

Human Capital Development in Shariah Audit

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Abstract: The Shariah Governance Framework (SGF) is a set of organizational arrangements through which Islamic Financial Institutions (IFIs) ensure effective oversight, responsibility and accountability of the board of directors, management and Shariah Committee. In measuring the IFIs compliance to the Shariah, SGF requires regular internal Shariah reviews and Shariah audit. This paper aims to identify the independence and competency quality that requires for human capital development in Shariah audit. This research adapts focus group study conducted with the stakeholders of IFIs which consist of regulators, IFIs management, employees and shareholders. The results from this study indicate that Shariah auditors must possess Shariah and accounting knowledge. However, if the Shariah auditors do not have the necessary qualifications, their experiences in the Islamic banking could be considered. In terms of independence, the Shariah audit function shall currently attach to the internal audit department. The findings of the study could be used in developing syllabus and training modules for Shariah audit that reflects the Shariah requirements and also the industry's needs. Future research could be done by expanding the sample of the study that covers wider group of informants to achieve variety of feedbacks from the Shariah audit experts.

Key words: Human capital development • Independence • Competency • Qualifications

INTRODUCTION

The Islamic banking industry in Malaysia has emerged in the global banking system and continues to show strong growth for the past years [1]. The demand for Shariah audit practices is mainly to strengthen the Shariah compliance and enhance the integrity of the IFIs. Shariah audit is currently been performed by the IFIs in order to ensure that the activities and operations of an IFI are adherence to Shariah. Due to the unique features of the IFIs such as the prohibition of *riba*, *gharar*, *maysir* and additional requirements that the activities must be in compliance with Shariah principle, the current statutory audit may not be sufficient to satisfy the Shariah requirement. Furthermore, the accumulation and evaluation of evidence through the current statutory audit may not achieve the degree of

Shariah compliance in the IFIs since it should also covers the Shariah requirements in the activities and operations of the IFIs.

Shariah audit differs from statutory audit in many aspects. One of the main differences is statutory audit focused more on financial aspect of an institution that the report of the financial statements shall reflect true and fair view whereas Shariah audit highlights on the importance of the overall activities and operations of the IFIs must be in line with the Shariah requirements. For example, Shariah requirements prohibits, among other things, the payment and receipt of *riba* or usury, gambling, hoarding and speculation. Besides that, Islam also forbids any investing or dealing in alcohol, pork and other activities which are considered unlawful in Islam. In Shariah audit, the auditors must also attest that management has complied not only with the Shariah

aspects, but also with the wider objective of Shariah (*maqasid al-shariah*), which is to protect and improve the condition of human life in all dimensions.

Statutory audit requires an independent and qualified chartered accountant as an auditor whereas in Shariah audit the person must not only a qualified auditor but also a qualified Shariah person [2]. If the auditor who are performing Shariah audit is not competent in Shariah, he/she will not be considered as a competent person to carry the duties.

It is crucial to identify the extent of the scope of Shariah audit to determine the level of independence and competency required of the Shariah auditors since both elements silent in the SGF. The findings from this study will facilitate higher institutions in developing syllabus and training modules for Shariah audit that reflects the Shariah requirements as well as the industry's needs, thus narrowing the gap between the expectations and the performance of the Shariah auditor. The purpose of this paper is to identify the independence and competency quality requirements for human capital development in Shariah audit.

Independence in Auditing: Independence in auditing means taking an unbiased viewpoint in the performance of audit tests, the evaluation of the results and the issuance of the audit report [3] that management can place full reliance on audit findings and recommendations [4]. According to Malaysian Institute of Accountants [5] By-Law B-1.4, independence requires both (i) independence of mind and (ii) independence in appearance. Independence in fact (or actual independence) can be defined as the auditor's state of mind and his/her ability to maintain a proper attitude in the planning of his audit program, the performance of his verification work and the preparation of his report [6]. On the other hand, independence in appearance (or perceived independence) refers to the public's or others' perceptions of the auditor's independence. To be seen to be independent, an auditor should be able to demonstrate that there is no threat to his or her independence such that an outsider would not doubt the auditor's objectivity [3, 7]. Independence is a critical issue in auditing since it is the cornerstone of the profession [6].

