



Competency of Shariah Auditors in Malaysia: Issues and Challenges

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Abstract

Over the last decade since the inception of the first Islamic bank in Malaysia in 1983, Malaysia saw an increasing demand for Islamic banking services from consumers. Whilst the need for highly trained and skilled manpower in the Islamic banking industry is well established, the main challenge is really a mismatch of talent pool between what is required by the banks and what is offered by the market. Thus, this paper argues for a competency framework for shariah auditors in Malaysia. Prior research reveals that the competency requirements for shariah auditors were still not developed even though there is a need for it. A more recent empirical study reveals that most shariah auditors are either trained in shariah or auditing discipline. There is indeed an urgent need to draft the competency requirements which will include the knowledge, skills and other characteristics (KSOC) requirements to ensure adequate supply of competent shariah auditors to meet the expanding market demand. This paper proposes a new KSOC model as a basis for competency framework for shariah auditors that can uphold their effective functioning in our Islamic banking system.

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Keywords: Competent, knowledge, shariah auditor, skill, training

1. Introduction

The increase awareness for Islamic financial products encourages the demand for robust Islamic financial institutions (IFI) which leads to the rise for Islamic banks in Malaysia. Whilst conventional banking institutions have gained trust from the general public, the popularity and widespread use of Islamic banks (IB) has expanded in recent years. The Malaysian International Islamic Financial Centre (MIFC), a division of Bank Negara Malaysia (BNM) shows that as at 12 September 2013, the liquidity position of Islamic banks is only RM 3.7 billion as compared to RM28.3 billion of those in conventional banking (www.bnm.gov.my). This is indeed a discouraging scenario bearing the fact that according to the Population and Housing census in 2010, 61.3% of Malaysian population are Muslims (Department of Statistics Malaysia, 2014).

The Ernst & Young World Islamic Competitiveness Report 2013-2014 has also estimated that Malaysia's international Islamic banking assets are anticipated to raise to more than US\$390 billion (RM1.27 trillion) by 2018 from US\$125 billion (RM410 billion) in 2012 (Bernama, 2014). In addition, according to an industry publication, the Global Islamic Financial Review, over the past 30 years, the Islamic financial sector has grown from practically nothing to over RM1.6 trillion in assets. The financial crisis has also boosted the growth in Islamic financial industry where the industry assets has grown 19% and 21% respectively in 2011 and 2012, compared to less than 10% increase in non-Islamic banks all over the world (Popper, 2013). This indicates that the Islamic financial industry has been accepted by users worldwide, thus presents a huge potential for the Islamic financial provider to prosper.

However, as an IFI, an Islamic bank is envisaged to emulate Islamic values in all aspect especially to the eyes of its stakeholders. Any Islamic corporation specifically IFI needs to have a reliable governance model

and proper strategies that will encourage the implementation of robust and effective corporate governance (CG) within the Islamic environment (Hassan, 2010). Islamic banks have stakeholders such as Investment Account Holders (IAH), shareholders, creditors, management, employees and community at large. Each of them has strong interest with regards to the IBs continuity to uphold the *Shariah* principles and values. One way to safeguard the interest of these stakeholders is by ensuring shariah-compliant operation and offering *Shariah* compliant services. To do so, a shariah audit is performed to ensure that the IBs can uphold the shariah governance and at the same time increases stakeholders' confidence in the system.

The conventional audit on the financial statement has long been associated to independent verification on whether the institutions' financial statement has been presented with true and fair view (Eilifsen, Messier, Glover & Prawitt, 2011). To establish this, the auditors need to have the competency which comprise of knowledge and skills to apply certain techniques to verify their client's financial statements. The function of shariah audit from the Islamic perspective is much more important and delicate as it manifests the accountability of the auditors not only to the stakeholders, but ultimately to the Creator, Allah s.w.t. The Muslims believe that one's actions and thoughts are always being watched by Allah (the concept of *Muraqabah*). It is the fundamental of Islam with the edict that "...surely Allah will take account of all things" (*al-Quran, An Nisa'* : 86). In considering the rapid growth of the Islamic market, it is crucial for the Islamic financial industry to have an adequate 'check and balance' mechanisms in the form of shariah auditing consistent with the objectives and missions of the '*maqasid al-shariah*' or the objectives of Islamic law (Yaacob & Donglah, 2012). The key objective of '*maqasid al-shariah*' is the recognition of benefits to the people (*maslahah* of the *ummah*), relating to their affairs both in this world and the hereafter (Laldin, 2006) as oppose to merely maximizing profit which are the goals of conventional banking institutions.

