

A CONCEPTUAL PAPER ON THE FACTORS CONTRIBUTING TOSHORTAGES OF SHARIAH AUDITORS IN MALAYSIA

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ABSTRACT: *This paper explores and reviews previous studies on factors contributing to the shortages of shariah auditors. Based on the searches made, previous studies highlighted ten factors. Among these are talent management, knowledge and competency, training for competent Shariah auditors, higher pay demand, regulatory authorities for shariah compliance, and professional body for the shariah profession. These factors were discussed by previous researchers in separate papers. Data weremostly collected from questionnaires, case studies, and desk-based studies. From the reviews, we aim next to enhance and enrichprevious studies by conducting interviews with shariah auditors and relevant parties to gauge holistic factors on the issues to bestudied. The findings of the study are expected to be valuable and useful input to the relevant bodies and institutions in tacklingthe issues of Shariah auditors shortages, particularly in the Malaysian landscape.*

Keywords: Shariah, auditors, IFIs, Islam, shortages, compliance

INTRODUCTION

The governance of Islamic Financial Institutions (IFIs) requires the institutions to be shariah compliant. This is not only to ascertain compliance with shariah beyond the stakeholders' satisfaction as the users of its services but compliance with shariah in order to meet the required objectives of shariah. This is different from conventional finance where the primary objective is economics. However, IIFs' objective is not only focusing on the economic aspect but the spiritual aspect too. IFIs need 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 [1]. For instance, Islamic banks being one of the IFIs are having stakeholders such as Investment Account Holders (IAH), shareholders, creditors, management, employee, and the community at large. Each of them has their own interest with regard to the Islamic bank's continuity to uphold the shariah principles and values.

One way to safeguard the interest of these stakeholders is by ensuring shariah-compliant operations and offering shariah-compliant services. Thus, to do so, a Shariah Audit (SA) is urged to be performed in those Islamic banking to ensure that corporate, as well as shariah governance, are upheld, indirectly increasing the stakeholders' confidence. In a similar vein, the conventional audit of the financial statement has long been associated with independent verification of whether the institutions' financial statement has been presented with a true and fair view [2]. To establish this, conventional auditors need to have analytical thinking competency as they need to perform audit procedures using certain professional skills and techniques. Similarly, the shariah audit also requires slightly the same competency and skills, together with shariah knowledge in conducting the shariah audit.

Shariah auditing can be defined as a systematic process of obtaining sufficient and relevant evidence to form an opinion as to whether the subject matter i.e., the personnel, process, financial as well as non-financial performance consistent with the shariah rules and principles which is widely accepted by the Islamic community and to report to the stakeholders [3]. In addition, the function of audit from the Islamic view is not only to the stakeholders but ultimately to the Creator, Allah s.w.t as 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" (AlQuran, An Nisa': 86).

Yaacob and Donglah [4], concurs with earlier scholars such as Chik [5] and Kasim et al., [6] that it would be important for the Islamic financial industry to embed the 'check and balance' mechanism following the rapid growth of the Islamic market in the form of shariah auditing tailored made to the objectives and missions of its establishment, the 'maqasid al-shariah' which means the objectives of Islamic law and as part of religious obligation to be the best solution to achieve good corporate governance [5]. The key objective of shariah is the recognition of benefit to the people (maslahah of the ummah), relating to their affairs both in this world and the hereafter [7] as opposed to merely maximizing profit as the goal of conventional banking institutions. On another note, the Shariah Governance Framework (SGF) introduced by BNM in 2010 defined shariah audit in para 7.7 as a "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" [8]. Although the number of Islamic financial institutions is increasing across the world, SA is still in the amateur stage and considered a new competency area [9]. This is true not just in Malaysia, other developing countries also face the same challenges. For instance, in Bangladesh and Pakistan, although the number of full-fledged Islamic banks is increasing, SA is still not made mandatory and the Shariah Supervisory Council (SSC) is not even mandated by the central bank [9] [10]. Even the shariah governance practice is also voluntary in the Islamic insurance industry of Bangladesh [11].

SHARIAH AUDIT REQUIREMENT IN MALAYSIA

The Malaysian government recognizes the significance of having an independent audit performed on businesses. All private limited companies in Malaysia must be audited by external auditors, except for Islamic banks supervised by the Islamic Banking Act 1983. The relevance of shariah governance is recognized by instilling it as a way of improving corporate governance in Malaysian businesses, as detailed explicitly in the SGF issued by BNM and became effective on January 1, 2011. The guideline particularly states that Islamic banks in Malaysia must create and appoint a shariah affairs

committee. The committee is responsible for liaising with other boards of directors to verify that the banks thrive in a shariah-compliant manner.