The SGF issued by Bank Negara Malaysia [8] requires that the responsibility of conducting Shariah audit lies in the hands of the internal audit unit.

This signals that the responsibility of internal auditor has expanded their job scope. The internal auditor not only act as a player to ensure corporate governance as well as providing internal consultancy [9] but the role has been expanded to perform Shariah audit in ensuring that the operations of the IFI are Shariah compliant. This leads to the issue of independence and objectivity, competency of the auditor and auditor's performance in performing new task which has been outlined in the SGF issued by Bank Negara Malaysia [8]. In addition, this also triggers the perceptions of the stakeholders on the strength of the Internal Audit Function in performing Shariah audit. Studies conducted by Kassim [2] shows that gap exist in the practice of Shariah audit. There is gap between the 'desirable' and the 'current' practice of Shariah auditing in the IFIs in Malaysia. The desirable practice is to conduct Shariah auditing externally but the result shows that the current practice is done at the internal level only. She argued that there are gaps in Shariah audit in terms of the framework, scope, qualifications and independence. She also found that most of the IFI's internal auditors are not qualified to perform Shariah audit task since they do not have Shariah background.

Independence is achieved through the organisational status of internal audit and the objectivity of internal auditors [10]. The outcome from the Shariah Audit Function tabled to the Shariah Committee may trigger independence issues since the Shariah Committee of the IFI is responsible in decisions, views and opinions related to Shariah matters. The Shariah Committee is also expected to perform an oversight role on Shariah matters related to the institution's business operations and activities. This is achieved through the Shariah review and the Shariah audit functions. Independence is a fundamental concept in auditing, as auditors cannot audit or examine their own work [2]. This applies to the Shariah Committee of the IFI too, since they are responsible on the endorsement of Shariah policies and procedures and at the same time conducting Shariah review and Shariah audit on the overall operations that is Shariah compliant. In addition, the board of the IFIs bears the ultimate responsibility and accountability on the overall governance of the IFI and the board is expected to rely on the Shariah Committee on all Shariah decisions, views and opinions relating to the business of the IFI. This triggers question on the line of communications and reporting as the Board is expected to rely on the Shariah

Committee works. If the Board is expected to rely on the Shariah Committee works, again the issue of independence in reporting will take place. Due to that, it is crucial to investigate the independence issues in Shariah audit.

Competency of Shariah Auditor: Flint [11] stated that audit competence requires both knowledge and skill, which is the product of education, training and experiences. In a standard issued by International Federation of Accountants (IFAC) on International Education Standard (IES) 8 Competence Requirements for Audit Professional, outlines that auditors must have the formal education (knowledge) relevant to audit (IES 2), professional skills (IES 3) and be able to apply the professional values, ethics and attitudes (IES 4) to different contexts and organizations. Based on these definitions, it is clear that auditors' competence is determined by considering a set of relevant attributes such as knowledge, skill and attitudes. Thus, the internal auditors who are attached to the IFI must not only have the auditing skills but also need to have an additional qualification which is Shariah knowledge specifically in Fiqh' Muamalat. This is to ensure proper Shariah audit has been conducted and that the overall operations of IFIs are Shariah compliant.

According to the Institute Internal Auditors Malaysia [12] in the International Standards for the Professional Practices Framework of Internal Auditing, the internal audit unit should be appropriately staffed in terms of numbers, grades, qualifications and experience, having regard to its responsibilities and objectives. The internal auditor should be properly trained to fulfil all his responsibilities (paragraphs 15 to 26). The effectiveness of internal audit depends substantially on the quality, training and experience of its staff. The aim should be to appoint staff with the appropriate accounting and Shariah background as well as having personal qualities and potential to be trained as a Shariah auditor. Thereafter, steps should be taken to provide the necessary experience, training and continuing professional education. Rahman [13] argues that one of the challenges in implementing Shariah audit would be to produce competent and independent Shariah auditors. He also suggested that the education and training program on Shariah audit should equip the Shariah auditor with two basic knowledge i.e. specialised Shariah knowledge as applied in Islamic banking and finance and Accounting and Auditing knowledge and skills.

