Shariah Audit: Evidence & Methodology in Islamic Finance

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Abstract:
The growth of Islamic finance industry has attracted the attention of many around the globe. Both practitioners and academicians are looking into the mechanism and structure of this nascent field. This attention has gained momentum after the global financial crisis. One may observe that this growth is accompanied by a parallel growth in the related field of Islamic accounting as well as Islamic or Shariah audit. However, whereas studies in Islamic accounting are being conducted at a greater speed, Shariah audit has remained an untouched area of research so far. The current study is, therefore, an attempt to touch upon different aspect of Shariah audit, starting from its definition, its Islamic foundations, the current state of affairs and challenges, as well as its evidence and methodology, consisting of three phases including planning, examination and documentation. Conclusions and recommendations for different stakeholders of Islamic finance industry have been given at the end of the paper. Thus, this paper contributes to the scant literature on Shariah audit by touching both its theoretical aspects as well as some practical aspects that can assist those involved in carrying out the duty of Sharaih audit.

Key Words: Audit, Shariah Audit, Hisbah,
1. Introduction:
The present research paper is focusing on Shariah audit evidences and methodology in Islamic finance. The paper is an attempt to deliberate some related aspects and issues pertaining Shariah audit which is still regarded as emerging field of knowledge in Islamic finance.

2. The Nature of Accountability in Islamic finance
Accountability for all actions and even intentions of the human beings appears a recurrent theme in the Holy Quran. To begin with, the question of how human accountability will take place, a verse in Quran explains that, “while (appointed) over you there are watchers, who are noble, writers (of the deeds), who know whatever you do.” (Al-Infitaar: 82/11-13) Broadening the scope of responsibility to include even intentions, another verse contains that, “To Allah belongs what is in the heavens and what is in the earth. If you disclose what is in your hearts or conceal it, Allah shall hold you accountable for it; then He will forgive whom He wills and punish whom He wills. Allah is powerful over everything.” (Al-Baqarah: 2/284) Perhaps the most glaring example of how deep and encompassing this accountability by God is: “He knows the treachery of the eyes and whatever is concealed by hearts.” (Al-Momin: 40/19). In a nutshell, this vast accountability is the direct outcome of the concept of Tauheed (the confession of the omnipotent authority of God), as has been beautifully expressed in verses like: “Allah takes careful account of all things.” (Al-Nisa: 4/86). “Then shall anyone who has done an atom’s weight of good, see it! And anyone who has done an atom’s weight of evil, shall see it!! (Al-Qariah: 99/7-8).

Apart from a general sense of accountability for everything, Quran also touches upon one important aspect of accountability; the financial accountability. More interestingly, it is easier to find some indications in Quran for its specific focus on financial accountability. It is because human beings love wealth and are materialistic by nature: “and in his love for wealth, he is very intense.” (Al-Aadiat: 100/8). Another verse also throws light on the greedy nature of humans in detail: “It has been made attractive for people to love the desired things; that is, women, children, hoarded heaps of gold and silver, branded horses,
cattle and tillage. That is an enjoyment of the worldly life; but with Allah lays the beauty of the final resort. …” (Aal-Imran: 3/14) Therefore, it is the demand of this natural lust for wealth and material that human beings should be repeatedly reminded not to forget that they are “trustees” and that any violation in what they have been entrusted with might result in unpleasant consequences for them. In this regard, some of the verses which stress upon fulfilling financial “trust” and avoiding financial distrust include: “Whoever misappropriates shall bring forth, on Doomsday, what he misappropriated. Then, everybody shall be paid, in full, for what he has earned, and they shall not be wronged.” (Aal-Imran: 3/161) “Do not eat up each other's property by false means, nor approach with it the authorities to eat up a portion of the property of the people sinfully, while you know (that you are unjust in doing so). (Al-Bakara:188) “Give the measure and weight in full, and do not make people short of their things, and do not make mischief on the earth after it has been set in order. That is good for you, if you are believers.” (Al-Aaraf: 85) “Give full measure when ye measure, and weigh with a balance that is straight.” (Al-Israa: 17/35) “Woe to the curtailers who, when they measure something to receive from people, take it in full, and when they measure or weigh something to give it to them, give less than due. (Al-Motaffifin: 83/1-31). Thus it can be seen that Quran elaborates on the issue of both general and financial accountability to a great extent.