On the other hand, Malaysia lacks competent shariah officers who are both auditing and shariah experts [6]. Before BNM introduced SGF in 2011, the shariah governance of the IFI was delegated to a shariah committee responsible for overseeing any shariah-compliant affairs. They must conduct shariah review and shariah audit. No particular shariah governance standards in IFIs exists at the time. Nevertheless, significant developments have been observed in shariah matters in IFIs since 2011, when the SGF was implemented. Shariah issue has been taken seriously by the SGF through the establishment of four (4) shariah functions implemented in Islamic finance notably;

- i. Shariah risk management control under the supervision of the board risk management committee and the management
- ii. Shariah review function governed by shariah committee and the management
- iii. Shariah audit function under the shariah committee
- iv. Shariah audit function

This research will focus on the shariah audit function, which will report to both the board audit committee and the shariah committee. The shariah research and review functions are carried out by shariah officers who are shariah undergraduates in the respective IBs. Nevertheless, the shariah risk function is usually carried out in tandem by shariah and finance officers, who usually are undergraduates majoring in shariah or finance. The shariah audit function is presently carried out by the IBs' internal auditors with no clear guidelines on the ideal qualification of a professional to be appointed as the shariah auditor of an IB.

Therefore, shariah auditing must be addressed at multiple levels, including the industrial and educational levels, where human capital in the form of practitioners and shariah auditors must first be solved. Thus, this study will examine the factors that contribute to the shortages of shariah auditors, in the Malaysian context.

ISLAMIC AGENCY THEORY

Agency theory attempts to explain the relationship and self-interest of the vital individuals in the business organization. The theory has been commonly referred to when understanding the relationships between principals and agents. In a specific business transaction, the principal is represented by the agent and should represent the principal's best interests without consideration for self-interest. The differences in interests between principals and agents may cause conflict since certain agents may not always act in the principal's best interests. Miscommunication and disagreement lead to a variety of issues within an organization. Mismatching desires can further lead to inefficiencies, financial losses, poor scandal, and even a bad reputation for the organization. The principal-agent issue arises when the interests of a principal and an agent conflict.

Solid business policy and excellent corporate governance should be used to help companies avoid these scenarios. Normally ethical individuals are exposed to moral hazards due to these conflicts. Incentives can be utilized to redirect the agent's conduct and realign their interests with the principal's concerns. In IFIs, similar issues of agent principles are

believed to occur. Hence, this study refers to the Islamic agency theory related to shariah governance.

The traditional agency theory of corporate governance is quite different from shariah governance [12]. Agency theory is related to the relationship between manager and shareholder where agency conflict exists [13]. The shariah governance requires a different framework to explain the relationship between the principal and agent [14]. Agency theory in shariah governance focuses on compliance with shariah rules and regulations in shariah-based contracts. Sound shariah governance is mandatory for Islamic finance development because dealing with the dynamicity of shariah-based contracts is better [15]. Shariah audit is a tool that can mitigate the agency problem to a great extent and ensures good governance.

In some cases, agents may go beyond financial interests, such as religious values. They focus more on ethical values than financial interest, which is the primary concern of traditional agency theory. This philosophy makes the agent more accountable in shariah governance. Shariah Supervisory Board mainly applies the SGF, which is in charge of accountability [12]. The proper functioning of this board depends on the independence of board members' appointment, members' competence, consistency in the judgment provided and confidentiality or disclosure of information [16]. Shariah framework varies from the corporate governance framework from several viewpoints. Shariah framework does not allow any interest to be charged. Instead, it focuses on profit sharing investment contracts [17]. Investment is treated differently in the shariah framework and comprises a significant percentage of total assets in Islamic banks. Nevertheless, these investment holders have no representation on the board, making the agency problem more acute [18]. Moreover, the financial condition of IFIs requires additional items to be incorporated in the financial statements, such as zakat, which is absent in non-Islamic organizations, and an alternative theory was suggested to explain the relationship between principal and agent in Islamic financial contracts [12]. The agency theory was criticized as not fitting the structure of the shariah framework. Under shariah governance, the agency problem is the non-compliance of shariah, whereas traditional agency problems are limited to fixed agency costs. As the traditional agency theory has many limitations to fitting into the Islamic structure, this study has focused on shariah or Islamic agency theory. The shariah agent will be guided by the shariah rules and regulations, having utmost accountability to the Almighty. Besides, the shariah agent will apply the best practices to satisfy stakeholders' best interests. In the case of shariah audit, shariah auditor will serve as shariah agent who will ensure that all the activities of Islamic finance comply with shariah. Resultantly, agency problems and agency costs of IFIs will reduce.