MATERIALS AND METHOD

Sampling Design: This study uses a qualitative method that reviews and gathers inputs and feedbacks from a session of focus group interviews. One of the advantages focus group interview is that it highlights the uniqueness and human experience which is not being addressed and measured by using the quantitative method approach. In addition, focus group interview is useful to explore and generate ideas and issues through group interactions [14] and it also captured certain elements such as thoughts, feelings and intentions that are impossible to be observed or measured using other methods[15]. Another advantage relates to the position of participants in the interview. Interviewing provides researchers with an insight into the participants' thoughts, ideas and memories in their own words rather than those of the researchers'[14].

A sample of knowledgeable and expert in Shariah audit comprised of regulators, internal auditors of Islamic banks, external auditors, Shariah Committee members and Shariah officers of the Islamic banks. An expert should not only possess Islamic jurisprudence knowledge but must also possess some comparative knowledge on conventional banking law [16]. The initial number of the targeted sample was twenty. Although there may be a relatively limited number of experts with knowledge on Shariah audit, the panel size requirements are modest and it would be practical to solicit up to 10 to 18 members in size [17]. However, due to their tight schedule of the respondents only five experts agreed to participate in the study. The five respondents are consists of a representative regulator, an internal auditor of an Islamic bank, an external auditor, a Shariah Committee and a Shariah officer. Although the numbers of interviewers are relatively small the researchers are in the opinion that the sample is representative.

Data Collection: During the focus group interview the participants are guided by a series of questions developed based on the previous literatures. The questions are developed based on the objective of the research and validated by the subject matter expert in Shariah audit. All interviews were audio recorded and then transcribed. Content analysis was performed and inputs were compiled and reviewed into thematic findings.

The responses were coded to ensure confidentiality of the names, positions and the organization of which the respondents represent for. The respondents in this study were coded as R1, R2, R3, R4 and R5.

RESULTS AND DISCUSSION

Level of Competency: In order to achieve the objective of the study, the participants of the focus group interview were guided by four series of questions. During the first round, the participants are required to determine the qualifications of the Shariah auditor in terms of competency level.

Most of the respondents agreed that the criteria of Shariah auditors shall be determined by each of the Islamic banks. For instance respondent (R3) mentioned that:

“In the process of issuance BNM Shariah Governance Framework (SGF), the team wanted to include the qualifications of the Shariah Auditors in the framework. However, they decided to make it general since the industry people might not be able to cope with the requirements. Rather than to start it with strict requirements and industry cannot cope, better to make it general. Besides, we should give flexibility especially to the banks that offered only window in Islamic banking. I recommend that the basic qualifications of a Shariah auditor be fine tuned to take into account the current availability of talent in the market as well as Shariah training offered by Shariah training provider...”

Another respondent (R5) agreed with the criteria above but he highlighted that the Shariah auditor must be a person with Shariah background. He mentioned that:

“I suggest that in terms of the competency, let the Board audit committee and the Shariah committee of the IFI decide the appropriate level of the Shariah auditor. I think the person must be qualified in Shariah criteria. The Internal Auditor should have shariah background. Adequate is not enough. It must further elaborate on the shariah criteria...”

In addition, one of the respondent (R2) add on to the criteria above by saying that:

“...not only the person must have Shariah background. Accounting qualification is also necessary to ensure the flow in auditing process.....both qualifications accounting and Shariah is a must for a Shariah auditor”.