According to the Shariah Governance Framework (SGF), introduced by BNM in 2010, shariah audit is defined in para 7.7 as:

"periodical assessment conducted from time to time, to provide an independent assessment and objective assurance designed to add value and improve the degree of compliance in relation to the IFI's business operations, with the main objective of ensuring a sound and effective internal control system for Shariah compliance" (BNM, 2010; p.23).

Despite the importance of shariah auditing, there has been little understanding on how to train and groom qualified shariah auditors who can perform an effective and efficient audit. One notable guideline available is from the SGF where it states that shariah audit shall be conducted by the internal auditors of the IBs who have acquired sufficient shariah related knowledge and training. In essence, the SGF suggests that the competency of shariah auditors is similar to the competency requirement of internal auditors but with additional training in shariah matters. This is acceptable for now since specific training in shariah audit is not available in higher learning institutions. Hence, this research reviews prior works on shariah audit and human capital development and suggests the elements necessary in a competency framework for shariah auditors that can be used by higher learning or training institutions to develop curriculum or module.

2. Relevant literature

2.1. Definition of competency

The many facets of competency being defined by the previous researchers is summarised by Woodruffe (1993). Competency can be classified as a dimension of behaviours which are related to the superior job performance where certain people conduct better than others. In addition, competencies are also linked to technical skills, skills and knowledge to perform job particularly jobs with professional element. Moreover, competency can be generic or organization specific. Organization specific competency refers to competencies related to certain managerial roles; list of universal competencies for top management as well as supra competencies (such as planning and organizing).

Another interesting elaboration of the definition of competency was discussed by Hoffmann, Consulting and Waverly (1999) study where they argued that such term was viewed differently by different professionals such as psychologists, management theorists, human resource managers, educationists or even politicians. The same verb can also be assessed in the form of observable performance or the learning processes' output, as a standard or quality of outcome or simply referring to the attributes of an individual's

such as their knowledge, skills or abilities i.e. focusing on the inputs of an individual in order for them to produce competent performances.

Whilst study in Australia and US concentrated on the human aspects of competency, a much later study by Drejer (2001) viewed competencies in four (4) different aspects namely competencies in the form of technology i.e. referring to the physical tools; human beings as the focal point for competence development and using the tools; organization as which the prescribed management systems under which the individual operate and informal organizational culture of the companies.

Hence, based on the various definitions, ‘competency’ can be viewed as human being capabilities or expectation to perform certain tasks in an organization as well as the capabilities of a particular organization through their tools or system to perform certain function in ensuring the continuous operation of the organization. In light of shariah auditor’s competencies, there are certainly shariah auditing specific competencies that need to be mastered by the auditors in order to ensure maximum performance can be delivered to the bank’s stakeholders.

2.2. Professional Competency

From the accounting profession perspective, the International Federation of Accountants (IFAC) guidelines on International Education Standard (IES) 8 on Competence Requirements for Audit Professional outlines that an auditor needs to have formal audit education (knowledge) (IES 2), professional skills (IES 3) and able to apply professional values, ethics and attitudes to different situations and organizations (IES 4). Based on these guidelines, it is suggested that competency is a combination of relevant attributes such as knowledge, skills and attitudes (IFAC, 2014). These three elements form the basis of measuring general competencies of auditors.

The IIA Research Foundation (IARF), which is part of the Institute of Internal Auditors which govern the internal auditing profession worldwide has also undertaken a comprehensive research in 2011 to 2013 to obtain stakeholders’ views on internal audit competency. The competencies from this research reveals two (2) different perspectives i.e. competencies rated higher or lower and competencies showed largest rating gap between the stakeholders and the internal auditors. It was found that the higher ratings for components of competencies were ethics, confidentiality, objectivity and professionalism as opposed to lower ratings for negotiations skills, business process analysis and data collection and analysis tools and techniques. On the other hand, aspects in which the stakeholders gave internal auditors a significantly lower rating than the internal auditors themselves was understanding the nature of the business, business process analysis and problem solving skills. It is quite interesting to view that in some areas such as the perception on the overall performance of the internal auditor, the stakeholders view the internal audit performance higher than the internal auditor themselves (IARF, 2013).

