Shariah Audit Practices in Malaysia: Moving Forward

Fatihu Shehu Isa, Noraini Mohd Ariffin[*], Nor Hafizah Zainal Abidin

Department of Accounting, Kulliyyah of Economics and Management Sciences,
International Islamic University Malaysia

[*]*Corresponding author: norainima@iium.edu.my*

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Abstract

The Shariah audit being a monitoring tool for ensuring Shariah compliance proved to be an important component in the operations of Islamic financial institutions (IFIs). In the case of Malaysia, Bank Negara Malaysia has issued a Shariah Governance Framework in 2010 which categorically made Shariah audit function as one of the required functions in IFIs in addition to Shariah Review, Shariah Research and Shariah Risk Management. In line with this, this study aimed at exploring the extent of practitioners' awareness and perceptions of Shariah audit, the possible challenges associated with it as well as its future implications. The study used 83 practitioners drawn from various IFIs external audit firms that are involved in Shariah audit services through purposive sampling procedure. Questionnaire instrument was employed in generating the data. The findings of the study showed that practitioners' awareness is satisfactory, as majority of them got to know about Shariah audit through an educational programme, which gave them the opportunity to express what ought to be the desirable practice of Shariah audit. Similarly, the findings revealed that the lack of the independent Shariah audit report, the standalone Shariah audit framework and the inadequate competent Shariah auditors are among the main concerns in the practice. Moreover, the findings also showed that Shariah audit will have a high potential to take up as a marketable career in the near future. Finally, the findings suggest that the integration of Shariah audit in accounting courses in institutions of higher learning; comprehensive Shariah audit framework and standards; new regulatory/professional body with a mandate of supervising IFIs as well as a professional certification in Shariah audit should be made available. It is hoped that the study will contribute towards the development of desired Shariah audit practices in Malaysia.

Keywords: Shariah audit, Islamic financial institutions, questionnaire survey, Malaysia

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1. Introduction

Globally, the remarkable growth of the Islamic financial industry in recent years has been triggered by the strong demand for Islamic banking services to ensure all transactions are compliant with Shariah. The rapid growth in the industry has initiated significant changes in most of its current activities and this has had an effect on the auditing, accounting and economics professions, among others. There is a crucial need for a proper system of checks and balances in the industry to safeguard the reputational risk in lieu of Shariah non-compliance activities. A robust monitoring system would enhance and preserve the public's confidence in the operations and activities of the industry, and it has been argued that the audit function is ideal in serving this purpose (Yaacob and Donglah, 2012). In fact, the presence of Shariah audit, as the third line of defence, is to ensure that the overall processes and activities in Islamic Financial Institutions (IFIs) are not contravened to the Shariah principles (Yasoa et al., 2018). In the field of auditing, the sole objective of Shariah audit, in addition to conventional audit, is to attest to Shariah compliance.

However, in the context of Malaysia, many aspects of Shariah audit, including Shariah auditors' certifications, competency requirements, professional judgement standards and reporting structures, as well as Shariah audit framework, are not adequately covered by the Shariah Governance Framework (SGF 2010), which was introduced in 2010 (PwC, 2011). Indeed, a number of previous studies have raised several concerns in relation to the provision of guidelines on Shariah audit practices in IFIs, the competency of

Shariah auditors and the challenges of Shariah audit practices (Abdul Rahman, 2008; Haniffa, 2010; Kasim, 2010; Shafii et al., 2013). Careful scrutiny of SGF 2010 indicated that it places little importance on providing adequate explanations on the functions of the Shariah audit (Abdul Rahman, 2014). Many studies have expressed the opinion that the framework is too brief in relation to providing a generally accepted procedure for the performance of a Shariah audit (Abdul Ghani and Abdul Rahman, 2015; Abdul Rahman, 2014; Shafii et al., 2013; Shaharuddin, 2011). In addition, SGF 2010 does not pay much attention to providing a specific guide on the types of Shariah knowledge and the areas of Shariah in the framework needed by the internal auditors in order to conduct effective Shariah audit (Abdul Rahman, 2014). Whereas, in 2019, the revised Shariah Governance Policy Document (SGPD 2019) merely noted that the Shariah audit must be performed by a qualified person that has requisite knowledge on Shariah requirements applicable to the IFIs (Bank Negara Malaysia or BNM, 2019). Nevertheless, PwC (2011) emphasised that there is an urgent need to increase the number of competent and knowledgeable Shariah auditors, establish a Shariah audit framework and standards, and enhance Shariah audit methodologies. Echoing such need, Abdul Rahman (2014) expressed his concerns on the inconsistency of the current Malaysian Shariah audit practices if the Shariah audit framework is not made available. After all, the credible performance of the Shariah audit is crucial in order to enhance the faith and confidence of various stakeholders in the industry.

Therefore, in order to understand the current state of Shariah audit, this study explores Shariah practitioners' awareness and perceptions of Shariah audit practices in the Malaysian context. Insights on the challenges associated with the current practices and their implications for the future direction of Shariah audit in Malaysia are also discussed. Furthermore, there are several ways in which this study has contributed to the literature. To date, a limited number of studies have focused on the perceptions of practitioners, who are directly involved in the control functions under Shariah governance with regard to the issues and challenges they face in their current practices. In addition to that, prior studies were mostly conceptual and lack of empirical input from practitioners. Therefore, in this study, the perceptions of practitioners were gathered from three different groups, namely internal and external Shariah auditors and Shariah officers, who could offer up-to-date insights on Shariah audit practices from a range of perspectives. Finally, this study uncovers several important insights for future improvement of Shariah audit practices, including the need for SGPD 2019 to focus more on strengthening the positioning (structure) of Shariah audit activities within the IFIs and to provide more detailed guide on the scope and methodology of Shariah audit, as well as a need for more qualified Shariah auditors to be trained in the areas of accounting and *fiqh muamalat* (Islamic commercial jurisprudence).

The findings of this study also highlight several emerging issues that need to be addressed in order to move forward in improving Shariah audit practices, which lead to four key recommendations. First, dedicated in-house internal audit units should be set up in IFIs. Second, a clear line of functional reporting or authority should be included in the internal audit charter, which would enhance the independence of the audit function, i.e. by providing unfettered powers of inquiry and reporting. This would strengthen the positioning and recognition of independent internal Shariah audit activity. Third, the educational sector and professional bodies should focus on producing more qualified and competent human resources for performing Shariah-related work. Finally, Shariah audit practices should be standardised through the proper introduction of a Shariah audit framework or guideline. Besides, the presence of framework is crucial to establish efficiency and help to define the work, authority and reporting level.

