

## THE JOURNEY SO FAR ON SHARI'AH AUDIT: A CALLING FOR AN EXPANSION

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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 institutions. Therefore, in line with this, the aim of this paper present the journey so far on shari'ah audit right from the introduction period with a calling for more research to be conducted on shari'ah audit so that to add on the existing literature on shari'ah audit particularly in islamic financial institutions. It's a conceptual paper.*

**Keywords:** *shari'ah audit, shari'ah governance framework, audit*

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### 1. Introduction/Background

Shari'ah audit is relatively the new term in shari'ah. Generally, auditing in Islam means to watch and inspect the operations which include the process of reviewing, controlling and reporting about transactions and dealing according to the shari'ah rules to deliver useful, right, timely trust and fair reports for decision making process (Uddin et al, 2013). Traditionally, Islam introduces the concept of Hisbah which lies with the concept of amal maa'ruf and nahi munkar which means enjoining the goods and forbidding the evil (Nazri, 2011). This is based on the Quranic Injunction which states:

"Let there arise from you a group calling to all that is good, enjoining what is right and forbidding what is wrong. It is these who are successful."(surah Ali Imran:104).

Allah's Messenger (May the peace and blessings of Allah be upon him) said: "Whosoever among you sees an act of wrong should change it with his hands. If he is not able to do so, then he should change it with his tongue. If he is not able to do so, then with his heart and this is the weakest of faith.

In considering the rapid growth of the Islamic financial market, it is crucial for the Islamic financial industry to have an adequate 'check and balance' mechanism in the form of shari'ah auditing tailored according to the objectives and missions of its establishment, the 'maqasid al-(Yaacob & Donglah, 2012) which literally means the shariah' objectives of Islamic law.(Aishah et.al., 2014).It is addressed in Shari'ah governance framework, principle 7 as: "There shall be a robust shari'ah compliance function, comprising review and audit functions, supported by risk management control process and internal research capacity". That statement shows the

importance of having shari'ah audit in ensuring Islamic institutions implement proper shari'ah governance. The current practice of shari'ah auditing was conducted by internal auditor from internal audit department and due to that, the internal auditor itself should be competent in terms of shari'ah knowledge and understanding all shari'ah issues related to the Islamic product.

## **2. Literature Review**

### **2.1 Definition of shari'ah audit**

In Islamic framework, the term of auditing has wider scope than the current practice of auditing due to the different worldviews and concepts (Hamid et.al., 1993; Haneef, 1997; Abdul Rahman, 2008) embedded in Islamic regulation known as shari'ah audit. In contemporary practice, the auditor is directly liable only to his clients who are the owner of the business being audited. He is not guided by religious principles, the quality of managerial decisions too are not his concerns. Therefore, the auditor is just responsible to give his opinion whether company's financial statement being prepared in accordance with accounting and auditing standards. In light of Islamic teaching, the role of auditor would assimilate some different approach and objective i.e. upholding shariah principles. (Yahya & Mahzan, 2012). The function of external auditors of Islamic Financial Institutions is not only to conduct financial audits, but also conduct tests on the shari'ah compliance of Islamic Financial Institutions, according to the religious opinion and guidelines set by the shari'ah committee (Haniffa,n.d). The function of shari'ah review assist in ensuring all business activities and operations of Islamic Financial Institutions adhere to shariah precepts. Shari'ah auditing can be defined as a systematic process of obtaining sufficient and relevant evidence to form an opinion as to whether the subject matter i.e. the personnel, process, financial as well as non-financial performance is consistent with the Shari'ah rules and principles which is widely accepted by the Islamic community and to report to the stakeholders (Mohamed Sultan, 2007). On the other hand, the Shari'ah Governance Framework (SGF) introduced by BNM in 2010 defined shari'ah audit in para 7.7 as "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" (BNM, 2011, p. 23).

