

ANALYSIS OF SHARIAH AUDIT/REVIEW REPORT: MALAYSIA, PAKISTAN AND BAHRAIN

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ABSTRACT

The function of audit from the Islamic view is much more important as it manifests the accountability of the auditors not only to the stakeholders, but ultimately to the Creator, Allah s.w.t as the Muslims believe that one's action and thoughts are always being watched by Allah (the concept of Muraqabah). Based on shari'ah governance framework which was circulated in 2011, the function of shari'ah audit considered as mandatory for every Islamic financial institution. Therefore, in line with this, the aim of this paper is to critically analyze how Shariah review and Shariah report are practiced in three different countries namely Malaysia, Pakistan and Bahrain. The analysis will be done based on content analysis from the bank's annual report for the year 2010, 2012 and 2014 and the selected banks which will be used in this paper is Bank Islam Malaysia Berhad (Malaysia), Meezan Bank (Pakistan) and Albaraka (Bahrain). Finally, the paper will provide some recommendation for the improvement of Shariah review practiced in those three countries.

INTRODUCTION

Shariah compliance is the core and essence of Islamic banking. This statement emerges from the fact that Islamic banking has taken grounds from the need of Muslim community to have opportunities to carry on their banking and relevant commercial activities in line with the principles devised by Islamic shari'ah. In the Islamic banking practices, the core responsibility of guiding and supervising the operations of Islamic banks rests with respectable *Shariah* Advisor (SA) and also members of *Shariah* Boards of Islamic Financial Institutions (IFIs). *Shariah* Boards requires SA to review operations of the IFIs on a periodic basis for *Shariah* compliance to ensure that all the products and services offered by the IFIs conform to the rulings of *Shariah* rules and principles. Based on the general information about the *Shariah* compliance as described above, the aim of this paper is to critically analyze how *Shariah* review and *Shariah* report are practiced in three different countries namely Malaysia, Pakistan and Bahrain. The analysis will be done based on content analysis from the bank's annual report for the year 2010, 2012 and 2014 and the selected banks which will be used in this paper is Bank Islam Malaysia Berhad (Malaysia), Meezan Bank (Pakistan) and Albaraka (Bahrain). Apart from doing the

comparative analysis, the paper also will examine the lacking aspect in *Shariah* Audit Report (SAR). Based on the analysis, we can evaluate which country provide the best shari'ah audit report throughout the past three years. Finally, we will provide some recommendation for the improvement of *Shariah* review practiced in those three countries.

The analysis will start on the brief overview of the *Shariah* Auditing in these three different countries. In Malaysia, SA is known as *Shariah* Committee or *Shariah* Supervisory Council (SSC). The preparation of SAR is based on the guideline issued by Bank Negara Malaysia (BNM) known as GP8-i. In 2011, the shari'ah governance framework was circulated which gives a huge impact to the governance system especially to the Islamic institutions. The main objective of the framework is to provide a comprehensive guidance to the board, Shari'ah committee and management of the Islamic Financial Institutions in discharging its duties in matters relating to shari'ah and to outline the functions relating to shari'ah review, shari'ah audit, shari'ah risk management and shari'ah research. While in Pakistan, the SA is known as *Shariah* Advisor (SA) and the guideline used in preparing SAR is based on the requirement issued by State Bank of Pakistan and some of AAOIFI requirement. The SA in Bahrain is known as *Shariah* Supervisory Board (SSB) and they strictly follow AAOIFI's requirement in preparing the SAR. Throughout the paper, the word *Shariah* Auditor will be used to represent *Shariah* Committee or *Shariah* Supervisory Council and *Shariah* Audit Report will be used to represent the report that have been issued by the SA.

COMPARATIVE ANALYSIS OF SHARIAH AUDIT REPORT

The main purpose for the requirement of *Shariah* review for IFI is to make certain that all the activities carried out by the IFIs are truly in compliance with the *Shariah* rules and regulations as reflected in the fatwas, rulings and guidelines issued by the *Shariah* Auditor (SA) (Besar *et al*, 2009). All the procedures in examining and reviewing the IFI transactions and business activities should be properly executed based on *Shariah* guideline and compliance. The procedures include the planning review procedures, executing review procedures, preparation and review of working paper as well as procedures in documenting conclusions and preparation of the *Shariah* Audit Report (SAR). All those procedures should be disclosed in SAR in order to well inform the shareholders about the IFI *Shariah* compliance in operating the business activities. Among other things that need to be reported in SAR are IFI business policies, IFI products and activities, *Zakat* calculation and payment, contracts and agreement of IFI, human resource and development and also on the social activities of IFI. The comparative analysis of SAR is basically divided by two categories which include the elements of SAR and scope of SAR. The first part of analysis is done on the basic elements or components which should be properly reported in SAR. The analysis of the banks is summarized as follows:

1. COMPARATIVE ANALYSIS: ELEMENT OF SHARIAH AUDIT REPORT

a. Title of the report

According to AAOIFI Standards, every SAR should have a proper title as to well inform the users of financial statement where the SAR is exactly being placed in the annual report.