The above mentioned Quranic injunctions and emphasis on accountability were practically implemented in the early Islamic period by the Prophet peace be upon him. Numerous instances can be quoted in this regard. For instance, the Prophet peace be upon him stressed “individual” accountability in these words: “Beware that every one of you is a shepherd and everyone is answerable with regard to his folk. The caliph is a shepherd over the people and shall be questioned about them. A woman is a guardian over the household of her husband and his children and has to be questioned about them. A slave is a shepherd over the property of his master and shall be questioned about it”. Then the Prophet, may peace be upon him, added: “beware that every one of you is a guardian and every one of you shall be questioned with regard to his trust”. The words of this hadith explicitly make each individual responsible for his/her subordinates. Thus, it is a manifestation of both individual and “institutional” or “organizational” accountability in
which those in charge of some task or some persons are responsible for their duties towards them accordingly. Dost argues that the institution of “hisbah” that is to be found in the later Islamic era was inspired by the practice of the Prophet peace be upon him, as he used to visit the market personally and check on the accuracy of measures. He also assigned specific places to different mongers and prohibited different market practices like meeting the producer-farmer at the entrance of the city before they reached the market, fearing they may sell at lower price. The Prophet peace be upon him was also opposed to price fixation at the time of scarcity when he replied those who complained high prices and requested to fix it: “the seller and the buyer, the one who provides and who fixes the prices are nobody but the God. I don’t wish to die whilst people having demands of life and property from me”. On one such occasion, the Prophet peace be upon him observed that a person was selling some food stuff in the market. He put his hand in the pile and saw that it was wet from inside, while it seemed fine apparently. The Prophet peace be upon him rebuked the seller by saying that why he did not put the wet stuff on the top of pile so that the people could see it? He further added: “The person who cheats is not amongst us.” At another occasion, the Prophet peace be upon him did “audit” of one of his appointees of zakah collection. When the person arrived after collecting zakah, he presented one part of the collected stuff to the Prophet peace be upon him and kept one part for himself saying that it has been gifted to him. The Prophet peace be upon him rebuked the person in a very polite manner and asked if he would receive such gifts if he were sitting in him home? Indeed, these and other kinds of instances reveal to us how the Prophet peace be upon him was seriously concerned with the financial accountability of his appointees as well as the accountability of the market practitioners.

3. The Institution of Hisbah

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Keeping in view the aforementioned examples from the life of the Prophet himself, a separate institution for market supervision called *hisbah* was established. This institution was formed based on the Islamic concept of “*al amr bil maroof wal nahyu anil munkar*” i.e. (the task of) enjoining what is right and forbidding what is evil. This is an essential feature of a given Islamic society and Quran stresses upon the establishment of this institution, either by the state or by the community members themselves. In its strict financial and business sense, the duty of *muhtasib* or the person in charge of *hisbah* was “to ensure that the daily business transactions are done in a manner that is not harming the society.” The major responsibility of *muhtasib* was to ensure that the business practices prevalent in the market are in accordance with Islamic injunctions and each party is getting its due rights as well as performing its duties. It is not an exaggeration to state that the current day “auditor” has the same task to perform as was done by the classical *muhtasib*, although the auditor’s role is restricted to the extent of monitoring that everything in the financial “papers” is according to the regulations whereas *muhtasib* concentrated on the physical inspection of the market. This change is the direct outcome of the changes that have taken place in the business structure during the course of the centuries.

The classical Muslim writer, Al-Mawardi, has elaborated the duties of *muhtasib* in his famous book *al-Ahkam al-Sultaniyya*. In fact he has devoted a full chapter of his book for this purpose which he titled as *al-hisbah*.

The accountability in general and financial accountability in particular has held great importance in both Islamic literature and the practice of Islamic state at the time of its inception and later on. Whereas the two major sources of Islamic Shariah, namely Quran and Sunnah, provided a general framework as well as theoretical foundation for financial accountability, it was practically demonstrated by the Prophet peace be upon him and his followers since the early Islamic era. Both these steps led to the establishment of the

5 Rahim et al (2012). A New Breed Of Islamic Accountants And Their Role In Islamic Institutions. Advances in Natural and Applied Sciences
institution of *hisbah* or market supervision in the later years. The rulings about *hisbah* and the duties of *muhtasib*, the market supervisor, were elaborated by Muslim jurists and scholars such as Al-Mawardi as an example of it. This shows the deep concern of Islam with what can be termed in today’s world as “audit”. However, we have also observed that the audit or accountability in Islamic terminology is wider than its meaning in conventional term; the former encompassing one’s actions, thoughts, and even intentions.

