal control system for *shariah* compliant auditing that can be conducted periodically. The same guideline also outlines the scope and the process of (but not limited to) *shariah* audit as follows:

- a) *Scope of shariah audit*  
The *shariah* audit shall cover all aspects of IFIs' business operations and activities including;
  - i. Financial audit;
  - ii. Compliance audit of the organizational structure, people, and information technology applications system;
  - iii. Review of adequacy of *shariah* governance process.
- b) *Shariah Audit Process*  
The *shariah* audit process will involve performing activities as follows:
  - i. Identifying an appropriate scope for auditing exercises, such as auditability and relevance, by understanding the business activities;
  - ii. Developing a comprehensive internal audit program or plan, which should

encompass the objectives, scope, personnel assignment, sampling, control and duration as well as establishing proper audit processes, policies, and procedures of IFIs' operations;

- iii. Obtaining and referring to relevant sources, including published SAC's rulings, *shariah* committee's decisions, fatwas, guidelines, *shariah* audit results, and internal *shariah* checklist;
- iv. Conducting *shariah* audit on a periodical basis;
- v. Communicating the results of *shariah* audit to the *shariah* committee and the board audit committee;
- vi. Providing recommendations and rectification measures to be followed up by IFIs.

At the international level, to spur the growth of Islamic finance, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) plays an important role in guiding *shariah* audit. AAOIFI, through its Auditing Standard for Islamic financial institutions (ASIFI), has established a series of standards and guidelines with the main objective of enabling external auditors to express their opinions as to whether IFIs' financial statements have been prepared in accordance with *shariah* rules and principles based on AAOIFI standards and other relevant national accounting standards. Essentially, the ASIFI has five chapters dedicated to guiding IFIs in carrying out Islamic audit.

The titles of these chapters (starting from the first to the last) are *Objective and Principles of Auditing, The Auditor's Report, Terms of Audit Engagement, Shariah Supervisory Board: Appointment, Composition and Report, and Shariah Review*. In addition, AAOIFI has also established *Governance Standard for Islamic Financial Institutions (GSIFI)*, of which its GSIFI No 2: *Shariah Review* and GSIFI No 3 : *Internal Shariah Review* discusses

the issues of *shariah*. According to Alwi (2007), the AAOIFI's Governance standard No 2 (GSIFI 2) provides the most reflective interpretation of *shariah* audit as defined in Para 3, GSIFI 2 in AAOIFI Standards as follows:

*“Shariah review or audit is an examination of the extent of and IFI's compliance, in all its activities, with the shariah. This examination includes contracts, agreements, policies, products, transactions, memorandum and articles of association, financial statements, reports (especially internal audit and central bank inspection),*

More importantly, the GSIFI No. 2 stipulates that the *shariah* review procedures need to include planning, executing, documenting, and reporting. The external auditors are the responsible group to conduct *shariah* review of the IFIs. As such, according to AAOIFI, coordination and close working relationship among external auditors, *shariah* committee, and audit committee is essential to ensure the effectiveness of *shariah* review. In addition, according to GSIFI No 2, external auditors need to have a sound understanding of IFIs' operations and fatwas (*shariah* edicts), resolutions, rulings, and guidelines. The review procedures should cover all activities, products, and locations of the IFIs.

Furthermore, external auditors are also responsible to conduct post *shariah* review procedures, such as reviewing the *shariah* review procedures, compliance of internal control procedures, and all parts of IFIs' operations, so as to establish whether adherence to the *shariah* principles is met or not. Finally, external auditors should document the review procedures and submit them to the *shariah* supervisory board for the preparation of *Shariah* Supervisory Board Report or *Shariah* Committee Report, which would be presented to the shareholders. Hence, external

auditors have to rely on the *fatwas* and rulings issued by *shariah* committee to help them ascertain whether IFIs' financial statements comply with all the *shariah* principles.

In AAOIFI GSIFI No. 3: Internal *Shariah* Review, the standard stipulates that the internal *shariah* departments of IFIs need to conduct *shariah* internal review. Their main responsibility is to ensure that the management of an IFI comply with the *shariah* principles. According to GSIFI No 3, the internal *shariah* review is to be carried out by an independent division, department, or part of the internal audit department. The IFI should ensure that the internal *shariah* reviewers should have no executive authority or responsibility for the activities that they are reviewing.