In the second round of discussion on competency of Shariah auditor, this study concludes that in the event of lack of expertise in performing Shariah audit function, the internal auditors of the Islamic banks may invite the Shariah team to be part of the internal audit team to perform Shariah audit. However, if the person is an experienced staff without qualification in accounting and Shariah, the banks shall send the staff for Shariah trainings. Respondent (R1) mentioned that:

“In the SGF mentioned that Shariah officers can perform the shariah audit function. So we can use their expertise in performing Shariah audit function. I think CIFP can be considered as one of the qualifications. Must have training as well. If the current auditor does not fulfil the fiqh muamalat courses they must undergo trainings that related to fiqh muamalat”.

Conversely, respondent (R2) have other views on sending the experience staff for Shariah trainings:

“If the Chief Internal Auditors are the controller, there should be no problem for the Shariah officers to help in doing shariah audit. It is mentioned in the Internal Audit Guideline on ‘guess review or peer review’. No independence issues will arise if Shariah officer help in doing Shariah audit. But if possible the Shariah auditor shall have qualifications in accounting and Shariah background. It is expensive to train. The practiced in my bank, is that we invite the shariah team to be part of the internal audit team. The Shariah team will be given specific area to be audited. The intention is to expose the auditors to Shariah requirements and at the same time exposed the Shariah team to the audit line...”

Another respondent (R4) shared different opinion on the competency level of a Shariah auditor. He mentioned that:

“I personally feels that the Shariah auditors should have experience is more important rather than the qualification. This is because Shariah knowledge is important besides the qualifications based on the practiced in my bank. Fiqh Muamalat and Usul-Fiqh degree or equivalent should not be made mandatory. Shariah knowledge can be acquired through relevant training programs”.

Based on the discussions above, it is agreed from the focus group interviews that the level of competency of Shariah auditor shall be as follows: a) the criteria shall be determined by each of the Islamic Banks, b) shall be well equipped with accounting and Shariah knowledge, c) the internal auditors may invite the Shariah team to be part of the internal audit team to perform Shariah audit, d) if the person is an experienced staff without qualification in accounting and Shariah, the banks shall send the staff for Shariah trainings.

Independence in Shariah Audit: The third round of discussion with the focus group discussions was on the independence issues in Shariah audit. The groups were asked to respond on the position of Shariah audit function in an Islamic bank; either to be attached to the internal audit department or to become a standalone department. It is important to allocate the chain of command or an effective hierarchical system of Shariah audit function in an IFI. Shariah audit function should be placed high in the institutions to ensure the independence and objectivity will not be jeopardised.

According to SGF issued by Bank Negara Malaysia [8], Shariah audit is one of the functions to be performed by the internal auditors. This shows that Shariah audit function shall be attached to the internal audit department of an IFI. According to the focus group interviews, 3 out of 5 respondents agreed that Shariah audit function shall be treated as part of the internal audit function due to the limitation of costs. Respondent (R1) mentioned that:

“It should not be a department. It should be a division in the internal audit department.”

Even though some of the respondents raised the issue of cost efficiency, it is still up to the Islamic bank to decide whether to treat Shariah audit function as a separate department. Respondent (R2) mentioned that:

“To open a separate department for Shariah audit will involve additional costs and human resources. At current we do not have enough expertise in the area. May as well it is attached to existing department such as Shariah department or internal audit department”.

In addition, respondent (R4) briefly commented from different angle:

“The current practice in XYZ Bank, the Internal Shariah Audit is part of the group audit. However in the future if the Internal Shariah Audit Unit to become a separate unit and accountable directly to the Board Audit Committee it should not be the problem but depending on the Human Resource of the Bank”.

In a similar assertion, respondent (R5) stated that:

“It shall depend on the staffing of the bank. If the staffing is enough it can go for separate unit”.

However, apart from the discussions above, another respondent (R3) viewed the situation differently by saying:

“I suggest that the requirement should be silent. It is up to the industry to decide whether to make it as a separate unit or not”.