4. Definition of Shariah Audit:

The growth of Islamic finance industry has lead to the parallel emergence of related fields of study. On the one hand, accounting has been looked and researched from an Islamic perspective. On the other hand, it is audit which is viewed from the same angle. However, the emergence of Islamic accounting is substantially advanced as compared to that of Shariah audit. Nevertheless, both these are getting momentum as the industry is expanding at a fast speed. Since the research about Shariah audit is at the embryonic stage, some basic issues and concepts of it have not yet been resolved. For instance, any field of study needs a proper definition before one can dig deep into its different aspects. However, there has not been any unanimous and clear cut definition of the term Shariah audit yet. In its simplest sense, Shariah audit has been defined as an audit attestation for Shariah compliance (Yahya and Mahzan, 2012)  

7 However, the term is not so easy to be explained by such a simple expression and the writers confess this fact by pointing towards different issues that might arise as a result of this definition. On the other hand, AAOIFI’s Governance Standard for IFIs no. 3 elaborate the objective of Shariah audit as “the primary objective of the internal Shariah review (carried out by independent division or part of internal audit department) is to ensure that the management of an IFI discharge their responsibilities in relation to the implementation of the Shariah rules and principles as determined by the IFI’s Shariah Supervisory Board (SSB)” .

8 It is visible in this statement that Shariah audit aims at Shariah compliance and it has been taken as an internal matter of an IFI which is the responsibility of an independent division or a

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branch of internal audit department. We find a more comprehensive definition of the term given by Haniffa (2010) which states that Shariah audit is: “a systematic process of objectively obtaining and evaluating evidence regarding assertions about religious and socioeconomic actions and events in order to ascertain the degree of correspondence between those assertions and those of the applicable financial reporting framework, including the criteria specified based on Shariah principles as recommended by the Shariah Supervisory Board (SSB) and communicating the results to all interested parties”.  

This definition catches the broad scope of Shariah audit by adding the socioeconomic aspect into it apart from the religious obligations. An operational definition of the term has also been provided which states that: “Shariah audit is the examination of an IFIs compliance with the Shariah, in all of its activities, particularly the financial statements and other operational components of the IFIs that are subjected to the risk of compliance including but not limited to products, technology supporting the operations, operational processes, the people involved in the key areas of risk, documentations and contracts, policies and procedures and other activities that require adherence to Shariah principles” (Haniffa, 2010; Sultan, 2007, as quoted in Yaacob, 2012; & Akram Laldin, 2009, as quoted in Mohiuddin, 2012). Although the socioeconomic aspects of the earlier definition are missing here, we can see that almost all the operational aspects, including technology, processes, and procedures etc are included in this definition. Whereas Rahman (2008) defines Shariah audit as “the accumulation and evaluation of evidence to determine and report on the degree of correspondence between information and established criteria for shari’ah compliance purposes”, Hameed (2008) has defined it as “a systematic process of objectively obtaining and evaluating evidence regarding assertions about socio-economic, religious and environmental actions and events in order to ascertain the degree of correspondence between those assertions and Shariah (Islamic Law), and communicating the results to

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users." This definition is broader in the sense that it captures the environmental aspects into considerations too, apart from socioeconomic and religious assertions.

Keeping in view the above definitions, Shariah audit is defined according to AAOIFI as an examination of the extent of an IFI’s compliance, in all its activities, with the Shariah. This examination includes contracts, agreements, policies, products, transactions, memorandum and articles of association, financial statements, reports (especially internal audit and central bank inspection), circulars, etc. (AAOIFI. Governance standards 2). Hence is it a very comprehensive and complete process to ensure the Shariah compliance status of the IFI.