Furthermore, the internal *shariah* reviewers should have direct and regular communications with all levels of management, *shariah* committee, and external auditors. The same guideline recommends that the internal *shariah* review should be performed according to four vital stages: planning; documentation; examination; and evaluation of internal *shariah* review information, reporting, and follow up. In addition, the guideline also emphasizes the competency and proficiency of *shariah* internal reviewers in discharging their duties by recommending appropriate training in accounting, auditing and *shariah* principles.

Interestingly, the guidelines and standards of SGF (issued by BNM) and GSIFI (issued by AAOIFI) pertaining to *shariah* auditing and review practices have similarities and differences between them. Their similarities lie with the objectives of *shariah* auditing of GSIFI No 3 and SGF, which are to ensure *shariah* compliance of all IFIs' activities, particularly their financial statements and other operational components, and the

internal *shariah* review function. However, the AAOIFI calls for external auditors and *shariah* review officers to provide attestation and assurance of *shariah* compliance as opposed to SGF guidelines.

To date, there are no regulatory requirements for external auditors to undertake *shariah* audit at IFIs in Malaysia. Then, the *shariah* review officer from Malaysia's perspective is expected to provide day to day *shariah* compliance checking, while internal auditor is expected to give assurance on the controls of the IFIs are adequate to address *shariah* compliance issue and principles. In addition, a number of different terms have been used to refer to auditing in Islamic institutions, thus clouding one's understanding of the subject matter. For example, in the literature, some researchers recognize *shariah* audit as religious audit or Islamic audit. Occasionally, these two terms have been used interchangeably.

### Issues

The complexity of financial institutions' roles, activities, and operations to operate profitably has spurred a significant interest in the internal audit functional role. This section provides discussion on three (3) main issues identified from previous literatures. From Malaysia practices, *shariah* audit is required to be performed by internal auditors of IFIs. The first (1) issue is rooted in terms of requirements of competency and skills of internal auditor in conducting *shariah* auditing practices as well as the clarity of the guidelines to specify the level of the competency. To reinforce the importance of the internal audit function within financial institutions, the Guidelines on Minimum Audit Standard for internal auditor of financial institutions issued by BNM (p. 2-4) emphatically states that:

*“A financial institution’s role has become more complex and with the continuing pressure to operate profitably, the industry has adopted innovative business approaches. This includes the management of complex assets and liabilities, search for additional sources of income, reaction to technological advances, response to changes in regulatory policy, and competition for deposits and insurance premiums have all added to the risks and complexities of the businesses of the financial institutions. As a result, the innovation and complexity of the industry’s pursuit of profitable activities create a constantly changing body of business and economic risks. These factors, together with the rapid pace of expansion in branch network, the increasing sophistication of operations and the centralization of operations at the head office or regional processing centers, call for a more dynamic rather than static audit process. Towards this end, internal auditors are expected to play a greater and more proactive role in carrying out management and compliance audits and to assist the financial institutions to achieve their objectives and goals. An effective internal audit function should serve as a resource to the management. The internal auditors should not only assess the soundness and adequacy of internal controls but also determine whether the established policies and procedures are effective in practice. The internal auditors should be able to advise management on the adequacy and effectiveness of the policies and procedures in protecting the organization against the attendant new risks”.*

As stated in the previous paragraph, the “*Shariah* Governance Framework for Islamic Financial Institutions” stipulates that *shariah* auditing should be conducted by the internal auditors from the internal audit department. These auditors should be competent in terms of *shariah* knowledge and understanding of the *shariah* issues related to Islamic banking products, services, and operations. In accordance with BNM’s and IIA’s assertive directives, the *shariah* auditing function, which needs to be performed by the internal auditors, can add value and improve an organization’s operations through the establishment of sound, effective internal control to adhere to *shariah* principles and compliance. To achieve this aim, the internal auditors must possess adequate Islamic knowledge to dispense their duties professionally. However, the term “adequate knowledge” has not been clearly defined by the BNM, which gives rise to many interpretations. For example, such interpretations might imply that internal auditors should hold professional certifications and qualifications or they should have a certain level of skills based on the number of hours of training. Given this vague requirement, IFIs will have no clear guidelines to qualify the appointment of their internal auditors to conduct *shariah* audit.