### **2.2 Journey so far on shari'ah audit**

The studies conducted in shari'ah audit are very limited. Among the pioneer paper is the done by Razak and Omar(2008) which dicussed on the implementation of shari'ah auditing in Islamic financial institutions in Malaysia and they recommanded the shari'ah audit function should be enforced in order to enhance on shari'ah assurance. While Kasim et al. (2009) highlighted on the the gap between "the desired" and "the actual" practice of shari'ah auditing in IFIs in Malaysia. It is found that there exists a gap between the two concepts in terms of certain issues such as scope, framework, independency and qualification.

Later, in 2010, Shafii,Z. et al. has proposed shari'ah compliance audit framework in enhancing the shari'ah audit function. In the study, they emphasized on the basic general rulings in Muamalat are all transactions for Islamic Financial Institutions should be free from Riba, Maysir, Gharar and other prohibited activities. These rules are essential and considered the most important guidelines that need to be followed and in line with Al-Qur'an and As-Sunnah. Secondly, there is a need for Shariah compliance audit because of the requirements from regulators by Bank Negara Malaysia of GPS-1 on the duties and responsibilities of Shariah Committee in IFIs. The third level is where the auditing process of attestation and assurance on the documentations and procedures (proposal form, contract, agreement or other legal documentation used in executing the transactions, product manual, marketing advertisements, sales illustrations and brochures). At the last stage, then only Shariah compliance audit report will take place whereby the Shariah auditors need to state their opinion whether the institutions comply with the Shariah regulations and principles or not. The issuance of Shariah Compliance Audit report is important to the stakeholders that require assurance on Shariah compliance and accountability in the Islamic Financial Institutions. The audit programme also was introduced in this study which highlights on the elements of maqasid shari'ah, aqad, screening for the prohibition of riba', gharar and maysir, documentation and preparation of audit and financial considerations. Muneeza and Hassan (2010) has revealed the legal conflicts in shari'ah corporate governance in Islamic financial institutions in Malaysia and among the issues is regarding the shari'ah audit. They strongly opined that the function of shari'ah audit should be make compulsory and the qualification of shari'ah auditor need to be enacted.

In 2012, after the introduction of shari'ah governance framework, Yaacob and Donglah(2012) embarked to get the perspectives of the postgraduate students on shari'ah audit in a country relatively new to Islamic finance industry in Brunei. The result of the study indicates that majority of the postgraduate students are unaware of the term shari'ah audit. They also do not know the difference between shari'ah audit and conventional audit. However, the respondents feel that the scope of shari'ah audit is broader than conventional audit and the involvements of shari'ah scholar are vital to promote shari'ah audit. In addition, they state that the shari'ah auditor should be trained in accounting with a specialized certification in shari'ah as the auditor do not require the high level of knowledge in shari'ah as what the shari'ah. In 2012 also, Yahya and Mahzan investigate the current practice of shari'ah auditing in Islamic financial Institutions in Malaysia and the study discovered that the practices are still at development stage and need further improvement. For instance to increase the understanding of shariah auditing among internal auditors, enhance the shariah knowledge of internal auditors, standardization of shariah audit framework and providing general guidelines to design audit program for shariah auditing.

Then, in 2013 Zurina et. al. in the research title of "post implementation of shari'ah governance framework: the impact of shari'ah audit function towards the role of shari'ah committee", found that the shari'ah audit function has an added value in ensuring the compliance towards the shari'ah principles. In other different research, zurina et. al.(2013) identified the independence and competency quality that requires for human capital development in Shariah audit. The findings indicated that in term of competency quality in shari'ah audit, the criteria of shari'ah auditors shall be determined by IFIs at the institution's level. Shariah auditors must both have accounting and Shariah knowledge. Internal auditors also may invite the shari'ah team to be part