5. Objectives and Scope of Shariah Audit

It is evident from the definitions given above that the logic for Shariah audit is to ensure the compliance of IFI with Shariah in all possible respects. Indeed this is the core objective of Shariah audit. It has also been explicitly asserted by what AAOIFI published in 2010 about the objectives of auditing. According to this, the audit of an IFI aims to enable the auditor to express an opinion about the financial statements of the organization, as to whether they are prepared in all material respect in accordance with the fatwas, rulings and guidelines issued by the Shariah supervisory board of the said IFI, the accounting standards of AAOIFI itself, the national accounting standards and practices, as well as the relevant rules and regulations of the country where the IFI operates. The auditors conducting this audit should also cater for the Code of Ethics for Professional Accountant and should be dressed with righteousness, integrity, trustworthiness, fairness, honesty, independence, objectivity, professional competence, due care, confidentiality, professional behavior and technical standards. The definition and objective of Shariah audit makes it easier to comprehend the scope of Shariah audit. It is broader than conventional audit in the sense that it comprises of an extra attribute of making sure that an IFI must comply with Shariah. It does not, in any sense, mean that Shariah audit

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would ignore the financial aspects of the transactions. As argued by Rahman (2008) the first scope of Shariah audit would be the audit of financial statements of the concerned IFI. It would review and ensure that all the financial transactions are recognized, measured, and reportedly accurately and they precisely reflect the rights and obligations arising from different contracts. Furthermore, it would also ensure that there is an adherence to the relevant standards, like the rules and regulations of Bank Negara or those of AAOIFI etc. However, it is worth mentioning here that Shariah is a very broad term and it encompasses all aspects of life including business transactions. Hence, Hameed (2008) laments that the Shariah Supervisory Boards (SSB) currently take a narrow view of Shariah and confine adherence to it in the form of technical compliance of the financial contracts to the fatwas (opinions) of the SSB regarding what is permissible or otherwise. Therefore, he asserts that a broader and holistic approach needs to be adopted which should take into consideration the “business policies, processes and procedures, contracts and agreements, financial systems and reporting, human resource management, social activities and contributions, marketing and advertising, reports and circulars, zakat calculation and payment, and IT systems.” Yaacob and Dongla (2012) also assert that auditing is important for guaranteeing corporate accountability and enhancing the stakeholders’ faith in the company. However, unlike the conventional audit which focuses on the compliance of financial statements to be in accordance with GAAP and other relevant standards, “the auditing of Islamic Financial Institution (IFI) cover a wide range of scope. This is because auditors/Shariah auditors must attest that the management has complied not only with relevant standards but also the Shariah framework in all of the transactions to achieve the maqasid as shari’ah.” The broader scope of Islamic auditing has also been reiterated by Yahya and Mahzan who mention that in contrast to conventional audit where the auditor is liable to the owner of the

business and is not guided by religious principles, the Shariah auditor is: “In light of Islamic teaching, the role of auditor would assimilate some different approach and objective i.e. upholding shariah principles.” This broader scope is also pointed by Khan (as quoted in Yahya and Mahzan, 2012) who states that: “The scope of auditing in Islamic framework is much larger as compared to the scope of traditional auditing. From the traditional concept of attest and authority it would expand to report on various social and economic aspects of business organization. This is due to the reason that auditing in Islam has been derived from the basic values of Islamic societies and shariah principles.” 18

6. Issues in Shariah Audit

As stated earlier, Shariah audit is an emerging field with most part of it yet to be explored academically. Therefore, it is rather natural to find many unresolved issues in it. To begin with, the most important issue is Shariah audit is that of the independence of Shariah auditors. Independence is a fundamental concept in audit, be it conventional or Islamic. But members of Shariah Supervisory Board, who are involved in audit as is the practiced by some IFI, are paid by the same institution whose audit they conduct. In other words, they also audit their own work which raises the issue of independence as well as conflict of interest. In this regard, Kassim (2009) argues that although SSB members follow the Shariah rules, there is no professional code followed by them. AAOIFI does have a code of ethics for them to follow, but there is no framework developed for them that they can perform their task with. 19 Secondly, Hameed (2008) raises the issue of the competence of SSB members when it comes to the performance of conducting Shariah audit. He argues that although the members of SSB are well qualified in the task of issuing fatwas about the permissibility or otherwise of any financial product, they can not stand as qualified auditors because they do not have the necessary qualification and training. Besides, their dual role of advising at the product development stage and auditing at the later stage

