

AUDITORS 'S PERCEPTIONS ON SHARIAH AUDIT FUNCTION IN TAKAFUL OPERATORS: A QUALITATIVE APPROACH

Noor Aimi Mohamad Puad
Kolej Universiti Islam Antarabangsa Selangor (KUIS)
nooraimi@kuis.edu.my

ABSTRACT

Ineffective governance practice in any Islamic Financial Institutions will lead to the possibility of facing shariah risk and incident of shariah risk in their activities and operation. Shariah audit function is one of the component of governance that play a role in ensuring Islamic Financial Institutions to have a sound and effective internal control system of shariah compliance. This study aim to examine the auditors perception on the objective of shariah audit function. Semi-structured interviews was conducted with the auditors whom involved in the shariah audit . Data were analysed by using thematic analysis. The finding discovers that there are different understanding demonstrated on the shariah audit function by the auditors. Exploring the practitioners' perception on shariah audit may contribute to better provision of shariah audit function. Therefore, the results may be used to find proper interventions to enhance the knowledge and understanding of practitioners on this important function.

Keywords: *Shariah Audit, Takaful, Risk-Based, Shariah Non-Compliance Risk, Shariah Governance*

INTRODUCTION

Shariah audit is one of the significant functions that serve as a governance mechanism for Islamic finance, as it ensures that the Islamic Financial Institutions (IFIs) operate according to Shariah. There should be an appropriate Shariah auditing framework to provide a quality assurance environment. A specific guideline for Shariah auditing is essential as it acts as a unique added value to Islamic Financial Institutions. However, this function of shariah audit was pronounced very briefly in Shariah Governance Policy Document 2019 (SGPD 2019) and caught the attention of researchers, who then requested one specific framework for shariah audit to be developed (Kassim et al., 2013; Ahmad et al., 2017; Yussof, 2015). There is also a lack of clarity on the Shariah audit function as described in the SGPD as compared to the normal internal audit function. The lack of specific guidelines made it very challenging for auditors to carry out a comprehensive shariah audit procedure.

From the issues discussed above, this study aims to examine the auditors perception on the objective of shariah audit function. This paper is divided into four main sections. The literature review section discusses the definition of shariah audit, available guidelines on shariah audit and shariah audit practices in Malaysia. Section three features the discussion on study design and methodology. Section four presents substantial findings, and the final section contains the concluding comments.

LITERATURE REVIEW

Shariah 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 Shariah rules and principles which is widely accepted by the Islamic community and to report to the stakeholders (Mohamed Sultan, 2007). The role of Shariah auditing from the Islamic perspective is much more essential and complex as it manifests the accountability of the auditors not only to the stakeholders, but eventually to the Creator, Allah s.w.t. (Mohd Ali et al., 2015).

Understanding the definition of Shariah audit is essential as it can reflect on how Shariah audit should be practised. An extensive description of Shariah audit can be presented by combining the definitions of AAOIFI and SGPD which could further described as function that provides an independent assessment on the quality and effectiveness of the IFI's internal control, risk management systems, governance processes as well as the overall compliance of the IFI's operations, business, affairs and activities with Shariah.

Apart from that, Shariah audit should also consider the elements of *maqasid Shariah* to be incorporated together in enhancing the function of Shariah audit. In Islamic finance, the significant aspect of *maqasid Shariah* is the preservation of wealth that will result in the fulfilment of stakeholders' requirements, including the society as a whole (Kamaruddin & Hanefah, 2017). The basic objective of the Shariah audit is to ensure that the transactions carried out by the IFIs are in compliance with Shariah rules and regulations and there is no prohibited element involved, i.e. *Riba* (interest), *Qimar* (gambling), and *Gharar* (uncertainty) (Shahzad et al., 2017).

In Malaysia, the Shariah audit function became mandatory when BNM introduced the Shariah Governance Framework in 2011 and currently SGPD 2019 was issued and thus supersede the previous framework. Before SGF was introduced by BNM in 2011, IFIs' Shariah governance is assigned to the Shariah committee to supervise any Shariah compliance issues (Shafii et al., 2013). They may also be required to carry out both Shariah review and Shariah auditing.