The foregoing discussion concluded that the requirement to have Shariah audit function attached to the internal audit department. However, the Islamic banks shall allocate the resources from now to cater the future demand on having Shariah audit as an independent department if it is required to the stakeholders.

The fourth round of the discussion continued with regard to the issue of reporting the Shariah audit findings. Majority of the respondents agree to maintain the existing practice held in Islamic bank which is to report the Shariah audit findings to the Audit committee. According to respondent (R1):

“It should be tabled to the Audit Committee of the bank, as simple as that. I don't think this should be an issue. It is a standard practice that whatever findings during internal audit shall be reported to the audit committee. So, I think it shall be the same in the case of Shariah audit finding”.

Another respondent (R5) agree with opinion above saying that:

“We shall maintain the existing practice held in the banks. Previously whatever findings related to internal audit are directly tabled to the Audit committee. So I guess we should maintain the practice”.

There is one responded that the Islamic bank may invite the Shariah Committee to discuss any uncertainties before table the findings to the Audit committee. Respondent (R2) suggested that:

“I don’t think it is practical for the Shariah audit findings to be reported to the Shariah Committee. Normally what we will do is in the event that needs further confirmation from the Shariah Committee, we will conduct special meetings to resolve the Shariah matters an invite the Shariah Committee to discuss the issues. Then only we will bring the outcome to the Audit committee”.

However, some argued that the Audit committee of the Islamic bank may not have the expertise in the Shariah thus, need to table the findings to the Shariah Committee as well. As according to respondent (R3):

“In my opinion it shall be tabled to both parties. The Shariah Committee and the Audit Committee. Since the Audit Committee may not be aware with the Shariah issues due to their background. So we need to involve the Shariah Committee in Shariah audit”.

In addition, there is a view that the management of the Islamic bank shall decide that if the Audit committee have the Shariah background, it is optional to report the Shariah audit findings to the Shariah Committee. As mentioned by respondent (R4) that:

“It should up to the Bank to decide. If the Audit committee of the bank is from Shariah background, it should not be a problem to table the Shariah audit findings to the Audit committee”.

The discussions continued until the respondents agreed that in the event which involve Shariah matters that need to be resolved by the Shariah expert, the Islamic bank shall invite the Shariah Committee to discuss the Shariah audit findings with the Audit Committee.

The limitation of the study that the researchers manage to identify is on the number of focus group interview. The focus group interview consists of only five members. The focus group member consists of one representative from regulator, internal auditor of Islamic bank, external auditor, Shariah Committee and Shariah

officers. The small group size can arguably limits the depth of discussions on the relevant issues. However, this study gives a huge impact on the implementation of Shariah audit in IFIs. In addition, even though limited numbers of respondent through the focus group interview this study managed to explore and generate ideas and issues in Shariah audit. It also captured certain elements such as thoughts and intentions that are impossible to be observed or measured using other methods[15]. Future research could be conducted to capture more data from the experts.

CONCLUSION

The findings indicate that in terms of competency quality in Shariah audit, the criteria of Shariah auditors shall be determined by IFIs at the institution’s level. Shariah auditors must both have accounting and Shariah knowledge. The attachment of Shariah audit function to the internal audit department will not jeopardise the issue of independence since the Shariah audit findings will be reported to the audit committee of the Islamic bank. To efficiently perform the Shariah audit, internal auditors may invite the Shariah team to be part of the internal audit team to perform Shariah audit. Internal Shariah auditors with experience to audit IFIs have to be empowered with Shariah qualifications offered by institutions licensed by Bank Negara Malaysia. The outcome of the study could be used in developing syllabus and training modules for Shariah audit. The universities and other institutions in Malaysia must also take the challenge to produce graduates and certified Shariah auditors to cater the future demand globally. The development of Guidelines, standards, processes, systems and manuals that could be used to conduct Shariah audit will place Malaysia as an education hub in Islamic finance education as well as the a training ground for Islamic finance practitioners from all over the world.

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