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**EXPLORING SHARIAH AUDIT IMPLEMENTATION FOR THE STATE
ISLAMIC RELIGIOUS COUNCIL IN MALAYSIA**

By

MOHAMAD NAZROL BIN MOKTAR



**Thesis Submitted to
Tunku Puteri Intan Safinaz School of Accountancy,
Universiti Utara Malaysia,
In Partial Fulfillment of the Requirement for the Master of Science
(International Accounting)**



Kolej Perniagaan
(College of Business)
Universiti Utara Malaysia

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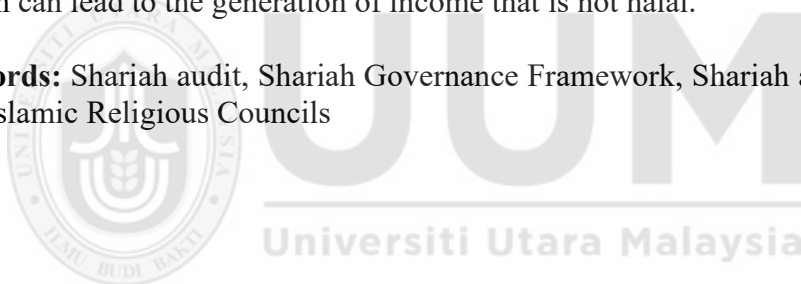


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ABSTRACT

This study explores the implementation of Shariah auditing at the State Islamic Religious Council (SIRC). This paper focuses on four main themes: issues and challenges, effectiveness of Shariah audit, Shariah audit implementation, and competency of Shariah auditors. The findings of this study indicate that SIRC has yet to develop Shariah Governance Framework and do not yet have Shariah auditing policies and procedures; Shariah audit has not yet been comprehensively implemented in SIRC, while they have internal auditors, the existing internal auditors lack expertise in conducting Shariah audits; and, most importantly, the understanding and acceptance of Shariah audit by the board of directors and management should be taken seriously. The practical implications of this study are that it offers an overview of the challenges in implementing Shariah audits to policymakers and practitioners for the future development of Shariah auditing practices among SIRC. This is part of a comprehensive study of the difficulties of Shariah auditing implementation in SIRC, to the best of the author's knowledge. Shariah auditing should be established as a necessary aspect of the governance structure of the SIRC. This is essential not only for instilling the public's confidence and trust in the sanctity of the SIRC's operations but also for receiving the blessings of Allah SWT. Nonconformance to Shariah can cause the loss of blessings from Allah SWT. It will damage the good reputation of the SIRC. Eventually, conducting activities or transactions that do not comply with Shariah can lead to the generation of income that is not halal.

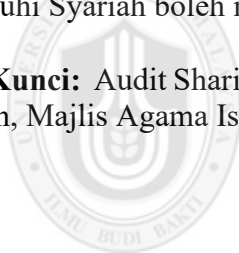
Keywords: Shariah audit, Shariah Governance Framework, Shariah audit Guideline, State Islamic Religious Councils



ABSTRAK

Kajian ini meneroka pelaksanaan audit Syariah di Majlis Agama Islam Negeri (MAIN). Kajian ini memberi tumpuan kepada empat tema utama: isu dan cabaran, keberkesanan audit Syariah, pelaksanaan audit Syariah, dan kecekapan juruaudit Syariah. Hasil kajian ini menunjukkan bahawa MAIN masih belum membangunkan Rangka Kerja Tadbir Urus Syariah dan masih tidak mempunyai Garis Panduan Audit Syariah; dan audit Syariah masih belum dilaksanakan secara menyeluruh di MAIN; walaupun mereka mempunyai juruaudit dalaman, juruaudit dalaman sedia ada tidak mempunyai kepakaran dalam menjalankan audit Syariah; dan yang paling penting, kefahaman serta penerimaan audit Syariah oleh ahli lembaga pengarah dan pihak pengurusan perlu diberi perhatian serius. Implikasi praktikal kajian ini adalah ia memberikan gambaran tentang cabaran dalam pelaksanaan audit Syariah kepada pembuat dasar dan pengamal industri bagi pembangunan masa depan amalan audit Syariah di MAIN. Ini adalah sebahagian daripada kajian menyeluruh mengenai kesukaran pelaksanaan audit Syariah di MAIN, sejauh mana yang diketahui oleh penulis. Audit Syariah seharusnya dilaksanakan sebagai satu aspek penting dalam struktur tadbir urus MAIN. Ini bukan sahaja penting untuk menanam keyakinan dan kepercayaan masyarakat terhadap keabsahan operasi MAIN, tetapi juga untuk memperoleh keberkatan daripada Allah SWT. Ketidakpatuhan kepada prinsip Syariah boleh menyebabkan hilangnya keberkatan daripada Allah SWT serta merosakkan reputasi baik MAIN. Akhirnya, pelaksanaan aktiviti atau transaksi yang tidak mematuhi Syariah boleh membawa kepada penjana pendapatan yang tidak halal.