18 ibid
creates “self review threat” as per the IFAC’s code of ethics. However it should be noted that in many jurisdictions including Malaysia the Shariah board members do not involved in the Shariah audit exercise because it is not within their scope and job description, but there is an interaction between them to clarify some outstanding issues faced by the auditors. Thirdly, Rahman (2008) pinpoints some issues in the reports produced by SSC which reflect complete conformity of the operations of Islamic banks with Shariah principles. On the contrary, the role of SSC is very limited and it is not even responsible to conduct audit in a way done by financial auditors. What they are responsible for is only the approval of products and services. The writer further elaborates that financial auditors are well educated, qualified, trained and experienced in their profession. They are free to perform their duty as auditors and perform their task impartially for which they are paid. On the contrary, although SSC members are well qualified Shariah scholars, they have not been exposed to proper training or qualification about how to conduct Shariah audit. Likewise, there is also the issue of the responsibility of SSB members. Their main duty is to “advise” the bank as how to conduct their business in Shariah compliant way. Ironically, the report they present shows that they are responsible for the “assurance” of Shariah compliance. This situation leads to an interesting fifth point, i.e. the liability of the SSB in case of non Shariah compliance. This issue has been raised by Muneeza and Hassan (2011) who argue that the current legal position is silent about the consequence of malpractice liability of the members of SSC. It makes these members immune to any legal action in the eyes of the masses and, therefore, it is needed to explain whether Shariah scholars could be sued by their customers in case of negligence or not? One might argue here that this issue has been addressed by IFSA 2013. However, the writers raise another interesting point by stating that if clients are allowed to sue these members of Shariah Board, they would be

reluctant to sit on these boards/committees which can hamper the industry already faced with the shortage of experts. Therefore, it is more reasonable to stipulate that Shariah scholars can only be sued in serious and extreme cases (Hodgins, 2010, as quoted in Muneera and Hassan, 2011). In short, there are some fundamental issues that still need to be addressed and solved in the context of Shariah audit.

7. Shariah Audit Evidence

7.1. Definition of Audit Evidence and its Main Features

Audit is the systematic process of collecting and evaluating evidence to form an opinion about an entity’s status. Audit evidence is the foundation on which the whole decision or opinion making process is based on. Audit evidence stands for the information that is used by the auditor to arrive at a conclusion and form an opinion. Evidence is a piece of information collected and used to providing a factual basis for developing observations and arriving at some conclusion regarding audit objectives. It provides the basis for believing that a particular assumption is true or not by providing persuasive support for a fact or a point under consideration. Audit evidence is persuasive in nature and, thus, stands in contrast to legal evidence. The auditor gets reasonable assurance after it and that is all his decision is based on. Absolute certainty is rarely possible with the help of audit evidence. Legal evidence on the other hand is a type of rigorous proof which is beyond audit evidence in its certainty and assurance. Substantially good audit evidence should have the following features:

(1) Sufficiency: Sufficiency does not mean that the hundred percent audit evidence should be availed. It means that the quantity of the evidence should be adequate enough for the auditor to form an opinion.

(2) Appropriateness: As against sufficiency which considers audit evidence in terms of its quantity, appropriateness measures the quality of the audit evidence. In other words, it measures whether audit evidence helps in detecting any

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24 ibid


27 Fundamentals of Accounting and Auditing (2012). ICSI, New Delhi
misstatements and breach of compliance; whether it is both reliable and relevant or not?

(3) Reliability: The audit evidence needs to be reliable in order for the auditor to base his assessment upon. Once again, one hundred percent reliability is not possible logically. Hence the evidence should be persuasive rather than conclusive.

(4) Relevance: The type of evidence should also match the matter being investigated. For instance, if it is aimed to check the balance stock, the physical verification is the most relevant evidence.

(5) Persuasiveness: Audit evidence does not need to be conclusive as is the case with legal evidence. It is enough if the auditor finds the evidence to be persuasive. Only a small is usually used in order to arrive at some conclusion. Persuasiveness of evidence is increased if there is harmony among evidence obtained from different sources.  

