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Revisiting the Idealism of Syariah Audit for Islamic Financial Institutions

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Abstract: *The rapid development of syariah audit goes hand in hand with demands for governance of syariah compliance that promotes accountability and transparency. From its inception, syariah audit as a concept has been interpreted and practiced from various perspectives. This research aims to conceptually revisit the ideal conception of syariah audit by looking back at its root, discussing the emergence, meaning, characteristics, and issues of syariah audit. This study demonstrates the need for more holistic development of the conceptual framework for the syariah audit. It consists of defining subject appropriately, standardising the qualification and competence requirements for syariah certified auditors, regulating who should appoint syariah auditors, identifying the scope and extent of syariah audit, establishing the regulatory body for syariah audit, and enforcing the dedicated standards for syariah audit.*

Keywords: *syariah audit, syariah governance, Islamic financial institution, auditor*

Paper type: *Conceptual paper*

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Abstrak: Perkembangan pesat audit syariah sejalan dengan tuntutan tata kelola kepatuhan syariah yang mengedepankan akuntabilitas dan transparansi. Sejak awal kemunculannya, audit syariah sebagai sebuah konsep telah diinterpretasikan dan dipraktikkan dalam perspektif yang berbeda. Penelitian ini membahas pendefinisian subjek audit syariah secara tepat, standarisasi persyaratan kualifikasi dan kompetensi auditor bersertifikat syariah, pengaturan siapa yang harus menunjuk auditor syariah, mengidentifikasi ruang lingkup dan luas audit syariah, pembentukan badan pengawas audit syariah, perumusan dan implementasi standar khusus untuk audit syariah.

Kata kunci: audit syariah, tata kelola syariah, lembaga keuangan syariah, auditor

INTRODUCTION

Syariah governance is increasingly becoming the major focus in the recent development of Islamic financial institutions (IFIs). Significant steps have been taken to ensure comprehensive compliance by the IFIs towards syariah principles. For example, the Central Bank of Malaysia issued a Syariah Governance Framework (SGF) in 2010, which superseded the previous Guidelines on the Governance of Committee for the Islamic Financial Institutions (El-Gamal, 2005). An exposure draft of the amended framework was further issued in 2016. Saudi Arabia, for instance, issued the SGF in February 2020, which sets out the minimum governance and oversight requirements for its Islamic financial institutions (Issa, 2020). Meanwhile, the state bank of Pakistan has also issued detailed set of instructions and guidelines for Syariah compliance in 2008, followed later by the issuance comprehensive SGF in 2015. The SGF issued by Pakistan was even further amended in 2018.

Within the SGF, syariah audit is regarded as the key pillar in the assurance of comprehensive syariah compliance. Nevertheless, there has been no common understanding of what constitutes the conception of syariah audit. Syariah audit has been generally perceived as an internal syariah review in the modern development of Islamic finance and banking. This has been evidenced by the practice and even by the enormous amount of literature identifying the surrounding issues inherent in the internal syariah review process of Islamic financial institutions (Ab Ghani, Ariffin, & Rahman, 2019; Algabry, Alhabshi, Soualhi, & Alaeddin, 2020; Khalid, 2020; Khalid, Halim, & Sarea, 2019; Khalid, Haron, & Masron, 2018; Rahman, Mastuki, Osman, & Kasim, 2020; Yasoa, Abdullah, & Endut, 2020). Even by limiting its concept to the internal review, Yussof (2013) identified no proper framework to govern internal audit practice.

Nonetheless, the recent literature noted a growing discussion on the implementation of syariah audit on a broader horizon. Apart from its early predominant association with the internal review, syariah audit as a concept and practice has further embraced an external form of audit that was initially regarded as a merely external financial audit. Research on the issues of syariah audit, which was considered lacking in the early establishment of Islamic banking and finance, now has flourished tremendously. Contemporary research have questioned the role, competency, and responsibilities of auditors carrying the audit function in the Islamic financial institution (Khalid et al., 2018; Othman & Ameer, 2015), the issue

of syariah audit report (Fakhfakh, 2017; Pua⁶¹ Shafii, & Abdullah, 2019), how a basis of syariah audit can be provided from Islamic legal maxims Rahman et al., (2020) and more broadly about the ideal governance framework embracing the audit practice (Alam, Ahmad, & Muneeza, 2020). These numerous unresolved issues surrounding the conception of the syariah audit necessitates more research to be embarked on to discuss the core concept of syariah audit.