Kata Kunci: Audit Syariah, Rangka Kerja Tadbir Urus Syariah, Garis Panduan Audit Syariah, Majlis Agama Islam Negeri



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LIST OF ABBREVIATIONS

SIRC	: State Islamic Religious Council
AAOIFI	: Accounting and Auditing Organization for Islamic Financial Institutions
IFI	: Islamic Financial Institutions
SSB	: Shariah Supervisory Board
BNM	: Bank Negara Malaysia
PPIBZW	: The Islamic Accounting Standard for Baitulmal, Zakat, and Waqf
AGD	: Accountant General's Department of Malaysia
SGF	: Shariah Governance Framework
IAM	: The Institute of Internal Auditors Malaysia
MIA	: The Malaysian Institute of Accountants
NAD	: The National Audit Department of Malaysia
IPPF	: The International Professional Practices Framework
CIA	: Certified Internal Auditor
CPSA	: Certified Professional Shariah Auditor
IBFIM	: The Islamic Banking and Finance Institute Malaysia
IA	: Internal Auditor
MS 1900	: Shariah-Based Quality Management System
JAWHAR	: Department of Awqaf, Zakat, and Hajj
JAKIM	: Department of Islamic Development Malaysia
QMS	: Quality Management System
ABMS	: Anti-Bribery Management System



CHAPTER 1

INTRODUCTION

1.0 Introduction

This chapter provides an overview of the research's background, beginning with a broad discussion of Shariah auditing, including its historical evolution and development. It then narrows the focus to specific aspects relevant to the research. Furthermore, this chapter addresses the problem statement, highlighting current challenges and barriers identified by previous researchers regarding the implementation of Shariah auditing. This chapter also outlines the research questions formulated around four core areas of focus: Shariah audit implementation, auditor competency, effectiveness, and challenges in Shariah auditing. Additionally, the chapter specifies the research objectives, designed to address the four research questions identified and developed.

This chapter further discusses the scope of the study, focusing on the implementation of Shariah audits across 14 State Islamic Religious Councils (SIRCs) throughout Malaysia. It also highlights the significance of the research and the anticipated positive outcomes, including the benefits for relevant stakeholders. Additionally, this chapter provides definitions for key terms utilized throughout the research, such as Shariah audit, State Islamic Religious Council, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), Islamic Financial Institutions (IFIs), and competency. Lastly, the chapter outlines the structure of the research, which is organized into five chapters, and concludes with a closing statement.

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APPENDICES

Table 3.2
Details of Questions

No.	Research Question	Research Objectives	No.	Questions
1.	What are the key issues and challenges faced in implementing Shariah audits in SIRCs in Malaysia?	To identify the key issues and challenges encountered in implementing Shariah audits within SIRCs in Malaysia.	1.	What are the issues and challenges faced by your institutions in implementing Shariah audit practices?
			2.	Is the management aware of the challenges associated with the implementation of Shariah audits?
			3.	Does the management undertake proactive measures to address the challenges in implementing Shariah audits?
			4.	Are the identified challenges formally presented to the board of directors for discussion and resolution?
2.	How is the implementation of Shariah audits by the SIRCs effective in achieving Shariah compliance in Islamic entities?	To evaluate the effectiveness of Shariah audit practices implemented by SIRCs in ensuring compliance with Shariah principles in Islamic entities.	5.	How does the management provide support (i.e., financial allocation and resources) for the implementation of the Shariah audit?
			6.	How does the external auditor of the institution help improve the effectiveness of the Shariah audit?
			7.	How do external auditors contribute to Shariah assurance at your institution?
			8.	Does your institution require an Independent Shariah Auditor Report to improve the level of internal control systems and Shariah compliance?
			9.	In your view, in the next 5 or 10 years, should your institution appoint an external Shariah auditor?
			10.	Do the internal auditors in your institution also carry out Shariah auditing?