Arguably, having acquired IBF, *shariah*, and internal auditing knowledge may not be sufficient to determine the internal auditors’ level of expertise. Apparently, they would need to develop their expertise through from time to time to cope with the increasing demand of Islamic finance – which can come from constant training and experience. In regards to competency/knowledge issues for the regular internal auditors performing *shariah* audit, a survey by PwC Malaysia, *Shariah Audit : Industry’s Insights* (2011) reinforces the need to expand the talent pool of internal *shariah* auditors to enhance the comprehensiveness of *shariah* audit coverage and to improve *shariah* audit

methodologies, including risk management. However, this act does not specifically spell out the competency requirements of the person who is responsible to conduct such an audit on *shariah* compliance. Definitely, the IBF, *shariah*, and internal auditing knowledge are important knowledge that internal auditors must have when carrying out *shariah* auditing process. More important, internal auditors are deemed competent in dispensing their duty only when they have a repertoire of skills, knowledge, and understanding of a subject matter by which they can apply successfully in a range of contexts and organizations (Maclure and Norris, 1992 as cited in Hassall et al., 1996).

Second (2) issues are in term of structured *shariah* auditing framework. Abdul Rahman (2008a and 2008b) provides a useful discussion on the challenges, issues, and limitations in the implementation of *shariah* auditing from the perspective shared by the *shariah* committee, external auditors, and internal auditors. In particular, he emphasizes the need to have a structured *shariah* auditing framework that would guide all concerned in carrying out such audit. At present, there are no standardized frameworks or structured framework being issued and mandated by any regulatory body. The regulatory body should issue one standardized or structured framework to harmonize *shariah* auditing practices among IFIs. Having such a framework would help IFIs in recognizing and designing appropriate *shariah* auditing protocols, programs, and procedures as well as prerequisite requirements (i.e., qualifications and certifications) of those who are required to undertake *shariah* audit process. Later, the above issue was taken by Yahya and Mahzan (2012), who found that a majority of internal auditors preferred to have a standardized framework of *shariah* audit. With such a framework, general guidelines can be developed to guide these auditors to perform their tasks more efficaciously.

In this respect, Abdul Rahman (2008a and 2008b) highlights the need for the establishment of a comprehensive *shariah* audit program, which consists of a manual based document that clearly spells out step-by-step *shariah* audit procedures, policies, and processes when offering Islamic financial services. Examples of *shariah* auditing process may involves; Risk assessment, internal control assessment, review contract relating to business activities, review policies and procedures of business activities, examine process flow of the activities, follow up, communication of results to auditee and etc. In addition, the structured framework should comprises of audit program that take into consideration the standard operating procedures, which include accounting (e.g., MASB and AAOIFI), regulatory requirements (BNM), and other requirements. This idea is supported by Haneef (1997) who highlights the urgent need for the Islamic economics, banking, and finance and as well as accounting and auditing to have their own particular framework and criteria due to the differences in epistemology frameworks between Islamic thoughts and conventional thoughts. More importantly, Shafii et al.'s (2010) have proposed a framework for shariah compliance audit to be adopted by IFIs in Malaysia. This framework can serve as a guidance for auditors (i.e., *shariah* auditors, internal or external auditors) to conduct audit on the financial statements before deciding whether IFIs' transactions have complied with *shariah* requirements. The application of such a framework can help IFIs mitigate any non-compliant risks. According to Shafii et al. (2010), improper control of operational risk may lead to other types of risks, such as credit risk, management risk, investment risk, and market risk.

Similarly, a study by Kasim, Hameed and Sulaiman (2009) provides insights into the current practice of *shariah* auditing. More precisely, their study examined the gap

between the "desired" (expected) practice and the "actual" (current) practice of *shariah* auditing in Malaysian IFIs by focusing on four (4) important issues, namely theoretical framework, scope, qualification, and independence issues. Their findings indicated that there was a gap between the "desired" and "actual" practices of *shariah* auditing. In addition, they found that both the external and internal auditors' competency was questionable due to the latter's lack of expertise in *shariah*, accounting, and auditing. Furthermore, Kasim et. al. (2009) contend that the current practice of *shariah* auditing has a minimal impact on Malaysian IFIs due to the lack of *shariah* auditing framework, suggesting that existing practices of *shariah* auditing are highly unstructured.