In order to ensure companies’ internal auditors keep abreast with the changes in their working environment, several internal auditing competencies were outlined by Pickett (2000). Companies need to define their own competencies and build in-house programs as part of continuous development activity. In addition, Pickett (2000) suggests that competencies can be achieved from the interactions of three factors, called ‘the three circles approach’ which are the auditing standards, audit products as well as the organization’s risk management strategy. Whilst audit standard set boundaries within which work should be performed, audit products refers to the service that are delivered, the organisation’s risk management refers to where the audit role suits in by adding values to the reliability and integrity of risk management. Pickett (2000) also opined that companies must send their internal audit staffs for training as competencies need to change in line with changes in the working environment.

2.3. Islamic-based Human Competency

There is a need for adequate supply of competent human capital in order to uphold the authenticity of Islamic financial products and services (Laldin, 2011). Competency issue from the Islamic worldview is described by Laldin (2011) as the need to ensure the availability of human capital in the form of human talent management to generate ample pool of competent officers and Shariah experts are crucial to spearhead innovation of Islamic financial products and services.

A holistic approach to the human capital competency as the basis for mismatch skills within the Islamic and conventional financial services industry was performed by Natt, Al-Habshi and Zainal (2009). Their findings reveal the existence of different standards in terms of training programs; effectiveness of training programs measured by the individuals' employee key performance indicators (KPIs); new recruits of different institutions requires different set of generic or specific skills or competencies and institutions have different preference when it comes to recruiting new staffs ranging from discipline-specific such as banking and finance to a much broad-based discipline such as economics or human resource. As the trainings of these IFIs seem to be driven towards achieving individual institutions, it is highly suggested that Islamic Financial Services (IFS) establish an industry-wide standard on training and human capital development. Only a holistic perspective on human capital can produce a well-balanced knowledge worker who is not only competent academically but most importantly possess sound knowledge and sturdy commitment to the fundamentals of Islamic teachings and principles (Natt et al, 2009).

In addition, there is a challenge for future accounting graduate to understand the different adoption of standards in the Islamic accounting world as different standards have been adopted differently by different Muslim countries. For instance, study by El Razik (2009) shows that cultural and business environment effect on the choice of accounting standard in the Muslim countries. Hence, in order to produce competent graduates in Islamic banking, we would expect graduates from Malaysia to also understand International Accounting Standards as well as standards adopted by other Muslim countries if they wish to work in other countries besides Malaysia. To meet this increasing demand for manpower, institutions of higher learning and the IFIs are urged to initiate new programmes and training for Islamic banks.

2.4. General competency dimension

Competency issues have also been discussed by scholars in various disciplines. It is regarded as a tool to cope with organizational change where new demanding tasks and development in technologies requires employees to continuously updating their knowledge and training (Heilmann, 2007) whereas Boyatzis (2009), on the other hand, find that cognitive intelligence competencies coupled with emotional and social intelligence respectively can predict effectiveness in professional, management and leadership roles in many sectors of society.

A local research focusing on the training and development of human capital in the Islamic Banking (IB) industry in order to improve staff's competency was performed by Dewa and Zakaria in 2012. Their study proposes the emphasis be made in the area of enhancing Shariah knowledge of practitioners as this is where their niche lies. They also postulate that highly trained employees whose career development are effectively managed by the company prone to demonstrate high levels of commitment, flexibility, invariably multi-skills and produce significant contributions to the quality of services the bank offers. The findings are consistent with Mustafa Kamil and Che Mohd Salleh (2013) who assert that having competent human capital resource within the right time and workplace may ensure the sustainability of the IFIs in the industry.

Since employers would reap the benefit of having competent worker which may translate into better performance of the organization, investment on human resources should be encouraged. To further elaborate the importance of human capital in an organization, Cheng, Liu and Chien (2009) in their longitudinal studies on human capital and audit quality, reveal that higher investment in human capital corresponds to higher level of auditor quality. Shafii, Salleh and Shahwan (2010) also stress that successful audit depends on the strength of human resources such as having competent and credible expertise to set the work plan and reviewing the result. There is also a strong need for proper training on *Shariah* concepts since most of the bank officers are trained from conventional background, thus they do not understand how to apply Shariah concepts and run the risk of providing the wrong explanation on the banking products to their customers (Abdul Rahman, 2006). Hence, there is a challenge for scholars and academicians to ensure the current as well as future accounting graduates are exposed to *Shariah* knowledge before they embark on the job market. This argument is supported by a PwC survey in 2011 and Abdul Rahman (2006) which suggest the need to expand the talent pool with shariah audit knowledge and competencies. Hence, previous empirical findings seem to suggest that there is a need to integrate shariah audit as part of curriculum offered to the accounting students.