The remainder of the paper is structured as follows: in the next section the prior literature is reviewed, and this is followed by an explanation of the research method. Then the results of the analysis are presented and discussed. Finally, the paper ends with some concluding remarks, highlighting the implications, limitations of the study and some suggestions for future research.

2. Literature review

2.1 Shariah Governance

The Islamic Financial Services Board (IFSB) Guiding Principles on Corporate Governance took the position that 'no single model' suits all IFIs globally and the effectiveness and soundness of a corporate governance framework depends on the specificities of the individual IFI (IFSB, 2009). Due to this, the IFSB (2009) recommended that the implementation of the guiding principles should be proportionate to the size, complexity, structure, economic significance and risk profile of each IFI. IFSB defined the Shariah

governance system as a set of institutional set up within an IFI. It aims to ensure an effective oversight mechanism on Shariah compliance over the structures, operations and activities of IFIs are in place. In the case of Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), no proper definition is provided with regard to SG, however, several standards (i.e. Standard No. 1, 2, 4, 6 and 7) of AAOIFI stated the roles and conducts of Shariah organs of IFIs. However, SGF issued by the Central Bank Malaysia (BNM) is used in the case of IFIs in Malaysia. These guidelines are used to assist IFIs to establish their governance structures and improve its transparency (Shafii and Salleh, 2010).

In the context of Shariah audit in Malaysia, the BNM, in an effort to establish proper Shariah compliance in IFIs, issued SGF in 2010 (BNM, 2010) (thereafter SGF 2010), which later was revised to SGPD in 2019 (BNM, 2019) (thereafter SGPD 2019). In between, the Islamic Financial Services Act (IFSA) was passed into law in 2013 (BNM, 2013). SGF 2010 contains sections on Shariah risk management, Shariah review, Shariah research and Shariah audit functions, whereas the IFSA was designed to encourage Shariah compliance in IFIs. Hence, the requirements of SGF 2010 are mandatory for all IFIs as its implementation is mandated by the law stipulated in IFSA (2013). The Act also highlighted various penalties for Shariah non-compliance (SNC). Both SGF 2010 and IFSA 2013 were meant to ensure adequate implementation of Shariah compliance across Malaysian IFIs. In addition to that, the SGPD 2019 further strengthened the oversight functions of the Shariah Committee and other Shariah control functions to continuously ensure strong practices of Shariah compliance within the IFIs. The emphasis on Shariah non-compliant events are further governed by Operational Risk Integrated Online Network (ORION) (BNM, 2018). Close monitoring on Shariah non-compliant events is being done by BNM through reporting submitted by IFIs.

SGF 2010 clearly stated that the presence of SG organs is to observe comprehensive compliance with regard to Shariah principles in all conditions. This would uphold the confidence of the general public and financial markets towards IFIs in Malaysia. Definitely, Shariah Committee, being the heart of SG, owe fiduciary and oversight duties towards the stakeholders (Kasim et al., 2016). The role of the Shariah Committee is to supervise the bank and confirm that the products and operations are in compliance with the Shariah requirements. In the case of SNC, the Shariah Committee should advise ways to solve the issues by the provision of alternatives in compliance with Shariah for the Board to decide. SGF 2010 also stated that Shariah compliance functions, comprising Shariah review, Shariah risk management and Shariah audit functions, to perform robust monitoring of Shariah compliance. For instance, Shariah review performs a regular assessment of activities and operations towards Shariah compliance of IFIs by qualified Shariah officers. Shariah risk management ensures risk management activities (risk identification, risk assessment, risk management) to mitigate SNC risks to be in place. While Shariah audit performs periodical assessment and provides independent assurance on the degree of compliance. The scope of the Shariah audit would cover all aspects of IFIs operations, including financial statements, people, processes and information technology application systems. These functions are often being supported by Shariah secretariat, comprised of Shariah officers, to undertake the administrative and secretarial matters as well as to conduct research and vetting of the pre-product approval process.

The structure of SG, as mentioned earlier, is in line with the requirements of the Basel Committee. Basel Committee on Banking Supervision (Goodhart, 2011), as asserted by Institute of Internal Auditors (IIA) (2013), aligns the interests of stakeholders through the emphasis of three lines of defence which specify that to increase monitoring efficiency in banking operations, adequate governance structure of management (1st line of defence), control functions like compliance and risk management (2nd line of defence) and internal audit (3rd line of defence) should be established. Therefore, in the case of IFIs, Shariah Review and Shariah Risk Management are classified as the second line of defence, which oversees the activities performed by the management are in compliance with the Shariah requirements (Shafii et al., 2015a). Shariah Committee would oversee the work and evaluate the report from these functions. Whilst, Shariah Audit, in providing objective assurance, is considered as the third line of defence that ensures the overall policies and procedures of the IFIs operations are in place and consistently implemented. A report from Shariah Audit is then communicated to the Audit Committee in respective IFIs. These components of Shariah governance systems should serve as an effective tool in managing and monitoring SNC risk.

Studies also affirmed that preceding requirements underlined the importance of SG in overseeing the practices and conducts of operations and activities of IFIs are espoused by Shariah principles (Chapra and Ahmed, 2002; Grassa and Matoussi, 2014). Essentially, the main duty of SG is to promote fair and just

financial transactions that would benefit all involved parties and the prevailing focus of the organs of Shariah governance is accountability and transparency towards stakeholders in particular and *ummah* (community) in general. In addition, Khalid (2020) stipulated that presence of audit and governance committee also may enhance the effectiveness of Shariah auditors in IFIs.