Further compounding the problem, many practitioners do not have a clear understanding of the roles of *shariah* audit function and *shariah* review function, and the appropriate groups that are responsible to conduct these functions (Yahya and Mahzan 2014). This lack of understanding is evident of the third (3) issues identified in the literature where the roles of *shariah* audit and review have been reported to be conducted only by *shariah* committee and external auditors. For example, in a study conducted by Abdelgader et al. (1994), they found that in Islamic banks there were two groups of auditors who had different reports on financial statements but carried the same responsibility in ensuring the Islamic banks comply with the *shariah* principles. Essentially, the groups consisted of external auditors and a religious auditor, who were appointed by the shareholders, to give assurance on the reliability of financial statements and operations of the Islamic banks.

Abdallah (1994) highlights that most banks and financial institutions have not performed ex-post *shariah* audit from the perspective of *shariah* committee.

According to him, ex-post *shariah* audit has been carried out on random samples of completed transactions to ensure that they conform to *shariah* rules and regulations. Similarly, Haji Besar et al. (2009) have raised the same issue as they observed *shariah* committee reports that had been prepared by respective banks' *shariah* committee lacked detailed information to establish the needed assurance. In fact, these reports were merely a general endorsement of the banks' *shariah* compliance without any emphasis on the actual operations or conduct of these banks. Nonetheless, several researchers have called for more efforts by IFIs to establish a dedicated unit, namely an internal review or audit department to conduct *shariah* audit and reviews.

### Conclusions

In summary, the review of existing literatures and current state of affairs in *shariah* auditing highlights a host of unresolved issues, such as: (i) the inadequate understanding of auditing process due to lack of knowledge and competency among internal auditors; (ii) ambiguity of the auditors' role; and (iii) lack of proper *shariah* auditing frameworks. Tackling these issues would not only entail closer examination on existing conventional practices, principles, and frameworks, but also on other factors related to Islamic precepts, worldview, and principles. *Shariah* auditing has to be addressed carefully for its holistic nature encompassing many interlink aspects, such as the system, products, employees, environment and society. Undoubtedly, any study addressing *shariah* auditing would provide new insights in terms of the nuances between the *shariah* (Islamic) and conventional (Western) perspectives, which would stimulate different philosophies, roles of auditors, and conceptual frameworks.

Inevitably, standard setters and regulatory bodies, such as Malaysian Institute of

Accountant (MIA), Institute of Internal Auditor (IIA), and Central Bank of Malaysia (BNM), need to continuously improve and update their regulatory, control policies and directives as the financial landscape is constantly undergoing numerous changes. Such improvements would involve establishing relevant, general standards and performing audit programs with regard to *shariah* audit. Having a standardized and structured framework of *shariah* auditing would harmonize *shariah* auditing practices among IFIs. However, clear understanding of the concepts, principles, objectives, and approaches of *shariah* audit among internal auditors, bankers, *shariah* reviews officers, *shariah* committee and management in IFIs is necessary prior to embarking on any improvement efforts.

Particularly, common *shariah* auditing practices and underlying principles need to be re-examined for which knowledge is vital in facilitating effective *shariah* auditing and *shariah* compliance among IFIs. The standard setters, regulatory bodies, education and training affiliates could offer appropriate enhancement programs for internal auditors and Islamic banking players. Specifically, these programs should provide participants with knowledge on certification and compliance requirements to enable their effectiveness in conducting *shariah* audit. Financial Sector Blue Print (2011-2020) report highlighted the needs for relevant competency and skills in dealing with the challenges of Islamic finance. The report also urges collaboration and coordination among relevant agencies, regulators, government, and academia to develop comprehensive education programs which would provide pool of quality talents to serve the financial industry in the future. Finally, relevant enforcement and regulating agencies, such as the BNM, IIAM, and MIA, should refine existing guidelines or formulate a new *shariah* auditing framework

to guide internal auditors to perform *shariah* audit with deeper passion, thus improving their performance.

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