Another empirical longitudinal case study presented by Hussain and Parker (n.d) on the issues of selection and training of shariah advisors in the Pakistan IFIs discovered that there was limited pool of competent shariah advisors who may be serving multiple IFIs, contravening the government banking regulation, thus creating conflict of interest. The dual role of external and internal religious auditor performed by the shariah advisor is also heightened to have led to the potential of conflict of interest in the IBs. The researcher recommended that there are dire needs for the Pakistani government as well private sector to invest on educational facilities in order to expand the number of qualified shariah advisors and to develop further regulation to govern the shariah audit issue.

Kasim and Mohd Sanusi (2013) examined the perspective of practitioners who are involved in the process of shariah auditing from IFIs in Malaysia on the issues of auditors' qualifications. The findings disclose that only 5.9% of the respondents are qualified in both shariah and accounting or auditing qualifications (mostly internal auditors and management of shariah division) as compared to 69% who claimed to practice shariah auditing in IFIs in Malaysia. Another recent research which supported the findings was performed by Mahzan and Yahya (2014) using a survey involving 158 internal auditors in IFIs that offer IB products. Although the majority of the respondents (39%) have 10-20 years of general banking experience, only 6% of them have 10-20 years in Islamic banking and finance working experience. It is also alarming to note that the research also reveal that the majority of the respondents i.e. 76% of the internal auditors who perform the shariah audit have no Islamic Banking and Finance and Shariah qualification. This situation clearly shows how human capital development in terms of having more competent internal auditors with shariah knowledge is at a critical stage. The finding of the recent study is consistent with the previous studies that the issues of insufficient competent shariah auditors is still unresolved and may affect the reputable image of the IFIs to the Muslim stakeholders as well as other financial service users.

Hence, internal auditors attached to the IFIs must not only possess auditing skills but also additional qualification which is shariah knowledge in particular Fiqh Muamalat in order to ensure comprehensive shariah audit has been performed and overall IFIs operation is shariah compliant.

3. Shariah Audit Process

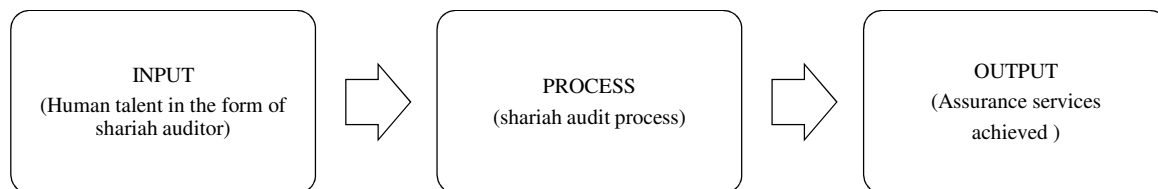


Figure 1: Shariah Audit Process

Figure 1 provides the schematic overview on the shariah audit process. The objective of the shariah audit process is basically a shariah compliance products or services, satisfying the stakeholders' needs as a whole and ultimately complying with the Maqasid Al-shariah, which aims to realise the public benefit and removes hardship and harm (Lahsasna, 2013). At the beginning of the process, the 'Input' consists of few aspects such as resources; human capital and regulation have to be injected in order to ensure the success of the whole process. The focus of this paper is on the 'Input' aspect, specifically the competency of human capital to perform the shariah audit process. In the next section, this competency will be elaborated in detail as to encompass knowledge, skills and other characteristics which is abbreviated as KSOC throughout this paper. The outcome of the shariah audit process is the 'Output' while the process includes audit planning, review, audit documentation and submitting the audit report. The feedback of the whole process shall be reviewed and continually adjusted to ensure the 'Input' or 'Process' can lead a better 'Output'. In a shariah audit, only when such audit manage to achieve the *Maqasid As-shariah* and satisfy the stakeholders' needs of the IBs, then only the desired 'Output' in the form of assurance service is said to have been achieved or delivered successfully.

4. Competency requirement for Shariah auditors

Figure 2 provides the schematic overview on the proposed elements of KSOC model on competent shariah auditor from this paper point of view. The following paragraphs provide detail discussion on each of the element.