This paper takes the position to conceptually revisit the ideal notion of syariah audit and the contemporary challenges by looking at the subject of syariah audit from its inception to the contemporary challenges. The discussion of this paper is expected to put syariah audit conception in a more holistic perspective²⁶ and give a refreshing horizon into the current understanding of syariah audit. The remaining of the paper is structured as follow. The first section discusses the root of auditing practice in the early Islamic era. Second, it explores the emergence of contemporary syariah auditing by explaining the meaning and concept of syariah audit. The next section examines the ideal conception and the challenges in the development of syariah audit and the last section concludes it.

The Root of Au⁴⁷ding In The Islamic Institutions

Accounting and auditing is not a new discourse in the Islamic scientific tradition. They have occupied the minds of Muslim philosophers and jurists in responding to the economic challenges of their times. The⁵⁵ thinking on economic issues was aided and guided by the Qur'an and Sunnah as well as by consensus intellectual reasoning (*ijma'*) and deductive analogy (*qiyas*). Khan (1985) served that accounting and auditing existed in pre-Islamic Arabia. The people of pre-Islamic Arabia had been actively involved in many commercial activities such as foreign exchange and trade, traditional banking and speculation. The⁴⁰ commercial activities would not be possible without having some mechanics of accounting and auditing.

The development of auditing was furth²⁰ marked with the establishment of the institution of *hisbah*. The term *hisbah*, derived from the root h.s.b. means 'arithmetical problem'; 'sum' or 'reward'. *Hisbah* was a classic institutions in the history of Islamic civilisation that was set up with responsibilities of enjoin the virtue and prohibit the evil in all human activities (Furqani, 2003). The later development, *hisbah* played a role to ensure that the community is organised and has access to facilities to help them in²⁰ their worshipping (*ibadat*) activities, enforce justice (*'adl*) in the society, and pay special heed to various municipal services in the town. Several authors⁴⁹ have related audit with *hisbah* owing to its parallel mission of safeguarding society and ensure that all affairs are compliant with precepts (Rahman et al., 2020).

The contemporary role and relevance of *hisbah* has received the attention of some scholars in the past until the present. Gambling & Karim (1993) suggest that such institutions can help supervise ethics in business and accounting. Al-Buraey (1990) considers it to be a necessary institution in Islamic management and administration, while Rahman (1998) sees its significance in guiding corporate accountability and governance.

Meanwhile, Dogarawa (2013) evaluates the role of *hisbah* institution in ensuring syariah business practices in Nigeria to reflect that *hisbah* is not meant only to serve spiritual and social purposes in the society devoid of economic contribution. It also has a specific role in ensuring that businesses are conducted according to Islamic business ethics, particularly of syariah implementation at states level. In a recent study by Attahiru, Al-Aidaros, & Yusof (2016), a new framework and new developed relationship was proposed between religiosity, Islamic culture, and Islamic work ethics with a moderating role of *hisbah* institutions based on an Islamic approach. Since Islamic economics is still developing, a mechanism of supervision and control similar to the *hisbah* is needed to achieve the objectives of syariah (*maqasid al-syariah*).

The Establishment of Syariah Audit

The movement in modern syariah audit has been largely driven by the growth of Islamic finance and the urgency to reform the auditing system in Islamic financial institutions to be in line with Islamic principles. The call for the establishment of syariah audit has been reflected in a number of scholarly articles, books, and postgraduate theses/dissertations. Among these are the writings by Khan (1985), Abomouamer (1989), Karim (1990), Al-Abji (1989), Hood & Bucheery (1999), Khan (2001), Janahi (2000), Simpson & Willing (2000) and Harahap (2002). Given the limited role of conventional auditing in fulfilling the objectives of the syariah, Muslim scholars have explored the idea of a syariah audit that will benefit all Islamic institutions and realising the sacred objectives of the syariah (*maqasid al-syariah*).