Bank	2010	2012	2014
Malaysia: Bank Islam Malaysia Berhad	Report of SSC	Report of SSC	Report of SSC
Pakistan: Meezan Bank	Shari'ah Advisor's Report	Shari'ah Advisor's Report	Shari'ah Advisor's Report
Bahrain: AlBaraka Bank	SSB Report	SSB Report	SSB Report

Referring to the table above, the three banks have put the title for their SAR and they consistently used the same report title for the year 2010, 2012 and 2014.

b. The addressee of SAR

The SA should appropriately report to whom the SAR is specifically reported for.

Bank	2010	2012	2014
Malaysia: Bank Islam Malaysia Berhad	To the shareholders, depositors and customers of Bank Islam Malaysia Berhad	None	None
Pakistan: Meezan Bank	None	None	None
Bahrain: AlBaraka Bank	The Shareholders of Al Baraka Islamic Bank	The Shareholders of Al Baraka Islamic Bank	The Shareholders of Al Baraka Islamic Bank

Generally, Meezan bank did not put the addressee paragraph for the three years. AlBaraka bank on the other hand did put the addressee for the three years. BIMB Berhad put the addressee for 2010 but later in 2012 and 2014 the addressee was not mentioned.

i. Opening or Introductory Paragraph

In this section, they should identify the purpose of engagement and describe the nature of work performed. There also should be a clear statement that the management of IFI is responsible to conduct *Shariah* auditing properly complying with the Islamic *Shari'ah* Rules and Principles.

Based on the table below, generally, BIMB Berhad and AlBaraka bank had properly put the introductory paragraph in their SAR as to comply with requirement by AAOFIF. On the other hand, Meezan bank did not have the introductory page in their report.

Bank	2010	2012	2014
Malaysia: Bank Islam Malaysia Berhad	In carrying out the roles and responsibilities.....”	“In carrying out the roles and responsibilities.....”	“In carrying out the roles and responsibilities.....”
Pakistan: Meezan Bank	None	None	None
Bahrain: Al-Baraka Bank	“We have supervised the principles and contracts used ...”	“We have supervised the principles and contracts used ...”	“We have supervised the principles and contracts used ...”

ii. Scope Paragraph describing Nature of the Work Performed

The SA should properly disclose on their audit work performed in examining the transaction and activities of the banks such as the appropriate tests, procedures and review work process.

Bank	2010	2012	2014
Malaysia: Bank Islam Malaysia Berhad	Note No. 2, “The Bank carried out Shariah compliance audit.....”	Note No. 2, “The Bank carried out Shariah compliance audit.....”	Highlighted on the function as required in Shari’ah Governance framework
Pakistan: Meezan Bank	Page 53, “Shariah audit & compliance review was conducted....”	Page 87, “..Shariah Audit was conducted to strengthen the internal Shariah controls mechanism ...”	Page 93, “..Shariah Audit was conducted to strengthen the internal Shariah controls mechanism ...”
Bahrain: AlBarakah Bank	“We have performed our supervision,....”	“We have performed our supervision,....”	“We have performed our supervision,....”

For the three years, all banks follow this requirement as this is the important part of the SAR in order to show that SA has done some appropriate test during the *Shariah* audit process.

iii. Opinion paragraph containing that expression of opinion on the compliance of the IFI with *Shariah* Rules and Principles

The main part of SAR should include the opinion by all SA members in confirming whether they have examined the bank’s activities and transaction and to check on whether the banks had fully complied with the *Shariah* guidelines and principles.