Knowledge – in general refers to the basic understanding of a person over something be it an information or a certain process. In the context of Shariah auditor, the acquired knowledge can be general and specific knowledge. A general knowledge can be referred to the formal curriculum based on the syllabus that a graduate would obtain throughout their university years.

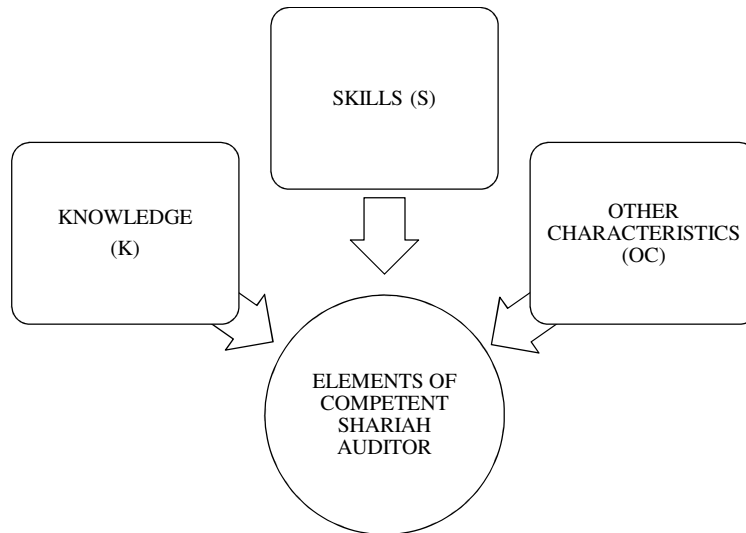


Figure 2: Proposed elements of KSOC model

As for a Muslim worker, Natt et al. (2009) propose that a well-balanced worker need to have both acquired and revealed knowledge. Whilst acquired knowledge refers to a formal education that a Muslim has obtained through years of learning in schools, the revealed knowledge refers to the primary source of knowledge as revealed by Allah s.w.t. Only when both type of knowledge are embedded in the human capital development and training programs, then only a competent and well-balanced knowledgeable Muslim worker is created and ready to serve in the Islamic financial services industry.

The acquired knowledge for shariah auditors in Malaysia can be categorized into two types i.e. general and specific knowledge. General knowledge obtained by having university education. With this regard, the local universities contributed in generating graduates majoring in various disciplines related to human resources needs in Islamic banking particularly Banking, Accounting, Finance and Shariah. The unpleasant part is however, currently, only one local university in Malaysia is offering shariah audit as part of its accounting degree curriculum which is the Islamic Science University of Malaysia (USIM). USIM also offers Fiqh Muamalat as well as shariah audit (*Al-Tadqiq Al-Shari'e*) to their accounting students. Even though the Islamic International University (IIUM) provides strong foundation on Islamic financial product through it Fiqh Muamalat and Islamic Accounting subjects to their Accounting undergraduate but no shariah audit course is specifically taught to their student. Hence, we would expect these graduates to be equipped with knowledge on auditing and regulatory standards as well as shariah concepts. Nevertheless, bearing in mind the small number of undergraduate produced by USIM and the fact that not all accounting students from USIM are interested to join the Islamic banking workforce, we would expect the market to have deficiency for new shariah auditor. Knowing shariah aspects of the IB operation is a prerequisite but that alone is not enough as the person bestowed with such designation as shariah auditor need also to internalise the shariah concept in their life, then only revealed knowledge is said to have been achieved.

Currently, the only specific knowledge to develop competent shariah auditor is in the form of training at local training agencies. Some of the agencies which provide training are Institute of Banking and Finance Institution (IBFIM), International Centre for Education in Islamic Finance (INCEIF), Centre for Research and Training (CERT) and RED-money (IBFIM, 2014; INCEIF, 2014; CERT, 2014& RED-Money, 2014). IBFIM for instance has developed Certified Qualification in Islamic Finance (CQIF) which consists of three (3) levels, namely core, intermediate and advanced level. An assessment will be conducted at the end of each level to assess the candidates understanding and ability to relate the knowledge gained to practice in the IBs (IBFIM, 2014). However, except for IBFIM, at the moment, the training programmes can be argued to be unstructured.

