

# THE CURRENT PRACTICE OF IFI SHARIAH AUDIT AND WHAT IT OUGHT TO BE EVIDENCE FROM PAKISTAN

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**ABSTRACT:** *The exclusive and distinguishing trait of Islamic Financial institutions (IFIs) which sets it away from its conventional competitor is the need of shariah compliance or confirmation of religious and ethical principles. The audit of Islamic financial institutions is not limited to financial performance, but it also covers the shariah aspects of all transactions. So high expectations from the practices of IFIs appear in the form of an existing gap between what is and what ought to be. Because "what is" may not be matched with "what ought to be". This article aims to discover the existing gap between the two concepts in the IFIs of Pakistan. This paper found that there exists some gap between the two concepts in certain issues that have been discussed in this paper. This study cannot hope to bridge the existing gap; however, it shows that the function of shariah audit has not taken a good impact in IFIs in Pakistan, although it is a crucial monitoring instrument for shariah compliance.*

**Keywords:** Shariah audit, Islamic Financial Institutions, Shariah Compliance

## 1. INTRODUCTION

The banking and insurance structure in Pakistan is based on two comparable financial systems, i.e. Islamic and conventional systems. The conventional financial institutions pose a great challenge to the Islamic financial institutions (IFIs) in profit-making as they are based on Islamic morals and spirituality. IFIs need continuous efforts to keep a balance between the self-confidence of spiritually sensitive shareholders and providing commercially feasible Islamic substitute to shareholders looking to differentiate their investment strategies from interest bases investment. This is only possible through an active shariah audit system, which makes it sure, the whole system of production, operation, and information system of IFIs are according to shariah discipline. Shariah audit is very important in auditing and checking the whole system of IFIs in the light of shariah [1]. The main focus of shariah auditors is to monitor and control IFIs in setting the strategies and parameters for their businesses and to confirm that their operation according to the guidelines and perimeters of shariah [2]. They have to act as a promoter for the development of IFIs and remain independent to the stakeholders for effective function.

### A. What does the Quran say About Audit?

In surah "Infitar" Allah says in verse no 10,11 and 12 "And indeed, [appointed] over you are keepers, Noble and recording, they know whatever you do." [3]. On another occasion, Allah also warns us "Then as for him who is given his record in his right hand, He will be judged with an easy account, and return to his people in happiness" [4].

### B. What Sunnah tells us about Audit?

In a very popular hadith of the prophet (SAW) known as Hadith, Jibraeel prophet says He said, "tell me about Al-Ihsaan (goodness)." He [the Prophet (s)] answered, "It is that you worship Allah as if you see Him. And even though you do not see Him, [you know] He sees you".

### C. What Sunnah tells us about Audit:

In the Islamic perspective, the general meaning of audit is to guard and examine the operation, production, and controlling of contract and dealing with the light of sharia principles to deliver right, trustable and useful information for decision making.

The functioning of Shari'ah compliance has become one of the most important parameters in Islamic banking. Since the financial services are designed in compliance with the Shari'ah guidelines derived from the Holy Quran, therefore, the financial institutions are supposed to make sure the operation of financial services is according to Shari'ah guidelines and to keep the IFIs different from the conventional system. There has been a lot of research work published on the comparison, religiosity, Islamic and conventional banking services, etc.; however, to the best of my knowledge, no research studies have been conducted on the transparency of holding Shari'ah audit while ensuring an independent and qualified auditor in Pakistan. This research study is going to define and bridge the gap between "what is and what ought to be" auditing in Islamic financial services in Pakistan. The research will set policy guidelines on the role of auditors as being independent and qualified persons of the financial services to expand Islamic banking, particularly in Pakistan, and all over the world in general.

The fastest growth rate of Islamic banking in all over the world has raised a number of issues since the conventional banking is also working in parallel. The products and services offered in Islamic banking are based on the parameters of Shari'ah guidelines and hence require complete compliance of all the activities to be performed at the time of executing the transactions. Very few research studies have been conducted on the Shari'ah audit of the transactions in Pakistan. The results of this study will be useful for policymakers, Shari'ah advisors, and general banking personals to ensure the performance of the financial transactions in the light of Shari'ah guidelines developed.