Bank	2010	2012	2014
Malaysia: Bank Islam Malaysia Berhad	Page 10..”.... have been conducted in conformity with the Shariah rules and principles.	Note no 8..” financial statements are in compliance with the Shariah rules....”	Page 13..”.... have been conducted in conformity with the Shariah rules and principles.
Pakistan: Meezan Bank	Page 54, “...comply with the rules & principles of Islamic Shariah in light of the guidelines...”	Page 89, “...in our opinion...activities and transactions...in whole comply with the Principles and guidelines of Islamic Shariah...”	Page 95, “...in our opinion,...comply with the rules & principles of Islamic Shariah.....”
Bahrain: AlBarakah Bank	“The contracts, transactions and dealings.. were made in compliance with the provisions and principles of Islamic Sharia’a.”	“The contracts, transactions and dealings.. were made in compliance with the provisions and principles of Islamic Sharia’a.”	“The contracts, transactions and dealings.. were made in compliance with the provisions and principles of Islamic Sharia’a.”

This also among the important part of the SAR which requires SA to check whether all the contracts involved by the banks is in compliance or not and they have to report if there are any violations against the *Shariah* principles.

iv. Date of report

The SA also needs to properly state the date of the report being issued by them.

Bank	2010	2012	2014
Malaysia: Bank Islam Malaysia Berhad	24 February 2012	25 February 2013	23 March 2015
Pakistan: Meezan Bank	13 January 2011	4 February 2013	28 January 2015
Bahrain: Al-Baraka Bank	1/2/2011	7/2/2013	18/2/2015

All banks have state the date as per required by AAOIFI.

v. Shari’ah Supervisory Board’s Signature

The SAR should be signed by all members of the Shariah Board and also put their designation status in the report.

Bank	2010	2012	2014
Malaysia: Bank Islam Malaysia Berhad	Yes	Yes	Yes
Pakistan: Meezan Bank	Yes	Yes	Yes
Bahrain: Al-Barakah Bank	Yes	Yes	Yes

Throughout the year 2010, 2012 and 2014, all banks have followed this requirement by placing their designation and signature on the report.

2. COMPARATIVE ANALYSIS: SCOPE OF SHARIAH AUDIT REPORT

Scope of Shariah Audit	Malaysia: Bank Islam Malaysia Berhad		
	2011	2012	2014
Business Policies (Products)	Page 10...” conducts its business in accordance with Shariah rules and principles.”	Page 11...” conducts its business in accordance with Shariah rules and principles.”	Page 12...” conducts its business in accordance with Shariah rules and principles.”
Process and Procedures	Page 10...”Note 1. The contracts, transactions and dealings enteredcompliance with the Shariah rules and principles.”	Page 11...”Note 1. The contracts, transactions and dealings enteredcompliance with the Shariah rules and principles.”	Page 12...”Note 1. The contracts, transactions and dealings enteredcompliance with the Shariah rules and principles.”
Zakat Calculation and Payment	Page 10...”The calculation, payment and distribution of Zakat are in compliance with Shariah rules and principles.”	Page 9...”Bank has fulfilled its obligation to pay zakat... and the zakat is computed using growth capital method	Page 12...” Bank has fulfilled its obligation to pay zakat on its business to state zakat authorities and the zakat was computed using growth capital method.”
Contracts & Agreements	Page 10..Note 1	Page 11..Note 1	Page 12..Note 1
Human Resource Management	None	Page 10...”Note 7. training sessions, courses and briefings ... understanding on Shariah application in	Page 10...” seventeen (17) Shariah training and briefing sessions were held covering 584

		the banking business and financial activities.	participants among the Bank's employees nationwide..."
Social Contribution (i.e:charity)	Page 10."Note 3...Earnings from sources or by means prohibited by the Shariah Rules...amounted to RM181,791.91 has considered for contribution to charitable causes;"	Page 10."Note 5.Bank received RM2,570.65 as Shariah non-compliant income from the Shariah non-compliance.... income were channeled to the following recipient..."	Page 12."Note 4."Earnings.... from sources or by means prohibited by the Shariah ...amounted to RM3,360.01 were disposed to charitable causes.

Based on the above analysis, from year 2011 to 2014, there was an improvement in *Shariah* audit reporting associated with BIMB Berhad. For the three years, the SA managed to express their opinion which they reported that the BIMB Berhad had run their operations in accordance with the *Shariah* principles. In short, BIMB Berhad consistently had fully complied with the requirement issued by BNM in GP8-i.