Table 3.2 (Continued)

No.	Research Question	Research Objectives	No.	Questions
			11.	Does the board of directors advocate for implementing Shariah audits in your institution?
			12.	Does the management cultivate Shariah practices in your institution?
3.	How are Shariah audits being implemented within SIRC's (involve process)?	To explore the processes and frameworks employed by SIRC's in executing Shariah audits.	13.	Can you explain who is responsible for providing documentation involving Islamic social financial funds (i.e., Zakat, Waqf, Baitulmal) in your institution?
			14.	How is the implementation of Shariah audit at your institution?
			15.	How does your institution do Shariah audit planning?
			16.	What is the scope of Shariah audit?
			17.	What are the operational issues faced in implementing Shariah audits?
			18.	How does the IT system and infrastructure at your institution support the Shariah audit process?
			19.	Can you share the general audit findings (issues/ weaknesses) that have been found?
			20.	What initiatives have been implemented by the management to improve the internal control system at your institution?
			21.	What are the management actions in the event of Shariah non-compliance?
			22.	What are the implications for zakat/waqf payers and recipients when non-compliance with Shariah occurs?
			23.	Has the management established a Shariah framework or specific guidelines to be utilized as criteria for conducting Shariah audits effectively?



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Table 3.2 (Continued)

No.	Research Question	Research Objectives	No.	Questions
			24.	Have comprehensive Shariah audit guidelines been developed to serve as a reference for auditors conducting Shariah audits?
			25.	In your opinion, who is responsible for comprehensively developing Shariah auditing guidelines: the Malaysian Institute of Accountants, the National Audit Department, or the Malaysian Institute of Internal Auditors?
4.	What is the current level of competency among Shariah auditors in SIRC in Malaysia?	To assess the current level of competency among Shariah auditors in SIRC, focusing on their knowledge, skills, and qualifications.	26.	Referring to the general skills of Shariah auditors, what is their level of knowledge/ knowledge/ experience in your institution?
			27.	In your view, what form of Shariah audit training is required for the council members, the management, and Shariah auditors in your institution?
			28.	What is the mechanism used to determine the level of competency of Shariah auditors?
			29.	In your opinion, should auditors possess qualifications in Islamic studies or Shariah to be eligible for appointment as Shariah auditors?
			30.	Do you agree that Shariah auditors not only need to know about Shariah or Islamic principles, but they must also have character, good ethics, trust, integrity, and responsibility?

Sources: Kamaruddin et al., 2021

Table 4.1

Initial Codes

No.	Initial Code	Files	Ref.
1.	Effective Communications	4	20
2.	Giving an Exposure	4	10
3.	Giving Training	11	20
4.	Having a Competitive Mindset	1	1
5.	Having a Good Appearance	1	2
6.	Having a Good Attitude	1	1
7.	Having a Professional Certification	5	7
8.	Having a Strong Moral	1	1
9.	Having an Experience	7	12
10.	Having Expertise	8	16
11.	Having an Understanding	1	4
12.	Having Codes of Ethics	10	14
13.	Having High Integrity	1	1
14.	Having Knowledge	9	18
15.	Having Muamalat Background	2	4
16.	Having Multiple Disciplines	1	1
17.	Huge Responsibility	1	1
18.	Lack of Experience in Shariah Audit	1	1
19.	Lack of Understanding of Islamic Transactions	2	2
20.	More Competent in Compliance Audit	1	1
21.	No Dedicated Shariah Auditor	1	1
22.	Not Mandatory in Shariah Background	4	5
23.	Obtain Appropriate Qualification	13	29
24.	Skill as an Auditor	2	2
25.	Skills in the Act and Standard Understanding	1	1
26.	Skills in Analytical	1	1
27.	Skill in Attention to Details	1	1
28.	Skill in Auditing Techniques	5	6
29.	Skills in Communications	1	1
30.	Skill in Detecting Non-Compliance	1	1
31.	Skill in Holistic Thinking	1	1
32.	Skill in Islamic Finance	1	1
33.	Skills in Persuasion	1	1
34.	Skill in Writing Quality Reports	1	1
35.	Still have a Gap	1	1
36.	Additional Workforce	4	8
37.	Appoint a Shariah Auditor	8	19
38.	Appoint Shariah Officer	1	2
39.	Board's Support	10	12