2.2 Shariah Audit Practices

IFIs must abide by Shariah precepts in all their business and financial transactions. This promotes social justice, equity, moderation and a balanced relationship (Kasim, 2010). The concept of *Hisbah* was institutionalised in the early days of Islam. *Hisbah* is a religious responsibility in which its role is to uphold the truth and forbid all wrongdoings in the society. This means that those who hold the responsibility must be truly qualified so that all the Islamic guidelines can be upheld.The role of a *Muhtasib* (a member of the *Hisbah* institution) is to monitor, control and prevent the fraudulent exploitation of consumers in the marketplace. *Muhtasib* is a noun taken from the Arabic word "*Hisbah*" itself which means someone who is responsible to uphold good or *ma'ruf* and forbid wrongdoings or *munkar* in the Muslim society. In addition, the tradition of *Hisbah* relies on the concept of enjoining good and forbidding evil (Nahar and Yaacob, 2011). Hence, the *Hisbah* function is important and it reflects the accountability of the auditor not only to users of financial statements but more importantly to Allah. The *Muhtasib* is a person who has the knowledge and qualification in Shariah economics, and who is able to advise and give an opinion on certain matters and issues that are in conflict with the code of conduct and Shariah (Yaacob, 2012). In line with the preceding arguments, the presence of Shariah audit is supported by agency theory. Main objective of the agency theory is to enhance accountability through providing a fair flow of information between the principal and agent as a result of information asymmetries and differing motives. In doing so, the trust and accountability is being enforced through the work of Shariah auditor that acts as the monitoring mechanism in ensuring the truthfulness of the information provided. In fact, assurance provided by Shariah audit practices in ensuring Shariah compliance is pertinent to enhance IFIs integrity and public confidence (Abdul Ghani et al., 2019).

According to Hameed (2000), under the Islamic worldview, auditors need to attest compliance with *Maqasid al-Shariah* (Objective of Shariah), including, for instance, the *maslahah* (public interest) of *ummah* and accountability. This is in line with the objectives of SGF 2010 that is to ensure accountability, and proper oversight are done through the establishment of organs of SG functions, whereas conventional auditors only need to attest and assure compliance as well as effectiveness against international practices. This view is supported by Abdul Rahman (2008) who stated that Shariah compliance is the cornerstone of Islamic financial products and services and if customers were to find that the products that they have in their portfolio are not Shariah compliant, this would seriously undermine the confidence in the Islamic financial services industry as a whole.

The tremendous growth in Islamic finance has seen the assets under the management of IFIs grow to in excess of one trillion US dollars (Dar et al., 2012). Inevitably, there is a need to have a proper audit system in place for IFIs to continue growing and to provide an assurance that they are strictly following Shariah in all its aspects. Therefore, IFIs have greater fiduciary duties and responsibilities towards their stakeholders than conventional institutions (Abdullah and Pillai, 2010). They must comply with Shariah in aspects of their operations and management and thus Shariah audit can be seen as a process to attest Shariah compliance. A considerable number of studies have highlighted a range of issues of great concerns related to Shariah audit practices in Malaysia. These include the absence of a proper Shariah audit framework and lack of generally accepted Shariah audit standards used by IFIs, as well as an insufficient number of competent Shariah auditors in terms of qualifications, competence and experience (Ali et al., 2016; Najeeb and Ibrahim, 2014; Othman and Ameer, 2015; Shafii et al., 2014a).

The conventional auditing framework (the International Professional Practices Framework) is limited in terms of its scope in relation to auditing practices in Islamic institutions, which requires a different perspective (Kasim et al., 2009). The conventional financial audit is inadequate to fulfil the needs of the stakeholders of IFIs (Haniffa, 2010) because the International Standards on Auditing do not take into account the Shariah aspects. Haneef (1997) highlighted that there was an urgent need for Islamic economics, Islamic banking and finance and as well as accounting and auditing for IFIs to have their own frameworks and use their own criteria. Essentially, the practices in these fields require a different epistemology framework to distinguish between Islamic thought and conventional thought. The development of such frameworks should

fit the specific context of Shariah audit practices, culture, business environment, policies, and regulations. The industry was recommended to adopt a common internal Shariah audit framework as a move towards achieving standardisation and uniformity of audit practices (Yussof, 2013). After all, the absence of a comprehensive framework and different standards used in different countries often cause inconsistencies in Shariah audit practices (Alam et al., 2017; Puad et al., 2015). This can be supported by Alahmadi et al. (2017), who reported that the absence of the Shariah audit framework has caused ambiguity and inconsistencies in Shariah audit practices in Saudi Arabia. It creates a discernible gap in practices particularly in Islamic windows, which are exposed to more SNC risks compared to full-fledged Islamic banks.

In a similar vein, Abdul Rahman (2014) revealed three shortcomings in SGF 2010 and also highlighted issues related to the source of internal auditors performing Shariah audit. First, SGF 2010 requires the Shariah audit to be performed by the internal audit unit of each IFI. However, a thorough study of SGF 2010 indicated that the framework failed to adequately define the function of Shariah audit. Second, the SGF 2010 further requires the function of the Shariah audit to be carried out by internal officers who have sufficient Shariah knowledge. Again, the framework lacked in detail because it did not specify the extent or the specific areas of Shariah knowledge the officers should possess. Abdul Rahman (2014) argued that those who are educated in religious education may not be well versed in banking and finance knowledge, thus they would require additional training to undertake such a task. Third, Abdul Rahman (2014) also claimed that the function of the external Shariah auditor was purposely omitted from the framework. On a flip side, the revised SGPD 2019 stated that Shariah audit could be performed by qualified internal auditors or independent external auditors. Shafii et al. (2015b) commented that the source of the Shariah audit could be executed in three mechanisms, namely in house, outsource or co-source. Besides, the Shariah audit unit can even be an independent standalone unit, as practiced in Kuwait, Bahrain and Qatar (Shafii et al., 2015b) or a leverage model where the qualified Shariah auditors formed part of the internal audit activity. Respective model or structure would influence the degree of independence subjected to the competency level required within the specific contexts of respective IFI. In addition, Arman (2013) stated that internal Shariah audit could reduce the cost incurred and leakage of internal information, while external Shariah audit would be able to gain access to a broader range of expertise and is able to express independent opinions towards the work of Shariah compliance. Recent SGPD 2019 also supported that IFIs may appoint an independent external Shariah audit if deemed necessary.