## 2. LITERATURE REVIEW

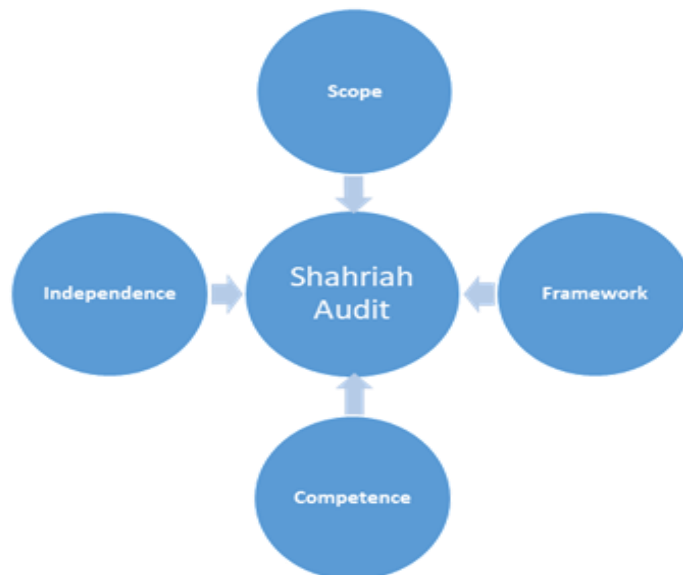
Critical observations on the audit system and demand for different responsibilities and accountability of companies have directed too many debates on the desired and ideal audit functions. E.g.[5,6,7,8]. The professional complications started after the sudden bankruptcy of well-known Enron and some other huge corporations, which made the auditors regular features of news headlines and stories [6]. It has also been debated that the role of auditing and financial institutions should not be limited only to the need of investors

in decisions making but also should be involved in more general apprehensions of corporate governance [5]. According to AAIOFI [9] the word shariah compliance means Islamic instructions, guidelines, and philosophies deteriorating in link with fatwa and directorial philosophies given out by them. Accountability to Almighty Allah (S W T) is the straightforward belief of Islam. Allah the Almighty tells us in the Holy Quran "Truly nothing is hidden from Allah in the earth or in the heaven" [10]. IFIs should have a different perspective from that of the conventional auditing structure which has a very limited scope. According to [11, 12]. While accumulating proof, the conventional auditor's support an objective methodology so the range and opportunity of conventional auditors is partial and imperfect. The area of sharia auditing system is very wide, including Agreement, financial reporting, Marketing, Charities, Zakah, Procedure, commercial plans, Public relations, and information technology applications systems, etc. [13]. So, a well-structured shariah frame is cooperative in keeping the shariah compliance in Islamic institutions [14]. Moreover, auditing in Islam has been resulting in the basic Islamic standards of the Islamic culture; from traditional aspects of "confirm and reassurance" to accomplishing the Maqasedu-al-Sharia [15]. It is also stated that Islamic institutions are supposed to be functioning under Islamic thoughts and should have different types of accounting and auditing system [16]. They are supposed to fulfill the requirements of Islamic culture whose emphases and right of ways are different from the conventional viewpoint. The main duty of the auditor is to support the general public in the daily business dealings [17]. The traditional Muslim

author Al-Mawardi has explained the responsibility of Muhtasib in his well-known book Al-Ahkam Al-Sultania. In fact, he has dedicated a full chapter of his book for this famous proposal which is titled Al Hisab [18]. It is not exaggerating to say that the existing auditor has the same job to complete as was completed by the traditional Muhtasib. The auditing system is based on the independence of auditors [19]. The main focus of the sovereign sharia audit is to protect the public interest not to maximize the profit [20].

**3. METHODOLOGY:**

The basic aim of this study is to explore the gap between the prevailing and the required shariah audit practices in IFIs of Pakistan. It has been discussed that a suitable check and balance system should be present in IFIs to ensure the operation of IFIs in the light of shariah Using interviews and questionnaires in the survey of a different group of responsible persons who are involved directly or indirectly with the practice of shariah auditing in IFIs in Pakistan to achieve the purpose of this study.to maximize the assurance and trust of all investors and stockholders of Islamic institutions. This is because to get a deep insight into the "what is and what ought to be shariah auditing in IFIs in Pakistan". The model for this particular study is developed from the former study Shariah Auditing in Islamic financial institutions: Exploring the gap between the "desired" and the "actual" [20]. The importance and input to the body of knowledge of this study are established on the requirement to study the association between actual and practice of shariah auditing in IFIs.



**Fig. 1**

Source: Kasim, N., Ibrahim, M., Hameed, S., & Sulaiman, M. (2009). Shariah auditing in Islamic financial institutions: exploring the gap between the " desirable" and the " actual" . Global Economy & finance journal, 2(2), 127-137.