Table 4.1 (Continued)

No.	Initial Code	Files	Ref.
40.	Budget Allocation	5	7
41.	Conduct the Surveys	1	1
42.	Cultivate Shariah Practices	11	24
43.	External Auditor Findings	12	17
44.	External Auditor Views	11	20
45.	External Parties Verification	3	6
46.	Lack of Appreciation from Beneficiary	1	2
47.	Made a KPI	1	1
48.	Management's Support	14	34
49.	Proactive Actions by Internal Auditor	3	9
50.	Review Shariah Elements in Conventional Audit	14	34
51.	Shariah Audit Implementation by IA	14	15
52.	Significance of Shariah Audit	1	3
53.	SIRIM's Involvement	1	1
54.	To Empower Zakat Distribution	4	5
55.	Unallocated Budget	2	2
56.	Actions for Shariah Non-Compliance	2	2
57.	AGD's Involvement in Developing Guidelines	4	7
58.	Appropriate Reporting Line	4	5
59.	BNM's Involvement in Developing Guidelines	1	1
60.	Collaboration in developing SAG	10	12
61.	Collaboration in empowering IAF	8	16
62.	Comply with Enactment	4	9
63.	Create Shariah Audit Plan	11	11
64.	Create Shariah Audit Scope	13	17
65.	Developing Appropriate Internal Control	14	45
66.	Develop Shariah Audit Guideline	12	17
67.	Develop Shariah Framework	12	16
68.	Enhancement of Compliance Activities	9	15
69.	Functions of Each Department in SIRC	12	33
70.	General Audit Findings	13	30
71.	IIAM's Involvement in Developing Guidelines	3	4
72.	Implementation of ISO	2	7
73.	Implementation of MS 1900	4	24
74.	Implementation of PPIBZW	5	16
75.	Implementation Requirement	3	4
76.	Implications of Improper Distributions	1	1
77.	Implications of the Negative Perception	1	1
78.	Implications for the Reputation	5	8
79.	Implications for the Trust Issues	10	13
80.	Implications for Zakat Collection	1	1
81.	Improve Monitoring	1	3
82.	Investigation for Shariah Non-Compliance	8	14

Table 4.1 (Continued)

No.	Initial Code	Files	Ref.
83.	Islamic Banking	1	1
84.	IT System in Shariah Audit	14	22
85.	JAKIM Involvement in Developing Guidelines	3	3
86.	Management's Roles	10	19
87.	MIA Involvement in Developing Guidelines	3	3
88.	Mufti's Involvement in SIRC Activities	4	8
89.	NAD Involvement in SIRC Activities	11	26
90.	Operational Issues	11	13
91.	Ratification of Process and Procedures	1	4
92.	Segregation of Duties	6	13
93.	Shariah Audit Implementation by SIRC	10	24
94.	SIRC Best Practice	2	2
95.	SIRC Functions	2	3
96.	SIRC Structure	5	7
97.	Zakat Goal Unachievable	1	1
98.	Absence of Guidance	4	6
99.	Accounting Background	5	7
100.	Ambiguity with Shariah Audit	1	13
101.	Audit Committee Rules	8	18
102.	Board's Roles	4	6
103.	Carry Out Conventional Audit	5	9
104.	General Guidelines	3	5
105.	Internal Audit Function	9	29
106.	Lack of Awareness	3	4
107.	Lack of Expertise	5	7
108.	Lack of knowledge	5	6
109.	Lack of Readiness	1	1
110.	Lack of Training	1	2
111.	Lack of Understanding	6	10
112.	Limited Resources	1	1
113.	Management Aware	10	16
114.	Present to the Board	11	13
115.	Present to Management	4	6
116.	Shariah Information	3	15
117.	Still in the Initial Stage	4	9
118.	Unclear Explanation	1	6
119.	Various Background	1	1