Issues related to competencies for Shariah auditors are also discussed in other countries such as Saudi Arabia, Bangladesh, Indonesia, Pakistan and Oman (Alahmadi et al., 2017; Alamgir, 2014; Alam et al., 2017; Arwani, 2018; Muhammad and Sulong, 2019; Abdul Ghani et al., 2019). Yaacob and Donglah (2012) also found that Shariah audit practices are in need of improvement in the understanding of Shariah audit among internal auditors, enhancement of Shariah knowledge and standardisation of Shariah audit framework. Preceding studies concluded that competencies comprise of knowledge and skills are pertinent to enhance awareness among employees performing the operational duties and making decisions in the right direction. For instance, highly competent managers in the IFIs should able to differentiate the faith-based or profit-motive decisions to be made in relation to business and investment transactions. Furthermore, Shariah compliance culture could be strengthened through continuous training to all employees in IFIs (Ali et al., 2017). Lack of understanding and ignorance would become serious obstacles which might create more negative attitudes and perceptions towards Shariah compliance practices. Thus, effective training would enhance awareness and knowledge which are translated into a higher level of employee commitment towards Shariah compliant activities.

On the other hand, Kasim et al. (2009) explored the gap between desired and actual practices of Shariah audit in Malaysia. The results found that Shariah audit practices at that point in time were no different from the conventional ones due to the similarities in their process and procedures. Furthermore, the scope of the Shariah audit was restricted to product compliance. Therefore, it seems reasonable that the concept of Shariah audit should be extended to activities related to, among others, the processes, products, employees, environment and society (Sultan, 2007). The scope of Shariah audit should cover areas that could potentially result in non-compliance issues which include products and services, financial reporting, organisational structure, human resources, processes, marketing and IT (Kamaruddin and Hanefah, 2017). A study by Shafii et al. (2014b) showed that the scope of the Shariah audit has been extended to include business policies, procedures, internal control systems, and assessment of financial resources. For instance, financial statements

should constitute part of the scope in Shariah audit. The extent of recording, reporting, disclosure and internal control in respect of financial activities needs to be considered in the assessment of SNC since it may not be covered by the external auditors in the conventional financial statement audit (Shafii et al., 2015b). In short, preceding issues need to be rectified and the presence of obstacles may hinder the progress of Shariah audit practices which is explained further in the next section.

2.3 Challenges of Shariah Audit

The absence of a proper framework to govern the practices of internal and external Shariah audit in IFIs has challenged IFIs to develop their own internal Shariah audit architecture (Shafii et al., 2014b). Shafii et al. (2013) opined that it is extremely important to develop human capital to conduct the Shariah audit effectively. The authors claimed that since the commencement of the modern practice of Shariah audit, the adequacy of independence, competence, and quality of Shariah auditors have often been questioned and revisited. The study concluded that Shariah auditors should possess both Shariah and strong accounting knowledge. Furthermore, the competency and independence of Shariah auditors are greatly dependent on the source of the Shariah audit itself either sourced internally or externally (Ali, 2018) and it was indeed difficult to get the right staff with auditing and Shariah skills (Ali et al., 2016). In most cases, the team of Shariah audit would comprise of a mixed background from auditing, accounting, banking and Shariah background. Ali et al. (2016) found that mixed practices were adopted and local IFIs preferred to appoint Shariah auditors from a mixed background of qualifications, consisting of individuals from accounting, banking and Shariah background, while foreign IFIs preferred to have Shariah audit to be conducted by individuals with an accounting background.

On another note, there is a mismatch as to what is required by the banks and what is offered to the markets (Ali et al., 2015). Therefore, Ali et al. (2015) and Shafii et al. (2014a) suggested that a proper development and management of human talent is needed in order to generate an ample pool of competent and qualified Shariah compliance officers and Shariah experts who can spearhead the innovation of Islamic products and services. This would ensure access to credible experts in Shariah knowledge who would be well versed in handling Shariah-related issues and whose decisions would then influence the quality of the Shariah audit profession as a whole. Besides, continuous acquisition of new knowledge is also done through job training and attending related courses on Shariah provided by several Islamic finance training centres (Ali, 2018). According to Alamgir (2014), training is equally important to all employees in creating awareness of the needs for Shariah compliance. Moreover, it develops a continuous understanding of the Shariah issues, strengthens the belief and improves acceptance towards Shariah compliance in banking operations.

Furthermore, Najeeb and Ibrahim (2014) also highlighted the importance of professional certification or qualification in enhancing technical knowledge and professional skills in the area of Shariah requirements. The study also underlined that the presence of Shariah scholars would probably help in strengthening the extent of compliance and better handling of the issues with regard to Shariah rules and principles in determining Shariah-compliant status. In addition to that, the study by Shafii et al. (2014b) also suggested that the elements of industry knowledge and *fiqh muamalat* should be considered in the certification programme as it will promote professionalism and improve the conduct of Shariah audit in the industry.

In their study on the trends in Bahrain, Khalid et al. (2017) highlighted the importance of an independent and competent internal Shariah audit. This independence is determined by the reporting level, direct interaction with those in charge with governance, unrestricted access to information as well as appointment and removal of the head of the internal Shariah audit unit. However, the authors found that independence is not statistically significant in terms of influencing the effectiveness of the internal Shariah audit. They suggested that this finding is due to the variations in Shariah audit practice in Bahrain, where the activity can be performed by either internal or external auditors, whose scope of work differs in terms of remit. On the other hand, the authors found that competence and work performance are statistically significant in determining Shariah audit effectiveness. Moreover, in the study by Yasoa et al. (2018), management support may also contribute to the effectiveness of Shariah audit.

In short, prior studies have mainly argued that the absence of a comprehensive Shariah audit framework undermines the possibility of standardising audit practice. In addition, the level of qualifications of Shariah auditors seems to be an important issue in ensuring the future supply of qualified human capital in the Shariah audit profession. The independence of the Shariah audit function has also been highlighted as another issue

that could undermine the quality of the Shariah audit. Eventually, scarce resourceful Shariah auditors with Shariah, accounting or auditing qualifications might lead to the threats of independence which may affect the reputation and growth of the IFIs (Kasim and Sanusi, 2013). In tandem with the rapid growth of IFIs, the identified issues should be resolved as soon as possible by relevant authorities in order to ensure the robustness and integrity of IFIs.