Maqasid al-Syariah and Auditing

Syariah, literally means the straight path, provides a comprehensive guidance on the human life and specifies the principles which aim to protect the interest of all human beings. Syariah presents both the social contract and the scientific groundwork for the new global order that is premised on the episteme of divine unity (Choudhury, 1997). *Maqasid al-Syariah* is the goals and objectives of syariah. It is an overarching objective to set things right (*maslahah*) and to remove corruption (*mafsadah*) in all kinds of human activities (Ibn Ashur, 2006:88). This is in line with the Islamic concepts of human well-being (*salah*) and good life (*hayatan tayyibah*) which are important aspects in ensuring a balanced satisfaction of both the material and the spiritual needs of all human beings (Chapra, 1992).

Maqasid al-syariah and its applicability in addressing contemporary issues facing the muslim society receives wide attention of muslim scholars to derive principles, guidelines and methods of discovering and implementing the objectives of Islam in a real practical context (Berghout, 2006). Studies have been conducted to examine the applicability and realisation of the concept of *maqasid al-syariah* in various aspects of economics and finance, such as the implication of the *maqasid* on the modern form of Islamic finance (Kahf, 2006), on the financial contracts in Islamic banking Laldin & Furqani (2012) on Islamic insurance or *takaful* (Abdulaziz (2006) and on Corporate Social Responsibility (Dusuki, 2006).

Maqasid al-syariah has essential implications on the economic activities of IFIs and consequently on the audit function. The scope and framework of the supervision and control mechanism or audit must be consistent with *maqasid al-syariah* and must be aimed at guaranteeing the *maslahah* of all the stakeholders of such institutions. The priorities of the needs of the stakeholders must be ranked according to the categorisation of the *maqasid*. The *maslahah* should be interpreted comprehensively in the auditing procedures to protect the interest of stakeholders sufficiently. In the *maqasid* framework, the audit should cover the entire business activities of the IFIs, including non-financial matters such as business policies, human resource management, societal and environmental impact of the IFIs' activities, and the marketing advertising function.

Syariah audit

Some scholars refer to syariah audit as religious audit or Islamic audit, and these terms have been used interchangeably in the past. However, the term syariah audit is more widely used in contemporary time as it reflects a comprehensive form of audit for IFIs. To date, the definition of syariah audit is still associated with syariah internal review. This is evidenced in the SGF of the Central Bank of Malaysia and also the Guiding Principles on Governance Framework as issued by IFSB. In the SGF, syariah audit is referred to as 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 about the IFI's business operations, with the main objective of ensuring a sound and effective internal control system for syariah compliance (Bank Negara Malaysia, 2010:23). AAOIFI does not specifically address the term syariah audit its standards and instead discusses the syariah review and external audit separately.

In terms of scholarly development in discussing the subject of syariah audit, there have been attempts to explore the conceptual framework of auditing from the Islamic perspective (Briston & El-Ashker, 1986; Harahap, 2002; Kasim, Ibrahim, & Sulaiman, 2009; Khan, 1985) writings which highlight the auditing issues in Islamic banks (Al-Abji, 1989; Janahi, 2000; Simpson & Willing, 2000) and studies on the role, functions, competency, responsibility and independence of syariah advisors (Abdallah, 1994; Rahim et al., 2004; Abomouamer, 1989; Ali, Mohamed, Shahimi, & Shafii, 2015; Kasim & Sanusi, 2013; Najeeb & Ibrahim, 2014; Othman & Ameer, 2015; Syafei, 2005).

There are also studies that compare the different models of the roles of the SSB and external auditors in Islamic banks (Banaga, Ray, & Tomkins, 1994), the notion of independence for the SSB and external auditors Karim (1990) and possible interaction between the two parties (Hood & Bucheery, 1999). The relevance of Islamic audit to the public audit institutions is explored by Khan (2001), who analysed the role of Supreme Audit Institutions (SAIs) in the Islamic economy.

A more comprehensive study in identifying the issues and challenges of the syariah compliance process is written by (Graiss & Pellegrini, 2006). Their study identifies limitations in relying on the syariah compliance assurance to the internal party (i.e. SSB) and proposes an effective framework to monitor and assess syariah

compliance. Meanwhile, Kasim et al. (2009) explore the gap between "the desired" and "the actual" practice of syariah auditing in IFIs in Malaysia and find that there exists a gap between the two concepts in terms of certain issues, i.e. framework, scope, qualification and independence. Various other studies have further explored either the perspectives of different stakeholders about the notion of syariah audit (Ali & Shafii, 2014), factors affecting the quality of audit according to Islamic audit criteria (Yazid & Suryanto, 2016), harmonisation of the audit report (Fakhfakh, 2017), and other issues related to syariah audit (Shahzad, Saeed, & Ehsan, 2017).