**4. DISCUSSIONS OF FINDINGS**

There are four different variables (framework, Scope, Independence, and Qualification) influence the shariah audit of IFIs in Pakistan has been discussed in this study. The table below shows the analysis of the data collected from a total of 70 out of a total of 100 questionnaires which were distributed

among the Shariah auditor involved directly or indirectly in the audit of Islamic Financial Institutions. The analysis was made on the basis of mean values and the variance on the standard of Strongly Agree (5.00) and Agree (4.00) which is tabulated as under.

**Descriptive Statistics:**

Variable	Aggregate mean values		Variance	
	What is	What ought to be	At 5.00 rating	At 4.00 rating
Scope	3.43	5 – 4	1.57	0.57
Framework	4.02	5 – 4	0.98	-0.02
Independence	2.89	5 – 4	2.11	1.11
Qualifications	1.05	5 – 4	3.95	2.95

The above descriptive statistical results were found for the variables (Scope, Framework, Independence, and Qualifications) for the shariah auditors. This points toward the total difference between what is and what ought to be the practice of shariah auditing in IFIs of Pakistan.

**A. Framework:**

Shariah audit framework is the frame of reference to be used by the Shariah auditors to audit the financial statements of Islamic financial institutions before they can decide that the operation of the business is performed in the manner not contradicts the Shariah [21]. This point should be clear that IFIs should start with the aim of helping the general public. Clash stands up when a country had been closely affected by the western legal system in accounting standards or in commercial codes, Because of the lack of knowledge regarding shariah auditing framework. Even though the majority of respondents recognized the crucial need for a specific shariah audit framework which should be different from the conventional framework. Maximum Islamic banks used the conventional auditing framework due to the unavailability of organized shariah auditing framework. According to researchers [22] IFIs are still struggling to launch an effective sharia audit framework. It can be inferred that due to the absence of organized shariah auditing framework the exercise of shariah audit has not prepared a thoughtful influence on the Islamic Financial institutions of Pakistan.

**B. Scope:**

It is essential to discuss the definition and objective of the shariah audit before we start discussing the scope of sharia audit. According to researchers [23] the definition of Shariah Audit is “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 users.” While according to researchers [12] the definition of shariah audit is, "the accumulation and evaluation of evidence to determine and report on the degree of correspondence between the information and established criteria for Shariah compliance purposes”.

According to researchers [24] the core objective of the shariah audit is to practice the compliance of Islamic

financial institutions with shariah in all conceivable aspects. The scope of shariah audit is quite bigger because unlike the conventional audit, it covers the shariah compliances as well as the financial transactions of the IFIs. According to researchers[22] in conventional audits, the auditor is only answerable to the owner and is not directed by shariah but in the shariah auditing system, the auditor is guided by shariah ideologies. This wider scope is also declared by [15] who indicated that "The scope of auditing in the 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"

**C. Independence:**

It is impossible to describe independence exactly because the rules are not able to generate or certify the presence of independence. Independence is an individual personality and also state of observance and should not be mixed up by the artificial and observable standard of independence which is sometimes forced by law. The perspective of independence is of two types, independence of mind and independence of appearance.

According to the International Federation of accountants (IFAC) the independence of mind is, the state of mind permits the delivery of judgment without being affected by powers and independence in mind is the averting of realities and conditions that are so important and rational and update the third party.

The sharia auditors need to be fully independent because shariah audit in IFIs is believed to be a public job for the benefits of common men. The advantages of shariah audits cannot be fully recognized if they are not really independent.

**D. Competence:**

It is mandatory for every auditor to be competent in auditing and accountancy. The competency of an auditor is based on the knowledge of the philosophy and practice of auditing [11]. So, to be competent as an auditor one must have a well-known knowledge of shariah and accounting and also should carry out the audit of IFIs to make institutions answerable to Allah, investor, participant, and to the public.

## 5. CONCLUSION

All variables discussed in this paper show contrary outcome which cause a gap between what is and what ought to be. Because "what is" does not match with "what ought to be". This unwanted situation indicates that shariah audit practice has not taken a good impression on the IFIs in Pakistan, although it is a critical observing instrument for shariah compliance. All variables discussed in this article show a critical gap between what is and what ought to be. It is a must for all the IFIs to fulfill the gap between what is and what ought to be if they want to survive in the market for a long time.

The outcome of this paper shows that still, the task of the shariah audit is extremely shapeless. Actually, the practitioners of shariah audits are mostly unable to fulfill the agenda of Maqasid al shariah. So, this study recommended to the regulatory bodies to design a separate framework for shariah audit and also recommended to the academia for the designing of comprehensive course work and training program for shariah auditors.

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