3. Method

The empirical data for this study were collected by means of a questionnaire survey. The self-developed instrument contained five sections. Seven items in section A assessed practitioners' awareness of Shariah audit practices. Section B to D covered practitioners' perceptions of current Shariah audit practices (7 items), challenges (5 items) and future implications (7 items). The respondents were required to indicate the relative importance of all items in Section A to D on a four-point Likert scale (1: Strongly Disagree; 2: Disagree; 3: Agree; 4: Strongly Agree). Section E gathered respondents' demographic information. The questionnaire was self-developed based on prior studies and SGF 2010 and the questionnaire has been pre-tested by several practitioners and academicians as subject matter expert in order to ensure the relevance of the items. For the practitioners' awareness of Shariah audit, the current questionnaire adopted part of the questionnaire items from the studies of Kasim et al. (2009) and Mulyany (2008). The questionnaire items on the perception of the practitioners' on Shariah audit, challenges and the future implication of Shariah audit are developed after reviewing most of the relevant literature (Yaacob, 2012; Yaacob and Donglah 2012; Yaacob et al., 2013; Kasim and Sanusi, 2013; Shafii et al., 2013; Kasim et al., 2013; Najeeb and Ibrahim, 2014; Shafii et al., 2014).

Meanwhile, as for the respondents, practitioners in this study are referred to those directly involved in the control functions as stipulated in the SGF 2010. According to SGF (2010), the Shariah control functions include Shariah - audit, review, risk management and research. This study will focus only on the practitioners who are directly involved in the Shariah audit function. They were the most relevant respondents as their daily involvement in daily operations can reflect the reality of working practices. The respondents in the pre-test were instructed to assess the format of the questionnaire. Wordings in the items were not ambiguous and were relevant to the current practices.

The internal consistency of the items was assessed, and the results showed that all the items met the minimum acceptable Cronbach's alpha value of 0.7, as recommended by Nunnally (1978) and thus they were also above the value of 0.6 that is commonly accepted for exploratory studies (Litwin, 2002). Specifically, the internal consistency of the items is – perceptions of Shariah audit – 0.798, challenges of Shariah audit – 0.7 and future implications of Shariah audit – 0.62. The questionnaire was distributed to Shariah officers, internal Shariah auditors and external Shariah audit providers. The respondents (practitioners) were selected as they represented individuals who practiced and involved in daily operations and activities within the realm of Shariah control functions that fit the scope of the current study. Indeed, the respondents are relevant as they were part of three lines of defence and were expected to reflect their views or responses based on their own involvement in the real-world setting. A total of 240 questionnaires were distributed and 115 questionnaires were returned (Table 1). However, 32 of the questionnaires were excluded due to incomplete responses, resulting in 83 useable questionnaires (a 34.6% response rate). The non-response bias suggested that the late responders did not differ significantly from earlier responders which suggest that non-response bias is not a problem. In fact, self-selection bias is reduced by obtaining the responses from a different category of practitioners like internal Shariah auditors and Shariah control functions accordingly. The respondents' profiles are stipulated in Table 2.

Table 1: Response Rate

Questionnaire distribution	Total
Distributed	240
Received	(115)
Incomplete	(32)
Total usable responses	83
Response rate	34.6%

Table 2: Profile of Respondents

	Frequency n = 83	Percentage
Shariah Qualification:		
Yes	32	38.6
No	51	61.4
Organisation:		
Full Fledged Islamic Bank	12	14.4
Takaful	7	8.4
Islamic Subsidiaries	39	47.0
Consultancy, Audit Firm	25	30.1
Designation:		
Internal Shariah auditor	33	39.8
External Shariah auditor	25	30.1
Shariah officers	20	24.1
Others	5	6.0

The respondents consisted of 33 (40%) internal Shariah auditors, 25 (30%) external Shariah auditors, 20 (24%) Shariah officers and five (6%) are other respondents. Malaysia has different types of IFIs. Most (47%) of the respondents were employed by Islamic subsidiaries of local financial institutions. The remainder of the respondents is employed by external providers of Shariah audit (audit firms) (30%) and full-fledged local IFIs (14%). A total of 51 (61.4%) respondents did not have any Shariah qualifications, while the remaining 32 (38.6%) had Shariah qualifications.

4. Findings and Discussion
4.1 Practitioners' Awareness of Shariah Audit
The respondents are requested to provide the responses on the six items, adopted from Kasim et al. (2009) and Mulyany (2008) to examine their awareness of Shariah audit in Malaysia. The six items include the sources of knowing Shariah audit, party to conduct Shariah audit, qualification of Shariah auditor, scope of Shariah audit, timing of Shariah audit and appointment of Shariah auditor. Table 3 below presents the result of the awareness of Shariah audit among the respondents. The survey findings revealed that all the respondents were aware of the Shariah audit. The main source of knowledge about the Shariah audit was formal education, followed by specialised training programmes. Therefore, internal Shariah auditors are expected to respond to the development of Shariah compliance as they are expected to build up their expertise and competence in the field of Shariah audit, which may eventually lead to an overall improvement in their competencies. As stipulated in SGPD 2019, internal auditors who perform the Shariah audit function are expected to have requisite knowledge on Shariah requirements applicable to the operations of IFIs. Furthermore, Shariah auditors often constitute part of the overall internal audit function in an IFI or externally sourced. Besides, as mentioned by Ali (2018), as part of continuous development, most practitioners attend training on Shariah related courses which may simultaneously increase awareness on Shariah audit.

The finding in respect of the party performing Shariah audit indicated that Shariah audit practices in Malaysia should be dominated by internal auditors who have the requisite knowledge or Shariah qualification such as in *fiqh muamalat* as this would enable them to be truly competent Shariah auditors. In addition, the findings on qualifications also revealed that Shariah audit practices are performed by auditors who have accounting and Shariah qualifications. This is in line with the findings of Najeeb and Ibrahim (2014) and Shafii et al. (2014a), which specified the importance of both qualifications as accounting and Shariah qualifications are crucial in ensuring that auditors have a better understanding of Shariah-related issues and the risks inherent in Islamic banking transactions and operations. However, in a recent study by Ali et al. (2016) also suggested that as the industry is getting mature, it is also looking into a mixed background of qualifications. Ali (2018) felt that Shariah knowledge is something that could be acquired through hands-on jobs and continuous training on Shariah-related subjects. In fact, Khalid et al. (2018) also recommended that an in-depth knowledge of Shariah would enable the auditors to detect non-Shariah compliance activities.