of internal audit team to perform shariah audit. In 2013 also, Arman revealed that market mechanisms, market structures, incentives are not vivid and adequate in Shariah auditing profession. He then suggested that there is a need to have an external shari'ah auditor to overcome the issue of independency. Kassim and Zuraidah (2013) then examined the perspective of practitioners who are involved directly and/or indirectly with the process of shariah compliance/auditing from Islamic financial institutions (IFIs) in Malaysia on the issues of standards for shariah auditing, auditors qualifications and independence. The study found that Malaysian IFIs are in need of properly guided shariah standards for shariah auditing practices to overcome the issues of scarce resourceful auditors with both shariah and accounting/auditing qualifications and issues of independency that may affect the reputable image of Islamic financial institutions. The findings then reinforce the importance of auditors' qualification and independence as currently there is no mandatory regulated professional shariah auditor code to be in tandem with drastic growth of the IFIs. Nawal et. al. (2013) in any different research assessed the current practice of auditing in Islamic financial institutions in Malaysia and Indonesia. The research found that the practice of shari'ah auditing either in Malaysia or Indonesia was unregulated as each IFI developed their own policies and minimum checklist in performing shari'ah auditing. Thus, there is a need to have a comprehensive framework for shari'ah auditing.

The recent paper in 2014 explored the current perception of the undergraduates on shariah audit in the Islamic Banks in Malaysia using questionnaire survey in Malaysia (Aishah & Shafii,Z., 2014). The research revealed that there was significant difference between students who are exposed to shariah audit course and those who are not. Ahcene et. al. (2014) in their research suggested on evidence and method of doing shari'ah audit in Islamic finance. They opined that good audit evidence should have the features of sufficiency, appropriateness, reliability, relevance and persuasiveness. Table below highlighted on the journey so far on shari'ah audit research.

**Table 1: summary of research on shari'ah audit**

Study	Method	Study focus and findings
Mohd Zamerey bin Abdul Razak & Nurmaezah binti Omar (2008)	Case study	This study highlighted on the implementation of Shariah Audit in Malaysia whilst recommending few enhancements to ensure the prescribed Shariah principles being effectively executed by Islamic such as enforcement of shari'ah audit function for every Islamic financial institutions with the competent shari'ah auditor.
Nawal binti Kasim, Assoc. Prof. Dr Shahul Hameed Mohamad & Prof. Dr Maliah Sulaiman (2009)	Questionnaire survey and interview	This paper examined what is the current practice of shariah auditing in IFIs in Malaysia and compare with what is the "desired" auditing in the Islamic perspective. Both the results of questionnaire survey and interviews revealed the relevance of developing a framework for shariah auditing in IFIs in Malaysia.
Zurina Shafi, Supiah Salleh & Syahidawati Hj Shahwan (2010)	Literature review	This study proposed shari'ah compliance audit framework in enhancing the shari'ah audit function. In the study, they emphasized on the basic general rulings in Muamalat are all transactions for Islamic

		Financial Institutions should be free from Riba, Maysir, Gharar and other prohibited activities. These rules are essential and considered the most important guidelines that need to be followed and in line with Al-Qur'an and As-Sunnah.
Aishath Muneeza & Rusni Hassan(2010)	Literature review	This study revealed the legal conflicts in shari'ah corporate governance in Islamic financial institutions in Malaysia and among the issues is regarding the shari'ah audit. They strongly opined that the function of shari'ah audit should be make compulsory and the qualification of shari'ah auditor need to be enacted.
Hisham Yaacob & Nor Khadijah Donglah (2012)	Questionnaire survey	The study embarked to get the perspectives of the postgraduate students on shari'ah audit in a country relatively new to Islamic finance industry in Brunei. The result of the study indicates that majority of the postgraduate students are unaware of the term shari'ah audit. They also do not know the difference between shari'ah audit and conventional audit
Yazkhiruni Yahya & Nurmazilah mahzan (2012)	Structured interview	This study attempted to investigate current practice of shariah auditing among IFIs in Malaysia. Research data for this study is obtained from 5 semi structured interviews conducted with chief audit executive of IFIs. It discovered that, the practices are still at development stage and need further improvement. For instance to increase the understanding of shariah auditing among internal auditors, enhance the shariah knowledge of internal auditors, standardization of shariah audit framework and providing general guidelines to design audit program for shariah auditing.
Md. Helal Uddin, Md. Hafij Ullah& Md. Musharof Hossain (2013)	Literature review	This study examined the development and approach of established auditing and point out some of its inadequacies from the Islamic point of view. In the last part, it stated the role of auditing in the Islamic framework.
Zurina Shafii, Supiah Salleh, Hajah Mustafa Mohd Hanefah and Kamaruzaman Jusoff (2013)	Focus group interview	The study identified the independence and competency quality that requires for human capital development in Shariah audit. The findings indicated that in term of competency quality in shari'ah audit, the criteria of shari'ah auditors shall be determined by IFIs at the institution's level. Shariah auditors must both have accounting and Shariah knowledge. Internal auditors also may invite the shari'ah team to be part of internal audit team to perform shariah audit.
Nawal Kasim & Zuraidah Mohd Sanusi (2013)	Questionnaire survey	The study examined the perspective of practitioners who are involved directly and/or indirectly with the process of shariah compliance/auditing from Islamic