Scope of Shariah Audit	Pakistan: Meezan Bank		
	2010	2012	2014
Business Policies (i.e:Products)	Page 50.."The Bank has developed a financing product.."	Page 39.."No 1-6..Deposit Product, Takaful...."	Page 38.."No.1 &2..Investment Banking of..Liberty Power Sukuk, Islamic Microfinancing & Agriculture financing".."
Process and Procedures	Page 30.."Activities on the liabilities side...the calculation of profit, weightage and redemption has been approved...."	Page 40.."Shariah Audit...SA has directed the Bank's management not to recognize income...as assets..were not quantified."	Page 40..."SA has directed the Bank's management to provide for income...on certain financing transaction where non-compliance was observed."
Zakat Calculation and Payment	None	None	None
Contracts & Agreements	Page 53.."Istisna and Tijarah..."	Page 40.."Standard agreements for Murabaha, Ijarah..."	Page 40.."Standard agreements for Murabaha, Ijarah, Istisna..."
Human Resource Management	Page 50.."During the year 85 Islamic banking training sessions were held in which 2117 employees participated throughout Pakistan...."	Page 39.."No.5..training and development..28 training sessions..."	Page 39.."No.3, Training & Development..24 Islamic banking awareness seminars..."
Social Contribution	Page 31.."Qurdh-e-Hasanah and	Page 40.."Rs 9.184 million was transferred to	Page 41.."Rs 51.170 million was transferred to

(i.e: charity)	Charity...to various hospitals, schools..”	the Charity Account..”	the Charity Account..”
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Based on analysis done on Meezan Bank, Pakistan in year 2010, 2012 and 2014, the SAR of this bank is being prepared based on the requirement by the State Bank of Pakistan and some of AAOIFI guidelines. Throughout the year, SA in Meezan Bank had disclosed all the relevant information with regard to the bank’s activities and products which are in line with *Shariah* guideline and principle. The SA of this bank had reported their audit approaches and procedures in examining and reviewing the transactions of the bank and SA also had provided their opinion which stated that the bank’s operation and products offered are in compliance with *Shariah* guidelines. The only information that is not being reported in SAR of this bank is on *Zakat* calculation and payment. In external audit report, the auditor had disclosed that the bank had deducted the *Zakat* at source and deposited in the Central *Zakat* Fund. Thus, any information about *Zakat* calculation and payment in SAR were not reported and it shown that the SA of this bank does not perform any review or audit approaches in relation to *Zakat*. Apart of non-disclosure of *Zakat* calculation, all other information that has relation with *Shariah* auditing has been performed and reviewed properly by the SA. The SA also reported on additional information about assets and liabilities management, release of bank’s new Islamic products and financing which will be beneficial to shareholders to get access on the bank’s activities and development particularly in relation to the *Shariah* compliance.

Scope of Shariah Audit	Bahrain: AlBaraka Bank		
	2010	2012	2014
Business Policies (i.e: Products)	Page 34”..The contracts, transactions and dealings entered into by thein compliance with the provisions and principles of Islamic Sharia’a.	Page 40”..The contracts, transactions and dealings entered into by thein compliance with the provisions and principles of Islamic Sharia’a.	Page 44”..The contracts, transactions and dealings entered into by thein compliance with the provisions and principles of Islamic Sharia’a.
Process and Procedures	None	None	None
Zakat Calculation and Payment	Page 34“....The management is not authorized to pay the Zakat on behalf of the shareholders..”	Page 40“....The management is not authorized to pay the Zakat on behalf of the shareholders..”	Page 44“....The management is not authorized to pay the Zakat on behalf of the shareholders..”
Contracts & Agreements	Note 1 page 34	Note 1 page 40	Note 1 page 44
Human	None	None	None

Resource Management			
Social Contribution (i.e:charity)	Page 34“... unintended gains obtained from sources or means prohibited by the provisions and principles of Islamic Sharia’a and disburse of it towards charitable...”	Page 40“... unintended gains obtained from sources or means prohibited by the provisions and principles of Islamic Sharia’a and disburse of it towards charitable...”	Page 44“... unintended gains obtained from sources or means prohibited by the provisions and principles of Islamic Sharia’a and disburse of it towards charitable...”

Based on the SAR in Al-Barakah Bank (ABB), the SAR is being reported and disclosed in accordance to the requirement by AAOIFI standard. From the analysis made, it shown that the ABB are fully complied with the minimal requirement of AAOIFI guideline and there was no additional information that are being reported in SAR of ABB. The SA in this bank does not report their audit test and approach that has been used in examining the *Shariah* compliance by the bank. Any review process on contracts and agreement made by the banks were not disclosed in SAR of this bank. The information about the human resource and development also are not being reported in SAR of this bank as compared to Meezan Bank in Pakistan. By referring to the report issued by the SA of this bank, not much information will be obtained by the shareholders if they were to use the SAR to assist them in making decision. This is due to the lack of some information which is not being fully reported in the report. For example, no information on how the SA review and audit the bank’s activities and Islamic products will create a confusion and reliability issues among shareholders because no certain evidence which stated that the activities and products as well as contracts and agreement are being audited properly by the SA. Thus, this lacking aspect actually should be improved by SA in order to provide reliable information to the users of SAR.