In relation to the scope of the Shariah audit, it is much broader than that of a conventional audit. In line with the requirements of the SGF 2010 and SGPD 2019, the scope of a Shariah audit should cover the

financial statement, people, process, product, IT system and organisational structure, as agreed by a majority of the respondents. Interestingly, none of the respondents indicated that the financial statement should be within the main scope of the Shariah audit. Shariah auditors indeed are required to examine the financial statements to ensure that recording, reporting, and disclosure on business transactions are in compliance with the Shariah principles. This raises an interesting question regarding whether practitioners feel that Shariah auditors should focus on the current or past financial statements as the latter is the main focus of external auditors.

Moreover, with regard to the independence of Shariah auditors, the majority of the respondents indicated that the Shariah audit should be performed by an external or independent party appointed by BNM or another regulatory body. Similarly, as reported by Ali (2018), the Shariah audit could be sourced from either internal sources or external providers. The source of Shariah audit is crucial as it might influence the degree of competencies and objectivity of the auditors as the external providers would be seen as more independent (as they are not being employed by the institution) and competent (due to greater exposure of the industry). Finally, in terms of the timing of the Shariah audit, the majority of respondents stated that it should be conducted all year long in order to enable the auditor to properly report any particular instances of Shariah non-compliance.

Table 3: Practitioners' Awareness of Shariah Audit

	Freq	%
Sources of knowing about Shariah audit		
Prior knowledge from reading	10	12.0
Formal education	34	41.0
Seminar attended on Islamic issues	9	10.8
Special training programme	12	14.5
All of the above	11	13.3
Others	7	8.4
Party to conduct Shariah audit		
Internal auditor under Supervision of Shariah Committee	7	8.4
Auditors with Accounting and Shariah Qualification	73	88.0
Shariah committee	3	3.6
Qualification of Shariah auditor		
Degree/professional in accounting	3	3.6
Degree/professional in *Fiqh Muamalat*	7	8.4
Degree/professional in accounting and certification in *Shariah*	69	83.1
Other Qualifications	4	4.8
Scope of Shariah audit		
Financial statement	0	0
People, process and products	16	19.0
Organizational structure	1	1.2
IT system	1	1.2
Governance	7	8.4
All of the above	58	69.9
Timing of Shariah audit		
Periodically	25	30.1
End of the financial year	8	9.6
Throughout the year	40	48.2
As it deems necessary	10	12.0
Appointment of Shariah auditor		
Stakeholders of IFIs through AGM	5	6.0
Bank Negara Malaysia	13	15.7
Shariah audit committee of IFIs	22	26.5
New established regulatory body	43	51.8

4.2 Practitioners' Perceptions of Shariah Audit

Table 4 shows the extent in which the practitioners perceived the current practice of Shariah audit. Based on the highest-ranked mean of 60.2%, most of the respondents strongly agreed that the main focus of the Shariah audit is to ensure compliance with Shariah-related issues. The respondents perceived that Shariah audit is a monitoring and control mechanism for attesting Shariah compliance in IFIs and should be given more priority (highest mean value of 3.60). This is in line with the sole objective of IFIs establishment, which is to operate on the principles of Shariah. This indicates that the Shariah audit is crucial in achieving *Maqasid al-Shariah* (gaining *falah* [success] in this world and in the hereafter) in the activities and operations of IFIs. Therefore, a Shariah audit must be conducted to realise such objective as both the auditors and the stakeholders of IFIs are continuously following a path to achieve *falah* now and in the hereafter. This finding supports the idea discussed by Abdul Rahman (2010) and Kasim et al. (2013) which stated the importance of providing assurance on Shariah compliance by the IFIs.

Adding to that, the majority of the respondents agreed that the presence of an in-house internal audit unit for Shariah audit in IFIs is crucial. This finding supports the establishment of an in-house Shariah audit function. It can be argued that an in-house internal audit function would have a better understanding of the organisational issues, culture and practices involved in such audit. Moreover, the unit could also be an internal training platform for employees and could also ensure that the issues or risks identified remained confidential. Kasim and Sanusi (2013) discussed the importance of adequate resources of Shariah auditors; however the proper structure of Shariah audit in an IFI was explored much by other studies.

Next, the majority of the respondents agreed that there are insufficient guidelines available for use in Shariah audit practices in IFIs. The practitioners also supported the statement that the present SGF has not adequately addressed Shariah audit-related issues. In fact, 67% of the respondents agreed that the current Shariah audit practices rely heavily on the conventional framework with a few modifications made by the respective auditors. These findings support those in Abdul Ghani and Abdul Rahman (2015). Comprehensive coverage of Shariah audit practices in the SGF 2010 is crucial in ensuring standardisation of practices. The respondents also perceived that due to the absence of a specific framework, the current practices of Shariah audit relies heavily on the conventional framework, which is ingrained with a capitalistic ideology. Therefore, establishing a Shariah audit framework that follows the teaching of Islam would enhance the confidence of stakeholders that the IFIs are operating within the principles of Shariah.

In the same vein, SGF 2010 and SGPD 2019 do not specify the extent or the specific areas of Shariah knowledge that should be possessed by practitioners (internal auditors) as it requires the "Shariah audit (is) to be carried out by the officers with sufficient Shariah knowledge" (BNM, 2010; BNM, 2019). Thus, these findings are in support of the idea discussed in Abdul Rahman (2014). Furthermore, Ali et al. (2016) and Ali (2018) stated that in hiring Shariah auditors, the IFIs are currently looking into mixed qualifications, such as banking, *fiqh muamalat*, and legal with greater emphasis given into accounting and Shariah. Moreover, Shariah knowledge could be enhanced through the acquisition of knowledge in Shariah-related training.

Finally, 66% of the respondents perceived that Shariah auditors are unable to perform their work independently and do not have autonomy in communicating their reports. These findings underlined the needs to re-evaluate the internal audit charter in terms of the provisions of authority, responsibility and reporting for Shariah audit practices. This finding raises concerns about the adequacy of the authority given to auditors to complete their audit work as well as the extent of their autonomy to report any issues found to those in charge with governance. The findings in Abdul Ghani and Abdul Rahman (2015) stated that the current internal audit charter does support Shariah audit practices. Table 4 summarises the practitioners' perceptions of Shariah audit.