Despite the diversity of focuses by the above authors, the most common theme has been the need for a proper theoretical, practical, and regulatory framework of syariah compliance assessment in the IFIs and other Islamic institutions. Addressing this issue will help in the systematic institutionalisation of the discipline of syariah audit. Even though SSB has been commonly regarded as religious auditors and been equated its functions as the functions of religious auditing (Abdallah, 1994; Abomouamer, 1989; Briston & El-Ashker, 1986; Hood & Bucheery, 1999; Karim, 1990). Yet, such assumption is rather narrow because members of the SSB are not well qualified and also independent enough to perform the duty of syariah audit as envisaged in the *maqasid*. While they may offer stakeholders a level of comfort on syariah compliance given the limited availability of professionals with syariah scholarship and financial skills, their independence and access to institution-specific proprietary information have been questioned. On the other hand, empowering external auditors to perform syariah audit also poses a dilemma, as they may not necessarily have expertise and qualification in the field of syariah.

METHOD

This study is build up upon a method of literature review. A literature review is defined as surveys of books, scholarly articles, and any other sources relevant to a particular issue, research area, and theory. Systematic literature review provides description, summary, and critical evaluation of research problem being investigated (Fink, 2014; Webster & Watson, 2002) noted that an effective review creates a firm foundation for advancing knowledge, facilitates theory development, closes areas where a plethora of research exists, and uncover research areas.

The articles were searched based on several keywords either in English or Indonesian. The keywords among others include "Islamic audit", "Syariah audit", "audit for Islamic banks", "*audit syariah*", "*shariah financial institution audit*", and other relevant terms. To reach out to the maximum numbers of articles for review purposes, this study does not limit the literature search within a certain period of publication, certain databases or specific indexed journals only. Premier academic journal databases consisting of, among others Science Direct (SD), Emerald Publishing (EP), Springer Link (SL), and Google Scholar (GS) were utilised to search for articles relevant to the topic. Each relevant article found was further scrutinised its references to identify the possible relevant article. In this context, it can be stated that reviewed articles were collected using two steps searching techniques, the first is database search, and the second is a snowballing method based on the available reference of articles found in the first step.

RESULT AND DISCUSSION

The Ideal Conception of Syariah Audit

Besides, its foundation is based on the Islamic worldview; syariah audit is supposed to be distinct from the conventional audit in its scope, the role of the Syariah auditors, and their qualification requirements.

Scope of Syariah Audit

Unlike conventional audits, where the specific scope of audit engagement and its procedures to follow can be identified, it is not the case for syariah audit. Syariah audit should not only be a concern with the permissibility (*halal*) of the financial products offered by the IFIs but should cover a wider scope. The broader scope of audit has been emphasised by Hameed (2009). He defined auditing as a "systematic process of obtaining sufficient and appropriate evidence to form an opinion as to whether the subject matter (processes, personnel, financial and non-financial performance, financial position, systems, marketing, products, transactions, and contracts) corresponds with the criteria (the rules and principles) which is broadly accepted by the Islamic community and to report to stakeholders thereon". The implied scope of audit from this definition embraces financial and non-financial aspects, including the human resources development, marketing communication, and production process (Muhammad, 2018; Sultan, 2007).

Ziauddin (1991) believes that to carry the label of 'Islamic', IFIs must not only operate according to interest-free principles but also aim towards socio-economic justice. Among the elements of socio-economic justice that should be pursued include prioritising finance to disadvantaged uplift sections of society, preventing the financing of immoral and wasteful consumption, developing a just employer-employee relationship, and discharging societal and environmental responsibilities. Hence the role of audit in such an environment is to ensure that these elements are achieved. Besides auditing the financial control system of the IFI, other aspects such as its human resource management, marketing, business operations, assessment of *zakah* calculation and payment and the societal and environmental contribution of IFI also require attention in the audit of IFI.

The Auditing Standard for Islamic Financial Institutions No.1 issued by Accounting Auditing Organisation for Islamic Financial Institutions (AAOIFI) defines the 'scope of an audit' as the audit procedures deemed necessary by the auditor circumstances to achieve the objective of the audit (AAOIFI, 2010). However, the auditing standard by AAOIFI is particularly referring to the external financial audit.