Source: Generated by NVivo 15

Table 4.2

Final Themes Categorized by Research Question

No.	Name	Files	Ref.
1.0	Issues and Challenges (RQ1)	14	98
1.1	Governance and Oversight (Theme)	14	55
1.2	Knowledge and Awareness (Theme)	8	10
1.3	Inappropriate Guidelines (Theme)	5	10
1.4	Academic Background (Theme)	5	7
1.5	Skills and Competency (Theme)	5	9
1.6	Shariah Audit Landscape (Theme)	2	6
1.7	Readiness and Preparation (Theme)	1	1
2.0	Effectiveness of Shariah Audit (RQ2)	14	171
2.1	Enhances Organizational Advocates and Human Capital Development (Theme)	14	65
2.2	The Substance of Internal Audit Functions (Theme)	14	48
2.3	Significance of External Parties' Involvement (Theme)	14	44
2.4	Financial Allocation and Resources (Theme)	7	9
2.5	Significance of Shariah Audit Implementation (Theme)	3	5
3.0	Implementation of Shariah Audit (RQ3)	14	224
3.1	Performing Shariah Audit (Theme)	14	85
3.2	Collaboration among Agencies in Developing Framework and Guidelines (Theme)	14	46
3.3	Operational Structure and Management of SIRC (Theme)	14	21
3.4	Impact on the Reputation of Shariah Non-Compliance (Theme)	14	20
3.5	Empowering Governance Structure and Compliance (Theme)	13	25
3.6	Collaboration among Agencies in Facilitating SIRC's Activities (Theme)	11	18
3.7	Implementation of Standard for Value-Added (Theme)	7	9
4.0	Competency of Shariah Auditor (RQ4)	14	135
4.1	Embrace Appropriate Interpersonal Skills (Theme)	13	42
4.2	Ongoing Human Capital Development (Theme)	14	52
4.3	Embed Good Attributes and Ethics (Theme)	14	19
4.4	Auditing and Compliance Skills (Theme)	5	8
4.5	Status of Competency (Theme)	4	6
4.6	Analytical and Critical Thinking (Theme)	2	2
4.7	Attention to Detail and Reporting (Theme)	2	2
4.8	Regulatory and Technical Knowledge (Theme)	2	2
4.9	Communication and Persuasion (Theme)	1	2

Source: Generated by NVivo 15

Table 4.3
Final Codes and Themes

Name	Files	Ref.
Issues and Challenges (RQ1)	14	98
Governance and Oversight (Theme)	14	55
Present to the Board	10	11
Management Aware	10	14
Audit Committee Roles	6	14
Carry Out a Conventional Audit	5	6
Still in the Initial Stage	4	9
Limited Resources	1	1
Knowledge and Awareness (Theme)	8	10
Lack of knowledge	5	6
Lack of Awareness	3	4
Inappropriate Guidelines (Theme)	5	10
Absence of Guidance	4	6
General Guidelines	3	4
Academic Background (Theme)	5	7
Accounting Background	5	7
Skills and Competency (Theme)	5	9
Lack of Expertise	5	7
Lack of Training	1	2
Shariah Audit Landscape (Theme)	2	6
Shariah Information	2	3
Ambiguity with Shariah Audit	1	2
Unclear Explanation	1	1
Readiness and Preparation (Theme)	1	1
Lack of Readiness	1	1
Effectiveness of Shariah Audit (RQ2)	14	171
Enhances Organizational Advocates and Human Capital Development (Theme)	14	65
Management's Support	14	21
Board's Support	11	13
Cultivate Shariah Practices	10	10
Appoint a Shariah Auditor	8	10
Additional Workforce	4	7

Table 4.3 (Continued)