Every profession has its own body of knowledge. Examples are the medicine and legal fraternity. The internal auditor through its Institute of Internal Auditors Research Foundation (IIARF) has also conducted a worldwide survey to determine their common body of knowledge (CBOOK) in 2006 and 2010 over internal auditors to document how internal auditing is practiced of which one of the focus areas is knowledge of the internal auditors (IIARF, 2010). The five (5) main areas of knowledge with regard to competencies to perform work for internal auditors identified by CBOOK are auditing, ethics, fraud awareness, internal auditing standards and technical knowledge of the industry.

Albeit various trainings in Shariah audit provided by these trainings institutions, the onus to ensure that IBs shariah internal auditors responsible for auditing the IBs have the right skills, knowledge and other capabilities to perform shariah audit competently lies on the top management of these IBs. Without such support and continuous empowerment from them, shariah audit in a true sense cannot be internalized by these shariah internal auditors throughout their performance.

Skills refer to the ability of an individual to apply knowledge and apply such know-how to complete tasks and problem solving. Hoffman, Hampe and Muller (2010) described skills in the form of cognitive involving the use of logical, intuitive and creative thinking or practical i.e. involving manual alertness and the use of methods, resources, kit and instruments. Technical and communication skills are considered crucial by Woodruffe (1992) as part of being a competent worker. As for shariah auditor as the internal auditor in an IB, being able to apply the shariah knowledge in form of knowledge on the IB products allows them to understand the flow of transactions that have occurred in their organisation, thus being able to detect any shariah non-compliance products or activities. To do so, the shariah auditor's knowledge needs to surpass the conventional internal auditor's knowledge on the banking operations.

CBOOK 2010 as mentioned earlier also affirms that skills used by internal auditors have constantly evolved and transformed to meet the challenges of conducting new types of audit. It also classified skills into two (2) categories i.e. technical and behavioural skills respectively. The five (5) main technical skills identified by CBOOK 2010 are understanding business, risk analysis and control assessment techniques, identifying types of controls; governance, risk and control tools and techniques besides business process analysis. On the other hand, the five (5) main behavioural skills identified by CBOOK 2010 are confidentiality, objectivity, communication, judgement besides governance and ethics sensitivity (IIARF, 2010).

Other characteristics – refers to behavioural factor of a person which could be a trait and certainly differs between individuals (Hoffman et al., 2010). Recruitment stage for junior shariah auditor would be able to trace certain traits from the potential candidates through psychology test which is a normal process for many organizations who wants only the best candidates to fill in the professional vacancy. As for IBs in Malaysia, certainly such characteristics can be built in through two stages i.e. continual training on the analytical and interpersonal skill such as problem identification and solving skills, verbal and written communication skills as well strict screening of graduates upon joining the IBs workforce. Newly appointed graduated will be trained as junior shariah auditor for few years before they can be appointed as shariah auditor.

In general, the integration of these three (3) elements is argued to be able to produce a competent shariah auditor regardless whether the person is an external or internal auditor to the Islamic financial institution. A competent shariah auditor need to firstly have specific and general knowledge in shariah, audit and fiqh muamalat in order to perform certain checking over the documentation in the bank that they are working. Currently, the general knowledge obtained through university education is not sufficient because only one university offers shariah audit education as part of the graduates' curricula.

5. Conclusion

This paper provides an overview on the current issues on competencies of shariah auditor in Malaysia. A review of the literature on competency and shariah audit unveil that knowledge requirement for the shariah audit is not yet to be established. In practice, shariah audits are currently performed by the internal auditors of the IBs based on the Shariah Governance Framework. However, empirical evidence suggests that majority of the shariah auditors in IBs are inexperienced and have no professional or academic qualifications either in Islamic banking or shariah (Mahzan and Yahya, 2014). In addition, prior studies have not identified the specific knowledge, skills and other characteristics (KSOC) required for shariah auditors to perform the shariah audit function effectively. This situation warrants the formulation of KSOC or a common body of knowledge (CBOK) for shariah auditors. By doing so, the market will have a clear understanding of the requirements for a competent shariah auditor and develop a certification process for shariah auditors. Hence, the shariah auditing profession can attain its stature in the market.

As an immediate measure, we recommend the shariah auditors to have more exposure through shariah certified training programs conducted by established organizations such as IBFIM continuing professional development (CPD) from professional bodies such as Malaysian Institute of Accountants (MIA) apart from in-house trainings provided by the senior shariah auditors in the respective IBs. In addition, it is also timely for higher institutions of learning to consider adding shariah audit coupled with other Islamic finance courses into the curriculum for an undergraduate degree to prepare the graduates towards becoming future shariah auditors.

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