Table 4: Practitioners' Perceptions of Shariah Audit

No	Items	SD	D	A	SA	Mean	SDev
1.	The main focus of Shariah audit is to ensure compliance with Shariah related issues	-	-	33 (39.8%)	50 (60.2%)	3.60	.492
2.	There is presence of dedicated internal Shariah audit unit in the organisation	-	5 (6.0%)	52 (62.7%)	26 (31.3%)	3.25	.560
3.	The current practice of auditing in IFIs heavily relies on a conventional framework with few modifications	4 (4.8%)	11 (13.3%)	56 (67.5%)	12 (14.5%)	2.92	.684
4.	The newly issued Shariah Governance Framework comprehensively addresses the issue of Shariah audit function.	13 (15.7%)	29 (34.9%)	33 (39.8%)	8 (9.6%)	2.43	.872
5.	Auditors are adequately trained on Shariah compliance issues to perform their function effectively.	12 (14.5%)	31 (37.3%)	32 (38.6%)	8 (9.6%)	2.43	.858
6.	There are sufficient guidelines for Shariah audit practices to be used by all IFIs	11 (13.3%)	38 (45.8%)	24 (28.9%)	10 (12.0%)	2.40	.869
7.	Shariah auditors have autonomy to exercise their functions independently	20 (24.1%)	35 (42.2%)	21 (25.3%)	7 (8.4%)	2.18	.899

SD – Strongly Disagree; D– Disagree; A– Agree; SA– Strongly Agree; SDev– Standard Deviation

4.3 Challenges of Shariah Audit

Table 5 provides the challenges of Shariah audit. The survey revealed the presence of some major challenges in the current Shariah audit practices, specifically the poor availability of competent resources, the need to improve the existing guidelines or framework and the importance of the independent positioning of an internal audit unit in presenting its report.

The practice of Shariah audit in Malaysia is affected by a shortage of qualified Shariah auditors in terms of competency, expertise and proper Shariah qualifications. This finding is in congruence with a study conducted by PwC (2011), which showed that there is a dire need to increase the number of competent and knowledgeable Shariah auditors in Malaysia. Moreover, Ali et al. (2016) and Najeeb and Ibrahim (2014) highlighted the importance of competency requirements between Shariah qualified and non-Shariah qualified auditors.

The findings highlighted some of the challenges that could weaken Shariah audit practices, including the absence of a standalone Shariah audit framework and the absence of specific standards and guidelines for external and internal providers of Shariah audit. These findings are in line with Abdul Rahman (2010), Abdul Rahman (2014), Haniffa (2010), Kasim and Sanusi (2013), Kasim et al. (2009), Shafii et al. (2010), Shafii et al. (2013) and Yaacob (2012). There is a need for proper guidelines for effective implementation of independence and competency requirements. The lack of standardised requirements reduces consistency and makes it more difficult to measure and compare the quality of the internal and external providers of the Shariah audit.

Moreover, on the issue of independence, the respondents perceived that their function of 'providing independent assessment and objective assurance to value-add and improve IFIs' compliance with Shariah' could be violated. The respondents perceived that being internally attached to the organisations may increase self-review or familiarity threats. The absence of proper guidance on the structure of Shariah audit as well as the absence of specific Shariah audit charter could lead to the issue of independence in reporting findings of the audit report. This could influence the quality of the audit reports issued to those in charge with

governance. In fact, the findings in the audit reports could have an influence on the management. Perhaps, the current Shariah audit practices may improve on its autonomy in order to exercise independence.

Table 5: Challenges of Shariah Audit

No	Items	SD	D	A	SA	Mean	SDev
1.	Inadequate competent and well-trained personnel to execute Shariah audit function is a great threat to IFIs integrity	-	6 (7.2%)	53 (63.9%)	24 (28.9%)	3.22	.564
2.	Absence of independent framework for Shariah audit in IFIs affects its proper implementation	1 (1.2%)	11 (13.3%)	53 (63.9%)	18 (21.7%)	3.06	.631
3.	Closer scrutiny of the SGF indicates that the Framework has shown less emphasis in providing explanations of the competency requirements and the desired functions of Shariah audit	2 (2.4%)	8 (9.6%)	62 (74.7%)	11 (13.3%)	2.99	.574
4.	Absence of specific Shariah audit standard either from external auditing or internal auditing hinders effective practice of Shariah audit function	10 (12.0%)	11 (13.3%)	51 (61.4%)	11 (13.3%)	2.76	.835
5.	Internal audit unit of IFIs discloses an independent Shariah audit report.	10 (12.0%)	34 (41.0%)	26 (31.3%)	13 (15.7%)	2.51	.902

SD – Strongly Disagree; D– Disagree; A– Agree; SA– Strongly Agree; SDev– Standard Deviation

4.4 Future Implications of Shariah Audit

Table 6 presents the future implications of Shariah audit. The findings revealed the need to have an academic programme at a higher educational level in order to produce human resources with the required knowledge and skills to perform the Shariah audit function, supporting the idea discussed in Abdul Rahman (2010) and Abdul Rahman (2014). The provision of a standalone programme or the integration of a Shariah audit course into existing accounting programmes could provide an avenue for producing knowledgeable and competent practitioners, as reported by Najeeb and Ibrahim (2014). Definitely, high-calibre Shariah audit practitioners would help to improve the credibility of Shariah compliance and accountability in the activities and operations of IFIs. In addition, such programmes would supply the appropriate human resources required by the IFIs as well. Hence, the confidence of stakeholders, customers and the general public would improve substantially, as the current system is dominated by practitioners with inadequate Shariah certification may hamper for the effective practice of Shariah audit.

The findings also illustrated that making the Shariah audit a profession through the establishment of a separate regulatory/professional body would enhance the capacity to employ 'the right type of people' as practitioners. Moreover, to increase the greater number of competent Shariah auditors, immediate attention for a future pool of resources with the help of higher learning institutions and higher recognition through the introduction of professional certification is highly demanded. Furthermore, it is important to ensure that on-going or continuous professional development or education is provided to help auditors keep up with changes or developments in the industry. Employability skills should be one of the key criteria for employment as a Shariah audit practitioner in an IFI.

The majority of the respondents agreed that there is a need for a more comprehensive audit framework in order to ensure that there is a standardisation of Shariah audit practices between external and internal providers in the future. This would also simplify the assessment of the performance of auditors based on either a ranked or star system. In fact, a comprehensive Shariah audit framework and standard guidelines would make IFIs entirely different from their conventional counterparts as they would follow Shariah requirements in all their dealings and work independently towards satisfying the purpose of their existence. In addition, the availability of standards and guidelines would provide clear criteria for entry into the Shariah audit profession, thereby harmonising the practice as well as bringing practitioners into a professional cadre.