These are among the Shariah auditor's roles and responsibilities which have been agreed by most of the auditors before the issuance of SGF 2011 which include the following; i) To assure the shareholders and stakeholders that all the businesses and operations comply with Shariah; ii) to serve as the third line of defense; iii) to look into the internal control element of whether effective and efficient enough to prevent any possible Shariah breaches; iv) to emphasize on Shariah compliances to detect many issues and v) to advise the Shariah Committee on the operations by giving a clear and better understanding of the activities (Yasoa' et al., 2020).

However, it can be concluded that the roles and responsibilities of the Shariah auditor have been slightly changed after the issuance of SGF 2011 as revealed by Yasoa' et al. (2020). The roles and responsibilities are as follows; i) Shariah auditor should focus on Shariah non-compliance by giving greater emphasis on Shariah issues; ii) the approach has been changed from a compliance audit to a risk-based audit; iii) the roles of Shariah auditor are much broader and cover all aspects of businesses and operations ranging from pre-event to post-event detection of Shariah non-compliance; iv. Shariah auditor should submit the audit findings and report to BAC as well as Shariah Committee; v) Shariah auditor needs to consider two perspectives, internal control, and Shariah requirement; and vi) views and roles of Shariah auditors have changed from a fault finder to become advisors or consultants to auditees.

The requirement in SGF states that the Shariah audit should be done on an annual basis to verify that the IFI's key functions and business operations comply with Shariah. Shariah audit is

normally performed within the internal audit division in the IFI, together with the current internal audit practices (Yahya et al., 2018; Ab Ghani & Abdul Rahman, 2015). Based on SGF, a Shariah auditor should report directly to the Board Audit and Examination Committee. The new SGPD however, still uses the same structure and same mechanism as SGF.

Among of the issue raised in the shariah audit area is the confusion of the job scope between the Shariah auditor and Shariah reviewer which resulted in repetitious tasks in the procedures by both functions (Yasoa' et al., 2020). According to Yahya et al. (2018), many internal Shariah auditors and Shariah review officers are still unclear on their functions even though BNM provides a series of guidelines and policy documents to industry players. In relation to that statement, many of them only understand the differences conceptually, however they are still ambiguous in operationalization. Table 1.0 below demonstrates the main differences between the shariah audit function and the shariah review function.

Table 1.0 Main Differences between the Shariah Audit Function and Shariah Review Function.

Features	Shariah Audit	Shariah Review
Roles	Assurance and Internal Control, Post-event	Compliance, pre-event
Guidelines And Methodology	IIA, SGF 2011, SGPD 2019	Sgf 2011, SGPD2019, own Guideline (domestically recognized)
Scope Of Duties	Much wider, covers overall processes (micro and macro), covers whole transactions and Entities	Much narrow, focus on micro aspect only and limited to shariah compliance function
Technology	T-mate, A.C.L. software	Select manually
Independency	Independent party	Part of the management
Ability To Audit/Review Shariah Committee	Yes	No
Reporting Line	Report directly to BAC, indirectly to the Shariah Committee	Report directly to shariah committee, report administrative Matters to b.o.d./management
Qualification	Internal auditors who have the requisite knowledge on shariah requirements applicable to Islamic financial business	Officers qualified may include officers with Shariah qualification

Sources: Adopted from Yasoa' et al. (2020)

Previously, no study has been done to explore the perceptions of shariah auditors on the objectives of the shariah audit function. Thus, this paper aims to fill this gap by analyzing the perceptions of the shariah auditors on the objective of the shariah audit functions since the current

framework describe briefly on this important function. This paper has its uniqueness as it gauges new data through a qualitative approach that would contribute to new knowledge specifically related to this area. Besides, this study cover only for Takaful industry.

RESEARCH METHODOLOGY

A qualitative methodology was adopted to explore the perception of the auditors on the objective of shariah audit function to evaluate the current practices. The adoption is due to the richness of information and clarity of meaning that the approach usually provides.

The selection of respondents was also done using purposive sampling, and among the criteria was to choose respondents who were directly involved in the process of shariah audit and have more than three (3) years of experience. A total of eleven (11) interviews were conducted using semi-structured interview questions.