LACKING ASPECTS AND THE EVALUATION OF THE OVERALL SHARIAH AUDIT REPORT

Based on the analysis, it is shown that there are some lacking aspects which are being unreported in SAR. In BIMB Berhad, there is some improvement in SAR from 2010 to 2014; however, some of the information are still lacking on the products, operations, activities and transactions. The SA did not report whether they have performed any review or approaches in examining the bank’s transaction, activities and its Islamic financing products. Unlike Meezan Bank in Pakistan, the SA in BIMB Berhad does not take an initiative to disclose additional information which is beneficial to shareholders in making wise decision. ABB in Bahrain also does not fully disclose any relevant information in their SAR. The minimal requirement issued by AAOIFI serves as a basis for the SA in this bank to report on *Shariah* compliance activities. The information disclosed in SAR of ABB is not sufficient for the shareholders to assess the overall

performance and also activities of the banks. Lacking aspects such as on human resource development particularly training of SA should be disclosed in the report as the shareholders will feel confident that the SAR is totally relevant and complied with *Shariah* guidelines. Even though SA in Meezan Bank had disclosed most of the relevant information, but there are some lacking aspect which has not been considered by SA in this bank. They did not mention anything on how they review and test on *Zakat* calculation and payment made by the bank. The reason behind the non-disclosure of the *Zakat* is because the bank had deducted and deposited in the Central *Zakat* Fund. Overall, the country that produces the best report each year is Meezan Bank, Pakistan as SA in this bank always discloses very detail information in its SAR every year. They had disclosed and describe the information on new products issued by the bank if they discover the bank had issued new *Islamic* financing products during the financial year. Apart from that, they also reported the test and audit approaches that they use in examining the bank's *Islamic* financing product and activities as whether it complies with the *Shariah* guideline or not. The SA in this bank also takes an initiative to disclose additional information with regard to the management of assets and liabilities and provide some recommendation to the banks on how they can properly manage the assets and liabilities. Thus, all the information reported in SAR of Meezan Bank, Pakistan are able to provide strong assurance to the shareholders and other users which the activities, operations and transactions carried out by the banks are in compliance with the *Shariah* principles and guidelines.

CONCLUSION AND RECOMMENDATION

Shariah Audit Report is being prepared based on different guideline in each country. In Malaysia, the guidelines issued by Central Bank (BNM) known as GP8-i is being used as a basis to prepare SAR. There are also shari'ah governance frameworks which have been introduced to improve the shari'ah governance practice in Malaysia including the function of shari'ah audit. *Islamic* financial institutions have the duty to ensure the compliance with Shari'ah principles in all aspects of their products, instruments, operations, practices and management which will be achieved by the establishment of a proper Shari'ah governance framework (Miskam, 2013). In Pakistan, the SAR basis is based on the guidelines issued by State Bank of Pakistan whereas in Bahrain, it is strictly follow the AAOIFI standard requirement in preparing the SAR. Thus, different guideline used lead to the different presentation and disclosure of SAR in different countries. The approach taken by Meezan Bank in Pakistan can provide very useful information to shareholders and other users as it disclosed about activities, transactions and operations of the bank. To get in line with the purpose of having SA in IFI, the regulators of IFI in other country should follow a step taken by the State Bank of Pakistan in emphasizing the relevant information disclosure in order to enhance the public confidence in IFIs, as well as, achieving the fundamental objective of an IFI. Another possible alternative to ensure that the SAR is being produced at most relevant and useful information is by having useful *Shariah* audit framework to ensure effectiveness of the goals of *Shariah* compliance in IFIs which in turn can contribute positively to the ummah (society) at large (Kasim et al, 2009). It needs more development and disclosure to provide a deeper assurance to the stakeholders on the *Shariah* compliance of the institution. Moving towards a more transparent disclosure would require more proactive involvement of the regulators as it seems that the respective institutions will only abide with the minimum requirement as provided by the regulators (Besar *et al*, 2009). The greater involvement

by the regulators should be in place as to cater to the growing number of IFIs in current market and also to enable IFIs to remain competitive in Islamic banking industry particularly in providing *Shariah* compliance information to the users of IFIs financial statement.

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