Meanwhile, in achieving full syariah compliance, a syariah audit must be designed to cover all dimensions of the business operations and activities. The scope of the syariah audit, as required by the Central bank of Malaysia, is including audit of financial statements and syariah compliance audit on organisational structure, people, process and information technology application systems; and review of the adequacy of the governance process (BNM, 2010). While the current scope of syariah audit for IFIs in Malaysia is deemed comprehensive enough, PwC syariah audit survey responses indicate several areas that lack coverage in audits, such as on risk management (Pricewater House Coopers, 2011). With the increasing

efforts in the regulation of syariah governance practice, an expanded scope of syariah audit would probably become a reality shortly.

The Role of Syariah Auditors

Many Muslim scholars have criticised the role of conventional auditors in the Islamic framework. Incongruent to the development of the Islamic economic system, the role and functions of auditors need to be revised to suit the requirements of the system (Khan, 1985). As opposed to auditors in the capitalist framework, auditors in the Islamic economy are answerable to the management and the society at large and ultimately to God. Auditors are also expected to carry out their main responsibility of *'amr bil ma'ruf wa nahi 'an al-munkar'* (enjoining the proper and forbidding the improper) besides assessing the syariah adherence in the entity's financial statements. Hood & Bucheery (1999) opined that religious auditors are guided by religious beliefs prescribed in the Quran and Sunnah (the traditions and sayings of the Prophet), and *ijma'a* (jurisprudence) which would be more highly regarded compared to the legal rules and professional code of ethics. As auditor plays a crucial role in IFIS governance structure. Bosi & Joy (2017) highlighted that to maintain integrity, audit function should be split between auditors and management which internal or external auditors may perform the audit engagement. Yet, the review for the report shall be inspected by the management.

Al-Abji (1989) criticised the function of conventional auditors in Islamic investment companies and banks. Although he did not specifically address the issue of syariah audit, he highlighted the need for auditors' function and responsibility to be revised to meet the requirements of the unique characteristics of investment in Islamic banks. Indeed, the technical aspect of conventional audit is still important, but this should be part of the syariah audit. While auditors are mainly the accredited representatives of all the unit shareholders, it is ironic that there has been nobody nor legislator interested in or considered ways of ensuring that the group of depositors is in custodia legis. Given such absence, he suggested that the auditors' responsibility should be extended to cover the group of depositors. Although depositors are important stakeholders for Islamic banks and conventional banks that offer Islamic banking services, Rahman et al. (2004) found bank managers in such organisations perceiving depositors to be the least likely party for the Syariah advisors to be appointed by and reported to. This may be attributed to the absence of a legal relationship between depositors and Syariah advisors, supporting (Al-Abji (1989) view.

Briston & El-Ashker (1986) stated that the functions of religious auditors lie in three main areas: to provide advice, check actual religious performance, and report to the management on the *zakah* fund. Provision of advice here means advising the board of directors and managing directors on the entity's operation to ensure that all conform with the syariah rule. Checking the performance entails investigating and monitoring the syariah compliance of the top management and all of the financial transactions. Lastly, the task of a religious auditor is to ensure that *zakah* is properly calculated and administered. The functions of religious auditors, as highlighted by Briston & El-Ashker (1986), are undeniably essential, but its

scope is relatively too narrow as they focused mainly on the financial aspects of the entity and the financial products.

While the perceived role of syariah auditors in ensuring syariah compliance is significant, since, without the attestation, the products may no longer be acceptable by its targets market (Simpson & Willing, 2000), such role falls short in meeting *maqadimat al syariah*. In the case of IFIs, the role of syariah auditors is to ensure syariah compliance in all aspects of the business activities and guarantee the protection of interest of all stakeholders and achieve *maslahah* in this world and extended for the realisation of *falah* in the hereafter. In addition, syariah auditors are responsible and accountable to all the stakeholders and are also accountable to God.

3.2. Qualifications and Competency Requirements for Syariah Auditors

The International Federation of Accountants (IFAC) Education Committee defines 'competence' as: "The ability to perform the tasks and roles expected of a professional accountant, both newly qualified and experienced, to the standard expected by employers and the general public" (International Federation of Accountants Education Committee (IFAC), 1998). The questions over the requirements for the competence and qualification of auditors have been central in the discussion of mainstream auditing, i.e. financial statement audits. Various trust and competency issues have specifically arisen due to the many accounting scandals involving the accountancy profession (Palmer, Ziegenfuss, & Pinsker, 2004). In regaining public trust, auditors need to have strong integrity and ethical levels besides having competence and skills.