		financial institutions (IFIs) in Malaysia on the issues of standards for shariah auditing, auditors qualifications and independence. The study found that Malaysian IFIs are in need of properly guided shariah standards for shariah auditing practices to overcome the issues of scarce resourceful auditors with both shariah and accounting/auditing qualifications and issues of independency that may affect the reputable image of Islamic financial institutions.
Zurina Shafii, Ahmad Zainal Abidin, Supiah Salleh & Nawal Kasim (2013)	In depth interview	The paper studied on the impact of the Shariah audit function towards the role of Shariah Committee with regards to the post implementation of the Shariah Governance Framework and it found that the shari'ah audit function has an added value in ensuring the compliance towards the shari'ah principles.
Saleh Md. Arman (2013)	Literature review	This study revealed that market mechanisms, market structures, incentives are not vivid and adequate in Shariah auditing profession. He then suggested that there is a need to have an external shari'ah auditor to overcome the issue of independency.
Nawal Kasim, Zuraidah Mohd Sanusi, Tatik Mutamimah, and Sigit Handoyo(2013)	Questionnaire survey and interview	The study assessed the current practice of auditing in Islamic financial institutions in Malaysia and Indonesia. The research found that the practice of shari'ah auditing either in Malaysia or Indonesia was unregulated as each IFI developed their own policies and minimum checklist in performing shari'ah auditing. Thus, there is a need to have a comprehensive framework for shari'ah auditing.
Nor Aishah Mohd Ali & Zurina Shafii(2014)	Questionnaire survey	The paper explored the current perception of the undergraduates on shariah audit in the Islamic Banks in Malaysia using questionnaire survey in and it revealed that there was significant difference between students who are exposed to shariah audit course and those who are not.
Nor Aishah Mohd Ali, Zakiah Muhammadun Mohamed, Shahida Shahimi & Zurina Shafii (2014)	Literature review	This paper argued for a competency framework for shariah auditors in Malaysia. Prior research reveals that the competency requirements for shariah auditors were still not developed even though there is a need for it. This paper proposed a new KSOC model as a basis for competency framework for shariah auditors that can uphold their effective functioning in our Islamic banking system.
Achene Lahsasna, Shahul Hameed Haji Mohamed Ibrahim & Datuk Syed Othman Alhabshi (2014)	Literature review	This study attempted to touch upon different aspect of Shariah audit, starting from its definition, its Islamic foundations, the current state of affairs and challenges, as well as its evidence and methodology, consisting of three phases including planning, examination and documentation. Conclusions and

		recommendations for different stakeholders of Islamic finance industry have been given at the end of the paper.
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### 3. Conclusion

This paper presents different research that has been conducted on shari'ah audit right from the introduction period which indicates the journey so far on shari'ah audit. The paper is a conceptual literature review paper not an empirical paper. Nevertheless, the paper contribute to the body of knowledge by extending the existing literature on the shari'ah audit through the presentation of the previous studies on shariah audit with a calling for expansion on the existing literature on the shari'ah audit. Therefore, more research should be conducted on shari'ah audit especially on improving the effectiveness and efficiency of shari'ah audit function.

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