In addition to the above, following are a few rules of thumb that are helpful in judging the soundness of audit evidence: Firstly, documentary evidence is preferred over testimonial evidence. Secondly, evidence obtained from different sources or of a different nature is preferred. Thirdly, original papers are better than their photocopies. Fourthly, evidence collected from a third party is better than the evidence collected from within the organization. Lastly, direct evidence obtained by the auditor through personal observation, inspection etc is better than the evidence gathered indirectly.

7.2. Sources and Techniques of Audit Evidence

The information which constitutes audit evidence can be obtained from two main sources: primary and secondary.  

- Primary Evidence: This is the information gathered by auditors personally. The information can be gathered by auditors themselves by using different techniques like interviews, surveys, observation and inspection. What is essential in selecting

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29 Fundamentals of Accounting and Auditing (2012). ICSI, New Delhi
one or more of these techniques to gather information is that the auditor should possess the skills and expertise required in applying these methods.

- Secondary Evidence: Secondary evidence can be categorized into two types; information gathered by audited entity and information gathered by third parties. Since every business entity keeps records of its daily transactions, it produces ample amount of information that can be used in audit. Similarly, outside authorities like regulators etc also have substantial information about the entity which can constitute evidence that can be utilized in audit.

An auditor has the following options as techniques of collecting audit evidence:

- Inquiry
- Observation
- Inspection
- Recalculation
- Confirmation and
- Analytical procedures

7.3. Documentation of Audit Evidence

Evidence documentation usually contains the evidence itself. However, neither every document examined is to be copied and filed, nor the detailed information obtained from these documents is to be listed in it. For example, if the evidence consists of an entity’s financial record, it should suffice record which document was examined and how that specific document can be identified and located. Similarly, the working papers which contain the evidence should be structured in a logical manner and should be easily accessible. These papers should have either the evidence itself or the description of the evidence examined so as to enable the viewers to arrive at the same conclusions as those of the auditor himself. Once again, the professional judgment and experience of auditor will play the most important role in evidence documentation.  

8. Shariah Audit Methodology

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8.1. Planning Phase

Shariah audit is a “systematic process” which means that it should have a proper design from the very beginning. It should be properly “planned” and be according to the design drawn by the auditor. After proper planning, the second phase namely “examination” should follow. The third phase in implementing Shariah audit is the reporting phase which comes as a logical end of the first two phases. Finally, there should be the reporting phase of Shariah audit in the form of producing an audit report which is the ultimate objective of this whole process. Following are some essential elements of Shariah audit planning phase:

8.2. Understanding the Business of IFI

Not all the financial institutions and their respective businesses are the same. While some indulge in retail business providing small and basic facilities to their customers, others are broader in their scope and activities and serve both the individual customers as well as corporations and may provide funding to huge projects of the governments and other entities. Therefore, a Shariah auditor needs to understand first what kind of activities and businesses are the focus of an IFI. An Islamic financial institution may be serving the individual customers with retail banking as its main operation. Such an IFI will possibly be providing credit card facilities as well as home financing, and other personal financing facilities. If a Shariah auditor is entrusted with the task of auditing such an IFI, with retail banking as its core business, any audit plan consisting of techniques and procedures that are suitable for the audit of project financing. Hence, the Shariah auditor must first understand the business of the IFI before moving forward.

8.2. Understanding the Contracts Appropriate for the Business

Generally speaking, the nature of IFIs and the businesses that they do are different from the nature and business of conventional financial institutions. Whereas conventional financial institutions, especially conventional banks, primarily deal in lending and borrowing, the operations of Islamic financial institutions are trade based. That is to say, IFIs indulge in buying from and selling to their customers and not borrowing and lending. This is mostly true in the case of retail Islamic banks for instance. Consequently, a
Shariah auditor may find that the most proper and widely used underlying contract for personal financing and retail banking is murabaha. On the other hand, equity financing is usually done through the contract of musharakah and mudharabah whereas salam, istisna, and ijara contracts are utilized for project financing. Therefore, it would be illogical, as stated before, to prepare an audit plan focusing on murabaha transaction when the IFI is conducting project financing as its main business activity. On the other hand, a focus on salam and istisna when the IFI serves retail customers will be an inappropriate audit technique.