Attaining these goals would enhance and preserve the confidence of the various IFI stakeholders that the operations and activities of the IFIs are in line with the principle of Shariah. Furthermore, the findings of this study demonstrated the need to establish a new regulatory/professional authority, separated from the BNM, to oversee Shariah audit practices. This new authority could be in charge with regulating the profession, services, ethical conduct and welfare of its members. This authority could also enhance the performance of practitioners and promote healthy competition among the IFIs in rendering excellent Shariah-compliant services, in line with Najeeb and Ibrahim (2014) and Shafii et al. (2014a). Finally, the provision of standard guidelines and a framework, as well as the establishment of an independent professional body to oversee the activities of IFIs would make Shariah audit more of a profession, in line with other professions, and these practitioners would have adequate scope and autonomy to discharge their functions diligently with professionalism.

Table 6: Future Implications of Shariah Audit

No	Items	SD	D	A	SA	Mean	SDev
1.	Competence of Shariah audit practitioners could be improved through training, workshops, seminars and others alike	-	1 (1%)	46 (55%)	36 (44%)	3.42	.521
2.	The potentials of Shariah audit as a marketable career in the near future are very bright	-	3 (4%)	52 (62%)	28 (34%)	3.30	.535
3.	Offering academic programme in higher learning institutions on Shariah audit could help in providing educated Shariah auditors	-	2 (2%)	54 (65%)	27 (33%)	3.30	.512
4.	A professional body in charge of Shariah auditing should be established and given the responsibility of issuing professional certificate just like ACCA and CIA	-	5 (6%)	52 (63%)	26 (31%)	3.25	.560
5.	Future of Shariah audit depends heavily on a comprehensive Shariah audit framework and standard guidelines to be used in its practice	-	9 (11%)	58 (70%)	16 (19%)	3.08	.546
6.	To achieve uniformity, the performance of IFIs based on Shariah compliance should be ranked by using a (3-star system***)	3 (4%)	11 (13%)	59 (71%)	10 (12%)	2.92	.629
7.	The current practice of Shariah audit in Malaysia signifies that the future of Shariah audit is at stake	11 (13%)	38 (46%)	33 (40%)	1 (1%)	2.29	.708

SD – Strongly Disagree; D– Disagree; A– Agree; SA– Strongly Agree; SDev– Standard Deviation

5. Conclusion

The role of Shariah audit is to uphold Shariah principles and values and to ensure the compliance of IFIs' operations in offering Shariah-compliant services. The monitoring activities of Shariah audit are intended to safeguard the interests of the stakeholders of IFIs, namely account holders, shareholders, creditors, management and employees as well as the community at large. Shariah audit ensures that there is an adequate mechanism of checks and balances in place that is tailored to the objectives and missions of its establishment as per the *Maqasid al-Shariah* (Yaacob and Donglah, 2012).

This study examined practitioners' perceptions on the extent of the current Shariah audit practice in Malaysia several years after the implementation of the SGF 2010. The diversity of practitioners as the respondent is considered as part of theoretical contribution since limited studies applied similar respondents. Being those in charge of control functions in Shariah governance, they are most relevant due to their daily involvement in the reality of working practices. The findings showed that there is a dire need to establish a standalone Shariah audit framework to cater for the increasing number of IFIs in Malaysia. The findings also revealed that relevant qualifications apart from Shariah knowledge for the said function are greatly needed to be improved. Hence, this study will help practitioners to understand the type of competencies and qualifications that are expected of them. Then, hopefully, Shariah audit will be developed to the professional

level just like its counterpart, conventional audit. The study also provided an insight in terms of the role that the educational sector can play in integrating Shariah audit into the auditing curriculum, a step that is long overdue. Moreover, the findings of this study drew attention to some emerging issues and challenges in current Shariah audit practices. Particularly, the Shariah audit should strengthen its independence through approved functional reporting and autonomy, which should be stated clearly in the internal audit charter. This is crucial as it would influence the extent of the authority and autonomy of Shariah auditors in conducting audit work as well as in reporting their audit findings. In addition, IFIs also need to reassess the needs to establish a designated internal audit unit and capitalise on it as part of the internal training platform for their employees.

Some practical implications are offered that might be considered by relevant authorities and other stakeholders involved in making policies to uphold and protect the integrity of this emerging profession in order to safeguard its future. First, financial statements being part of the Shariah scope should be emphasised further as Shariah compliance aspects may not be considered by the internal or external auditors in its routine financial statement audit. Second, the presence of Shariah auditors is greatly needed; however, the best structure or model of Shariah audit activity would greatly depend on the needs and capacity of the respective IFI. The selected model may determine the extent of its independence and competencies. Third, the establishment of the Shariah audit framework would standardise the practices and ensure the quality of work performed by either internal or external providers.

Moving forward, in order to upgrade Shariah audit practices, priority should be given to the 1) provision of a standalone Shariah audit framework to complement the requirements of SGF 2010 and SGPD 2019; 2) providing proper Shariah guidelines and procedures for auditing; 3) establishing a separate regulatory/professional body to oversee the activities of IFIs; 4) offering an approved academic programme on Shariah audit as a course like other courses in institutions of higher learning or integrating Shariah audit into existing auditing programmes; 5) organising regular workshops, seminars, and training for both potential and existing Shariah auditors; 6) setting up a professional body similar in form of other professional bodies like the Association of Chartered Certified Accountants (ACCA) and Certified Internal Auditors (CIA by IIA), as suggested by Najeeb and Ibrahim (2014), where this professional body is given the responsibility to offer a professional certificate in Shariah audit; and finally, 7) revisiting the terms and references within the internal audit charter and its structure in respect of Shariah audit practices.

It should be noted that the findings and conclusions drawn in this study are subject to several limitations in respect of the respondent selection procedure, descriptive statistics and questionnaire survey used. Thus, future studies could cover the same group of respondents but using an interview or mixed-mode method (questionnaire, interview, and document review) in order to fully gauge practitioners' perceptions of Shariah audit practices. Moreover, a document review could contribute to a more in-depth understanding of the actual practices adopted by internal and external providers of the Shariah audit in Malaysia. In addition, future research could explore the suitable model of Shariah audit that is highly recommended given the specific context of the IFIs as well as the extent of coverage on Shariah audit practices in internal audit charter.

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