The semi-structured interviews addressed the perceptions on the objective of shariah audit function. To keep the confidentiality of the data, the name of organizations would not be disclosed and the respondents were referred as to R1, R2, R3 and accordingly. Table below demonstrate the participants involved in this study.

Respondents	Organizations	Gender	Role	Years of experiences in organizations	Years of experiences in industry
R1	A	Male	Shariah auditor	11-15 years	16-20 years
R2	B	Female	Shariah reviewer	11-15 years	11-15 years
R3	C	Female	Shariah auditor	6-10 years	11-15 years
R4	D	Male	Shariah auditor	6-10 years	6-10 years
R5	E	Female	Shariah auditor	11-15 years	16-20years
R6	F	Female	Shariah auditor	6-10 years	10-15 years
R7	G	Female	Shariah auditor	6-10 years	10-15 years
R8	H	Male	Shariah auditor	6-10 years	6-10 years
R9	I	Male	Shariah auditor	6-10 years	6-10 years
R10	J	Male	Shariah auditor	6-10 years	6-10 years
R11	K	Female	Shariah auditor	6-10 years	6-10 years

After the interview sessions, the audio recordings were transcribed in detail and in verbatim. A thematic content analysis was performed on all transcripts. Data are presented in words and themes in qualitative content analysis which allows some interpretation of the results to be drawn. The themes then discussed in the finding session.

FINDINGS AND ANALYSIS

The finding and analysis will describe the objective of shariah audit function from the auditors' perspective. At the end of the analysis, the main elements of shariah audit function will be highlighted.

1. Objective of shariah audit function

It is crucial to identify the objectives of Shariah audit as described by the auditors to evaluate the level of understanding of Shariah auditors regarding this Shariah audit function. As we know, this function became mandatory when the Shariah governance framework was introduced in 2011, and then, after ten years on the issuance of SGF, auditors' understanding on the Shariah audit function should be much better.

Previous studies had shown that at the early stage of the introduction of the Shariah audit function, the objective of this function is more towards ensuring Shariah compliance only. However, if we refer to the definition of Shariah audit in SGF, it should be beyond Shariah compliance. Table 2.0 summarizes the objectives of Shariah audit function based on auditors' perceptions.

Table 2.0 Perceptions of Auditors on The Objectives of Shariah Audit Function

Auditors	Objectives of Shariah audit function
A	To assess the control of potential Shariah non-compliance risk
B	To provide independent reasonable assurance on compliance with Shariah requirement
C	To check the control effectiveness and compliance with Shariah regulation
D	To ensure Shariah compliance
E	To assess design of control and effectiveness of control
F	To check on compliance for high risk area (beyond compliance level)
G	Test the control of Shariah risk whether the controls are in place or not
H	To assess whether the operations are in place or the controls are being followed through in accordance to Shariah compliance
I	To assess the control of Shariah compliance risk
J	To assess the control of Shariah compliance
K	To assess the control of Shariah compliance risk

Sources: Researcher (2019)

By analyzing all descriptions for objectives of Shariah audit function as described by auditors, majority of the auditors agreed that Shariah audit function is about the control of any Shariah non-compliance risk. There are a few elements that can be highlighted from their understanding on the objectives of Shariah audit function.