In the case of syariah auditors, they have to carry the religious values in their conduct, as they are accountable to the auditee and the public in general and God. Besides upholding the highest spiritual and ethical values, syariah auditors must have a high level of professionalism and well-equipped with the necessary level of competence, expertise and qualifications. Zaid (2000) illustrated that the qualification criteria in the appointment of accountants (*Al Kateb*) in the early Islamic era were *ilm* (knowledge), *hikmah* (wisdom) and *balagha* (eloquence).

Haniffa & Hudaib (2002) further explained that knowledge of *syariah islamiyah* helps justify recommendations and rationalisation of judgements. Meanwhile, knowledge of *mu'amalat* (business transactions) helps identify permissible and non-permissible transactions and other important aspects such as formation and types of business allowed, valuation of non-monetary assets, distribution of profit and loss, documentation of transactions, calculation and payment of *zakah*. In addition, they must also possess technical competence in accounting and auditing.

Khan (2001) emphasised that among the framework elements for realising syariah goals through the Supreme Audit Institution (the regulator of Syariah Audit Practice in general) is to train the auditors. There is a need to determine the knowledge and skill requirements on the expanded role and re-design training programs, teaching materials and training methods accordingly. He also argued for the training program to encompass the ethics component to enable the auditors to

audit against corruption and fraud and display the highest integrity level in their professional conduct.

Alam et al., (2020) argued that auditors should have expertise in matters related based financial transactions, Islamic economics and finance, and *fiqh* to ensure good quality of audit. Certainly, all these requirements necessitate an appropriate professional education to ensure that auditors are equipped with all this expertise. With the immense growth of Islamic finance, several qualifications such as Certified Islamic Finance Professional by International Center for Education in Islamic Finance (INCEIF) and Certified Shari'a Adviser and Auditor (CSAA) program AAOIFI, have been established to provide qualification for Muslim professionals. As professional certification is seen as significant in today's accounting profession, it is necessary to establish a professional certification specifically in syariah audit. Such a program is expected to give a well-focused education in preparing the auditors who should be expert in the auditing field and the syariah requirements to serve the unique characteristics of IFIs or other Islamic institutions. The CSAA program by AAOIFI, for example, is a good effort by the institution in responding to the market needs. Even though the program's focus is, among others, on the syariah review process, this could gradually develop into the more comprehensive concept of syariah audit.

The Challenges in The Development of Syariah Audit

The further progress of syariah audit is contingent upon significant contributions from various parties, including the scholars, standard setters, audit practitioners, government, and all other related parties. Like any new disciplines of knowledge, the syariah audit faces challenges requiring solutions. Among the challenges is the gap between the conceptual framework and application of syariah audit, lack of internationally accepted standards and guidelines and the dilemma as to whom the function of syariah auditor should be delegated. They are interrelated, and resolving one of the major issues might also help answer other related issues in this field.

The Gap of Conceptual Framework and Application of Syariah Audit

The conceptual gap seems to exist between the literature and the practice of Syariah audit. There have been noted gaps between the standard auditing method and the competency of auditors carrying the audit function. This is evidenced by Imran, Mad, & Bhuiyan (2012), who examined the auditing as practised by several Islamic banks in Bangladesh and concluded that the sampled banks did not follow Islamic auditing methods. They also argued that the auditors had not met the Islamic requirements.

Furthermore, in the actual practice of IFIs, syariah audit has been associated with the internal syariah review process undertaken by Syariah advisors or dedicated department within IFIs. Meanwhile, the expectation of scholars is much higher to include a more objective and independent evaluation of Islamic financial institution's operations. The current perception that syariah review can be equated with the concept of syariah audit give rise to concern over understanding the distinction of the term 'review' and 'audit'. While the former implicates a lower assurance level, the latter has a more comprehensive assurance level.

CPA Australia (2006) states that "review engagement is a service where the auditor's objective is to provide a moderate level of assurance, being a lower level of assurance than that provided by an audit". The review has also been defined as "a formal assessment of an activity to suggest or implement changes" or a review "implies an audit type investigation that does not meet the full requirements of Generally Accepted Auditing Standards (GAAS)" (O'Regan, 2004).