Name	Files	Ref.
Appoint Shariah Officer	1	2
Made a KPI	1	1
Conduct the Surveys	1	1
The Substance of Internal Audit Functions (Theme)	14	48
Review Shariah Elements in Conventional Audit	14	20
Shariah Audit Implementation by Internal Auditors	14	14
Internal Audit Function	8	14
Significance of External Parties' Involvement (Theme)	14	44
External Auditor Findings	12	17
External Auditor Views	11	20
External Parties Verification	3	6
SIRIM's Involvement	1	1
Financial Allocation and Resources (Theme)	7	9
Budget Allocation	5	7
Unallocated Budget	2	2
Significance of Shariah Audit Implementation (Theme)	3	5
To Empower Zakat Distribution	2	2
Advantages of Shariah Audit	1	3
Implementation of Shariah Audit (RQ3)	14	224
Performing Shariah Audit (Theme)	14	85
Developing Appropriate Internal Control	14	14
IT System in Shariah Audit	13	13
General Audit Findings	13	13
Create Shariah Audit Scope	11	11
Operational Issues	11	11
Create Shariah Audit Plan	11	11
Shariah Audit Implementation by SIRC	12	12
Collaboration among Agencies in Developing Framework and Guidelines (Theme)	14	46
Collaboration in developing SAG	12	21
Develop Shariah Audit Guideline	12	12
Develop Shariah Framework	13	13
Operational Structure and Management of SIRC (Theme)	14	21
Functions of Each Department in SIRC	11	11
Management's Roles	10	10

Table 4.3 (Continued)

Name	Files	Ref.
Impact on the Reputation of Shariah Non-Compliance (Theme)	14	20
Implications for the Trust Issues	10	10
Implications for the Reputation	4	5
Lack of Appreciation from Beneficiary	1	1
Implications of the Negative Perception	1	1
Implications for Zakat Collection	1	1
Implications of Improper Distributions	1	1
Zakat Goal Unachievable	1	1
Empowering Governance Structure and Compliance (Theme)	13	25
Action for Shariah Non-Compliance	8	8
Segregation of Duties	5	5
Enhancement of Compliance Activities	4	5
Comply with Enactment	4	4
Appropriate Reporting Line	3	3
Collaboration among Agencies in Facilitating SIRC's Activities (Theme)	11	18
NAD Involvement in SIRC Activities	7	7
Collaboration in empowering the IAF	8	8
Mufti's Involvement in SIRC Activities	3	3
Implementation of Standard for Value-Added (Theme)	7	9
Implementation of PPIBZW	5	5
Implementation of MS 1900	2	2
Implementation of ISO	2	2
Competency of Shariah Auditor (RQ4)	14	135
Embrace Appropriate Interpersonal Skills (Theme)	13	42
Having Knowledge	7	13
Having Expertise	7	12
Having an Experience	6	10
Having Muamalat Background	2	3
Having an Understanding	1	4
Ongoing Human Capital Development (Theme)	14	52
Giving Training	11	19
Obtain Appropriate Qualification	11	17
Having a Professional Certification	5	7
Not Mandatory in Shariah Background	4	5
Giving an Exposure	3	4

Table 4.3 (Continued)

Name	Files	Ref.
Embed Good Attributes and Ethics (Theme)	14	19
Having Codes of Ethic	10	12
Having a Good Appearance	1	2
Having a Competitive Mindset	1	1
Having a Good Attitude	1	1
Having a Strong Moral	1	1
Having High Integrity	1	1
Huge Responsibility	1	1
Auditing and Compliance Skills (Theme)	5	8
Skill in Auditing Techniques	5	6
Skill as an Auditor	1	1
Skill in Detecting Non-Compliance	1	1
Status of Competency (Theme)	4	6
Lack of Understanding of Islamic Transactions	2	2
Still have a Gap	1	1
More Competent in Compliance Audit	1	1
No Dedicated Shariah Auditor	1	1
Lack of Experience in Shariah Audit	1	1
Analytical and Critical Thinking (Theme)	2	2
Skills in Holistic Thinking	1	1
Skills in Analytical	1	1
Attention to Detail and Reporting (Theme)	2	2
Skills in Attention to Detail	1	1
Skills in Writing Quality Reports	1	1
Regulatory and Technical Knowledge (Theme)	2	2
Skills in the Act and Standard Understanding	1	1
Skills in Islamic Finance	1	1
Communication and Persuasion (Theme)	1	2
Skills in Communications	1	1
Skills in Persuasion	1	1

Source: Generated by NVivo 15