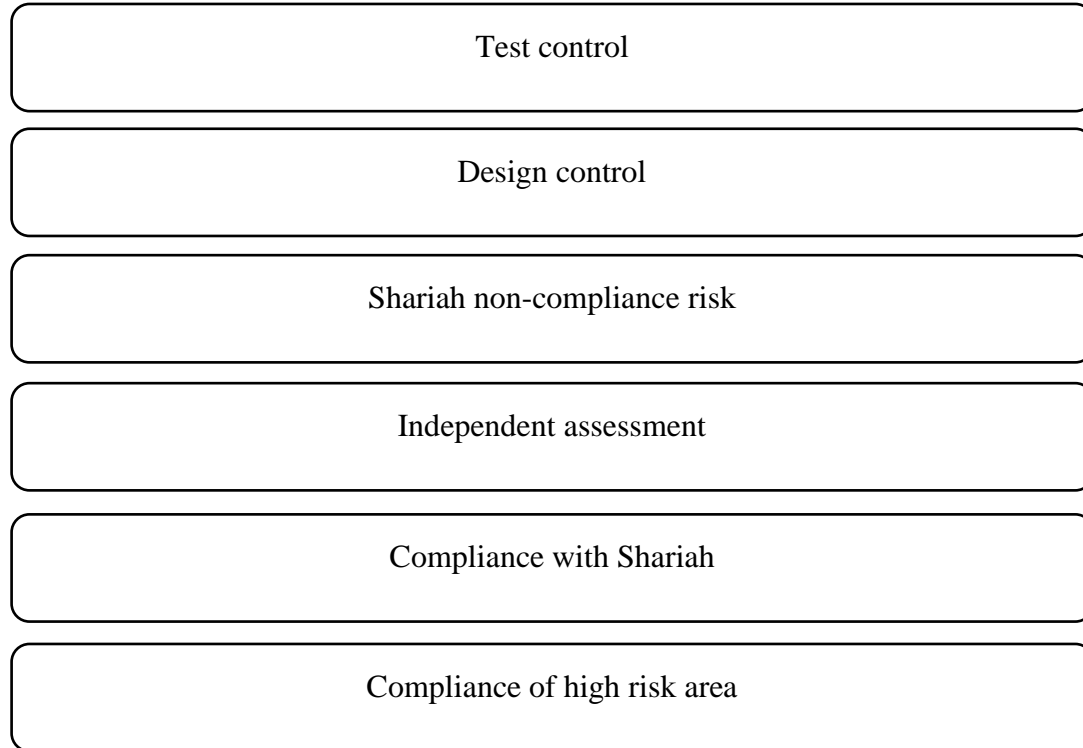


Figure 5.11 Highlighted Elements from the Description of Shariah Audit Functions Sources: Researcher (2019)

It is notable that most auditors agree and understand that Shariah audit function is not just for Shariah compliance purpose only, but it is beyond the compliance function. Risk and control are the most common terms used by auditors to describe this Shariah audit function. This proved that this category of practitioners is aware of changes in the development of the Shariah audit function as there is an evolution of the Shariah governance framework as a whole. It has been stated in the SGPD that the critical enhancements in the new SGPD are intended to reinforce a closer integration of Shariah governance considerations in the business and risk strategies of each Islamic financial institution.

The highlights on the word of risk and control to portray on the overall Shariah audit function is a resemblance with the definition of Shariah audit as provided by the new SGPD. It is also consistent with the definition of internal audit function as described by IIA which states that internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. At the same time, it helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. Besides, the evolution of internal audit function methods towards risk-based internal auditing also affects the description of this Shariah audit function as this function is currently conducted by the internal audit department

of the Takaful Operators (Abdul Rahman et al., 2018; Abdul Rahman & Matsuki, 2019). A study by Abdul Rahman and Matsuki (2009) also revealed that the process of internal Shariah audit has changed since before the issuance of SGF. All these changes should be adopted by all IFIs, including Takaful Operators, as they need to follow all the related regulatory framework.

Thus, from the above discussion, it is appropriate to say that, majority of the auditors who conducted the Shariah audit function have a good understanding on Shariah audit as they were able to describe the Shariah audit function as per what has been documented in the available guidelines. Only five per cent of the respondents who are the minority has the same thought as they perceived that Shariah audit is just for ensuring Shariah compliance.

CONCLUSIONS

The findings of this study indicate the understanding and the perceptions of the auditors on the objective of shariah audit function. The objective of shariah audit function should go beyond shariah compliance as this function should provide an evaluation of the internal control for shariah compliance. Majority of the auditors who conducted the Shariah audit function have a good understanding of Shariah audit as they were able to describe the Shariah audit function as per what has been stated in the available guidelines.

The analysis of the study is important for evaluating the current understanding of the shariah auditors and thus could become the indicator of measuring the level of competency of the shariah auditors. Perhaps, in the future, more thorough study can be conducted to further evaluate the competencies among these Shariah auditors in Islamic Financial Institutions (IFIs).

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