Another gap is probably in the scope of the Syariah audit. The expectation of Muslim society on IFIs is considerably high since IFIs manifest Islamic identity in the financial realm. Apart from offering halal financial products and services and operating in an Islamic manner, they are also hoped to uphold Islamic principles in a broader perspective, such as uplifting socio-economic justice. Hence, the scope of syariah audit is expected to reach all these elements. Nevertheless, the gap on this aspect has been narrowed from the formative years of IFIs until now, as evidenced in the expanded scope of the syariah audit required by the regulation, such as Malaysia's case.

The Urgency of an Internationally Accepted Syariah Auditing Standards or Guidelines

¹⁶ Simpson & Willing (2000) highlighted the continued lack of an internationally accepted framework of ⁷⁴ uniform and comprehensive accounting standards or ⁴⁰ auditing guidelines for Islamic banking. To mitigate ⁹ the diversities of adopting accounting and auditing standards in the IFIs, several international institutions are currently working to set -compliant standards and harmonise them across countries. These include the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the Islamic Financial Services Board (IFSB), the International Islamic Financial Market, the Liquidity Management Center, and the International Islamic Rating Agency (El Qorchi, 2005). ⁵⁶

While AAOIFI continues to contribute in initiating and promulgating the accounting, auditing and governance standards for IFIs, It has faced the difficulty of getting the industry to adopt or at least look to their standards as a base due to its reliance on ⁵ voluntary adoption. Karim (2001) highlighted among of the ³ factors that contribute to the low implementation of AAOIFI's standards is the lack of appreciation by the relevant agencies that are responsible for enforcing accounting standards of the benefits that can be gained by implementing AAOIFI's standards, i.e. (1) rendering the financial state⁵ments of Islamic banks comparable and transparent; (2) providing relevant and reliable information to the users of financial statements of the IBs. It can be deduced that AAOIFI is facing numerous issues in gaining its institutional legitimacy.

In addition, the AAOIFI standards have yet to cover specifically the issues and conceptual framework of the syariah audit. The current AAOIFI standards provide a different set of standards for the financial statement audit (i.e. auditing standard for IFIs) conducted by external auditors and syariah review, which the SSB performs. Although the objective, criteria and standards to be followed in conducting financial statement audit for IFIs (as envisaged by AAOIFI) is different from the conventional financial statement audit, the scope of this financial audit has

yet to cover the broader concept of syariah audit, which proposes an audit for all activities of IFIs.

On the other hand, even though GSIFI No.2 on Syariah review states that “Syariah review is an examination of the extent of an IFI’s compliance in all its activities with the syariah” (AAOIFI, 2010:15), the detailed guidelines seem to focus on the contracts and transactions (See GSIFI No.1, par. 20; and GSIFI No.2 par. 12).

The Function of Syariah Audit

Based on the current scenario of the operation of the IFIs, the question has been raised over who should carry out the functions of the syariah audit. In most of the literature the Syariah Supervisory Board (SSB) has been regarded as the religious auditors. The functions of the religious audit are equated with the functions of the SSB. The audit of financial statement is within the remit of the independent external auditor.

In terms of who should carry out the function of syariah audit, the standards by AAOIFI seem to suggest that the functions are to be distributed to different entities, i.e. SSB and external auditors. While external auditors are empowered to conduct the financial audit in accordance to the syariah principles, SSB’s duty is more comprehensive in providing guidelines (fatwa), reviewing and supervising the activities of the IFIs in order to ensure that the IFIs are in compliance with Syariah principles. GSIFI No.1 states that “... the SSB is entrusted with the duty of directing, reviewing and supervising the activities of the IFIs in order to ensure that they are in compliance with Islamic Syariah rules and principles. The fatwas and rulings of the SSB shall be binding on the IFIs” (AAOIFI, 2010:5).

The task of syariah review as entrusted to the SSB may be equated to the concept of syariah audit as it implicates a comprehensive understanding in ensuring syariah compliance of the IFIs. Syariah review as defined in the GSIFI No.2, para. 3 is “an examination of the extent of an IFI’s compliance, in all its activities with the syariah. This examination includes contracts, agreements, policies, products, transactions, memorandum and articles of association, financial statements, reports (especially internal audit and central bank inspection), circulars, etc.” (AAOIFI, 2010:15).