8.3. Identifying the Appropriate Evidence Gathering Techniques
Once the nature and objectives of the IFI business have been understood and the essence and sequence of the relevant contracts utilized by the IFI to obtain these objectives have been realized, the next step in planning Shariah audit is to identify the most suitable techniques that can be used to gather evidence in order to form an opinion about the Shariah compliance status of the IFI. Since the nature of business and the contracts utilized by IFIs are different, as stated earlier, it should come as a logical conclusion that some audit techniques would be more appropriate than others for this purpose. As an illustration, since buying and selling and not lending and borrowing is the main business of Islamic banks, for instance, such techniques would be needed that can cater for buying and selling aspect of the business. For instance, in case of project financing, a visit to the site, if felt necessary by the auditor, might be more handy than other techniques.

8.4. Developing Proper Audit Plan
After understanding the IFI business and deciding on the relevant techniques for collecting evidence, it is important that a proper and audit plan is prepared in the light of these decisions. An audit plan is the sketch of the key activities to be undertaken by the auditor in the process of auditing. It elaborates the objectives of each of the activities that are a part of this process. Similarly, it also outlines the respective techniques which

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will be employed to attain these objectives. In short, audit plan is first important step that lays the foundation of what is to be achieved through the whole process of audit.

8.5. Shariah Audit Methodology: Examination, Reporting and Documentation Phase

8.5.1. Examination Phase:

Examination or the actual field work is a very important decision in the audit methodology. Examination is the implementation of the initial audit plan and this is what will make the entire procedure a successful one. The most important decision/action at the examination step is the selection of an appropriate technique that can be deployed for gathering audit evidence. There are a number of techniques available with the auditor to select one or more tools. Usually, a Shariah auditor can select among the following list of techniques: 33

- Examination of Papers
- Interviewing
- Direct Observation
- Benchmarking
- Surveys
- Case Studies
- Flow Charting
- Statistical Analysis
- Walkthrough, and
- Questionnaires.

There are many factors that will lead to the selection and/or priority of one or more of these tools over others. For instance, the objective of the audit will be the first factor to determine this. Similarly, the nature of the business of IFI will also prefer some techniques over the others. Likewise, the availability of some of these techniques and the absence of others, as well as the superiority of some techniques like direct observation will also affect this decision.

33 ibid
8.5.1. Reporting Phase (Nature of the audit report)

An audit report usually consists of a few lines and is, therefore, very brief. Since the audit report is very brief and to the point, the elements that it comprises of are to the point too, avoiding any details or elements that are unwanted and unnecessary. The presentation of the report is depending on the approach of each auditor, hence the presentation of the report may vary, however the most important listed items in the Shariah audit report are:

Part 1: executive summary

- Introduction
- Overview
- Audit objectives and scope
- Risk profile
- Rectification of previous finding
- Audit assessment
- Management discussion
- Conclusion

Part 2: Details finding

- Current audit finding
- Status of previous audit finding

Part 3:

- organization chart
- Photograph

Appendices

8.5.2. Audit Documentation Phase

Audit documentation is the main record which forms the basis for the conclusions drawn by the auditor and supports his report. It also provides a review of the quality and
standard of the work by providing written evidence that support the conclusions of the auditor. Audit documentation is also referred to as working papers or work papers. These are the papers that record the overall activities of the auditor during the auditing process and the results and conclusions drawn by him from the audit evidence. This can either be in the form of papers or in an electronic form. 

Working papers perform different functions including:

- These help in the planning and performance of the audit. If the audit is to be planned and performed well, the required reference information and detail should be present in the form of these papers.
- Working papers also serve as proof that the audit evidence which supports the opinion of auditor is valid and in accordance with the concerned regulatory requirements.
- These papers also validate and confirm the very process of audit too. It helps the supervisory authorities confirm whether the whole audit process was efficient and is reliable or not.
- It can also serve different parties for their own purposes like the tax regulators, government bodies and others.

The question of what content should or should not be included in the working papers depends on the professional judgment of the auditor. Whereas it is not possible to include each and every point in it, it is also not plausible to skip any points that are supposed to be in these papers. As a general rule, the auditor should add anything that would be needed to provide another auditor with no past experience and knowledge of the entity to understand the performed audit work. They should provide the ground for the decision that has been made.

9. Challenges and Recommendations

There are no two opinions that Shariah compliance is the essence of Islamic finance. It is the very foundation and the primary objective for the inception of the entire industry. Shariah audit, a newly emerging field of study, is one of the important tools to achieve

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36 Ibid
this objective of ensuring Shariah compliance. The current study attempted to add to the current scant literature on Shariah audit. The objective was to explore the current status of Shariah audit, identify the gaps, attempt to fill some of these gaps and suggest some future directions for further research.

9.1. Challenges
While undertaking this study on Shariah audit evidence and methodology, the following problems were detected which need to be addressed:

9.1.1. Lack of Literature
Islamic finance saw some tremendous development only during the last decade or so. It is also during this time period that attention started to be paid to it as a discipline and it different areas are now being researched. However, it is also a fact that Shariah audit has not been given proper attention so far by the regulators as well as the practitioners and academicians. As a result of this situation, one faces difficulty at the outset while trying to search and explore the relevant literature for Shariah audit. Whereas the literature available on say, Islamic banking, is quite sufficient to conduct a further research study or know the existing status and level of the discipline, this is not the case of Shariah audit. This lack of literature makes any attempt to further enhance the field through academic research more problematic and difficult.

9.1.2. Lack of Experts
Since Shariah audit has not yet received its due importance from all the respective stakeholders including academia and industry players, there is a scarce number of experts, if any, belonging to this discipline. This is a natural outcome of the lack of literature as well as the lack audit practice by the industry as mentioned above.

9.1.3. Lack of Research
General observation tells us that although Islamic banking and takaful etc have received recognition as essential parts of Islamic finance industry and these have been taught to a certain extent, this is not true in the case of Shariah audit. Even worse, the discipline that
needs to be established before Shariah audit, i.e. Islamic accounting, has not yet developed fully to the extent that Islamic banking or takaful have developed. It is logical to expect that Shariah audit will get attention of the researchers once Islamic accounting makes further advancement as a research discipline. However, once again the common observation and experience tells the other story. This creates difficulty for anyone trying to do quality research on Shariah audit.

9.1.4. Non Recognition by the Relevant Parties
Unlike accounting, audit has not yet been accepted by the stakeholders of Islamic finance industry as an essential pillar needed for the development and uplift of the industry. This is visible from the current situation wherein the major stakeholders, like IFIs, practitioners, academicians and researchers have not yet put Shariah audit in their priority list. It is very essential for the development of this discipline as well as the industry as a whole that Shariah audit be recognized as an integral part of the Islamic finance industry by all. We should record here with appreciation the effort of the Bank Negara Malaysia towards providing Shariah audit framework for the industry which is still on-going project. Beside that very important aspects of Shariah audit have been highlighted in the Shariah governance framework that was issued by Bank Negara Malaysia. In the light of our discussion so far, this study would recommend the following for a robust growth of the discipline of Shariah audit.

9.2. Recommendations
9.2.1. Recommendations for IFIs
Shariah compliance is the hallmark that differentiates Islamic financial institutions from their conventional counterparts. Shariah audit is the mechanism or “stamp” that ensures this compliance. Therefore, if compliance with Shariah is the soul of Islamic finance industry, Shariah audit is the trade mark for this compliance. Hence, these institutions should join hands for its implementation and should welcome any efforts by the regulators in this direction. Even if there is delay from regulators’ side in the implementation of Shariah audit, these institutions should take voluntary steps in this direction.
9.2.2. Recommendations for Academia

The role of academia in the development and growth of any discipline needs no explanation. In order for Shariah audit to develop further and achieve its due place and importance, academia has to wake up. Carrying out individual research projects by learned academicians, as well as their facilitating and encouraging both graduate and postgraduate students to conduct research in this area can result in the much-needed growth of literature on the subject. It will also give Shariah audit the status of a well developed and properly recognized academic discipline that will pave the way for its acceptance as an essential pillar of the Islamic finance industry by the rest of the stakeholders, including the regulatory authorities, and industry players.

9.2.3. Recommendations for Regulators

The implementation of Shariah audit in the Islamic finance industry greatly depends on the role of regulators. It is suggested that the central authorities and regulatory bodies make the practice and conduct of Shariah audit mandatory for the Islamic financial institutions by introducing new laws for this purpose or properly amending the existing regulations. This will certainly be the starting point for the flight of Shariah audit and the industry as a whole in the right direction.
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