Based on the above standards, the SSB is required to conduct the ‘pre-audit and ‘post-audit functions. They are not just entrusted with issuing fatwas and supervising activities of IFIs to be in line with the syariah precepts and review the overall activities of the IFIs and decide if they comply with the syariah principles.

However, this raises the question of the independence of the SSB. Although the perceived independence of the SSB is very much influenced by moral-religious values and solid religious credentials of its members (Karim, 1990), its independence can be challenged due to its dual role in the IFIs, i.e. providing both ‘advisory’ and ‘review’ services. IFAC Code of Ethics for Professional Accountants Section 100.10 highlights that “compliance with the fundamental principles may potentially be threatened by a broad range of circumstances, with one of it being self-review threat, that may occur when a previous judgment needs

to be reevaluated by the professional accountant responsible for that judgment” (International Federation of Accountants [IFAC], 2005:1106) ⁶

Karim (1990) stated both SSB and external auditors should be from one corporate body since Islam ²⁴ does not recognise any separation between business and religion. Furthermore, due to the lack of experience of most external auditors on the syariah principles (Simpson & ¹⁶ Milling, 2000), they often have to rely on the SSB to confirm such aspects. Since the auditor must take steps to satisfy himself/herself on the syariah compliance aspects in expressing an opinion in the audit report, the reliance on other’s opinion may raise concern on the competence of external auditors to attest independently. This task is made more complicated due to the subjectivity of the syariah interpretations by different syariah boards. Therefore, establishment of common rules and regulations would enhance the effectiveness of external auditors in ensuring compliance to the syariah.

However, Hood & Bucheery (1999) argue for active interaction between the SSB and external auditors to ensure a proper check and balance. Similarly, Janahi (2000) does not see any problems for syariah audit to be conducted by either the external auditor or the Religious Supervisory Board as both have their advantages and disadvantages. Delegating the task of syariah audit to the external auditors would ensure independence. Still, the tradeoff is the risk of assessing compliance due to a lack of competence and expertise on syariah audit by external auditors. On the other hand, if the Religious Supervisory Board (RSB) were to carry out the task of syariah audit, they might be questioned in terms of their independence and expertise and competence to handle accounting and auditing matters. He asserts that both external auditors and the RSB must work closely to address and resolve any issues related to syariah and fiduciary compliance in any of these scenarios. The establishment of proper rules and regulations and a code of practice for the syariah audit could effectively ensure syariah compliance performance in IFIs.

Grais & Pellegrini (2006), on the other hand, proposed a more comprehensive solution to the above issue. They suggested a practical framework consisting of internal and external processes to monitor and assess the syariah compliance of the IFIs. While the SSB and syariah review unit are integral to the IFIs, the syariah auditors should be independent of the management of the IFIs and come from an external party.

CONCLUSION ²⁷

Auditing and the concept of accountability from an Islamic perspective are not ³⁵ new, as evidenced from the institution of *hisba* that existed during the caliphates. In the early stages of the development of IFIs, the focus has been ⁵⁰ on innovating permissible products through consultation with syariah scholars. Given the unique characteristics of Islamic banking, the function of conventional audit is deemed limited and unable to fulfil *maqasid al-syariah*. Hence, an audit with a wider scope than the conventional audit was proposed, known as the syariah audit.

This paper revisited the concept of syariah audit and its importance within the wider Islamic worldview. Some early works by scholars and their concerns are discussed. It also describes the unique characteristics of such an audit and its challenges. One of the biggest challenges is finding independent external auditors

with good knowledge of syariah and who can make a due judgement without too much reliance on syariah scholars. There have been efforts in overcoming this challenge through dedicated programs set up to train and certify such auditors.

Given the infancy of this discipline, it will continue to face new challenges parallel to the development of IFIs, and hopefully, an institution like *hisba* would soon become a reality. The discussion of this paper has both implications for the theory and practice in general. Theoretically, it provides an avenue to relook into an idealistic conception of syariah audit and sketch future research which can embrace the unresolved issues and challenges inherent in the subject of syariah audit. Practically, the idealistic conception of syariah audit is proposed to be guiding and improving the implementation of syariah audit not only to the environment of Islamic banking and finance but to the wider Islamic business and non-profit activities.

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