Thus, a sufficient number of shariah auditors serving as agents are very crucial in ensuring total compliance to shariah corporate governance in line with the Islamic Agency Theory. Although shariah auditing has been established for nearly ten years, it is still considered a new competency area [20]. The number of qualified shariah auditors in Malaysia is still relatively low despite the growth of IFIs. Therefore, this study aims to identify factors contributing to the shortages of shariah

auditors. The following section will discuss previous literature concerning the factors affecting the supply of sharia auditors in the IFIs.

LITERATURE REVIEW

There is currently a scarcity of literature in terms of empirical studies on shariah auditing issues. Previous studies discussed shariah audit practices, SGF, shariah auditor's competency, shariah talent, shariah standards, and shariah audit education separately. The majority of research is in the form of empirical study, case study, desk-based study, conceptual paper, and mere discussion through conference proceedings. Previous scholars have researched the areas discussed below.

TALENT MANAGEMENT

Despite the significance of shariah auditing, little is known on implementing efficient and effective shariah auditing from a human capital viewpoint. Thus, Shafii, Mohd Ali, and Kasim [21] explored human capital development from an educational standpoint in order to meet the need for shariah auditors in Malaysia IBs auditors in Malaysian IBs. Shafii *et al* [21] explored the competency criteria as a talent management tool for shariah auditors in Malaysian IFIs. They conducted in-depth interviews to obtain feedback from individuals directly engaged in developing standards for IFIs and practitioners who perform shariah audits within their organizations. Therefore, 30 practitioners were interviewed, including shariah auditors from IFIs, the heads of shariah audit departments (HSA), and the head of the BNM's IB department. From their findings, Shafii *et al* [21] concluded that one method to solve the difficulty of managing talent flow, particularly a scarcity of essential competencies from shariah auditors, is to be systematic in managing human resources if IFIs want to acquire and maintain a competitive edge in the years ahead.

They discovered from the participants that particular abilities, knowledge, traits, and years of field experience are essential to becoming competent shariah auditors. Hence, these aspects must be managed and considered when recruiting the shariah auditors or talent flow in this context.

KNOWLEDGE AND COMPETENCY

Islamic finance is one of the world's fastest-growing finance sectors. The continuous expansion of this industry certainly creates a significant need for skill and knowledge. According to reports, the sector is in dire need of highly skilled and talented human resources to drive its future development. Previous scholars have studied knowledge and competency in the context of shariah auditors. For instance, in their quantitative survey, Ab. Manan and Anas [22] concluded that graduated university undergraduate students in Islamic Finance have the ability to address the industry's shariah talent shortage, or in other words, they have the potential to be recognized as industry feeders. Knowledge, practical knowledge, analytical skill, interpersonal competence, and shariah knowledge were among the attributes used to evaluate respondents.

The majority of Malaysian undergraduates are trained in auditing due to accounting courses provided by public and private institutions or as shariah graduates of Islamic Studies degrees. In addition, Shafii *et al*. [21] found that no professional bodies or local universities in Malaysia offer professional certification for shariah auditors. Thus, they questioned whether the existing educational system is ready

and capable of preparing human capital to adopt shariah auditing in Malaysian IBs.

TRAINING FOR COMPETENT SHARIAH AUDITORS

Performing shariah audit requires auditors to have appropriate knowledge of shariah, Quran, and Sunnah besides traditional auditing and finance skills. According to Farooq and Alahkam [23], the auditors performing shariah audits must acquire knowledge of English and the Arabic language in addition to accounting, finance, auditing and modern business. These areas of knowledge are crucial to being a competent shariah auditor. With this knowledge, shariah auditors can make decisions based on their knowledge and experience when no specific guidelines are available to handle the situation.

During the initial phase of the industry, the IFIs faced challenges as shariah scholars, including shariah auditors, with experience and expertise in the field, were hardly found. Nevertheless, these people are highly demanded. Hence, preparing shariah scholars and shariah auditors to serve the industry better is essential to ensure that future generations of shariah auditing experts can be reared and prepared systematically.

As highlighted in the knowledge and competency discussion, education today does not combine both areas of fiqh muamalat (Islamic commercial jurisprudence/shariah) and auditing knowledge. Most graduates have either one of the qualifications only. Shariah auditors with good shariah and auditing knowledge are rarely found in practice [24]. The success of shariah audit relies on well-trained and competent shariah auditors [9]. Hence, personnel in this work scope are required to attend training in both areas to equip themselves with the proper knowledge and skills.

Currently, few local institutions in Malaysia have offered relevant training on shariah audits. Some of these agencies are International Centre for Education in Islamic Finance (INCEIF), the Centre for Research and Training (CERT), the Islamic Banking and Finance Institute of Malaysia (IBFIM), and the National Association of State Boards of Accountancy (NASBA).

The CERT offers a shariah audit workshop covering comprehensive and practical knowledge on shariah compliance review, information technology processes and methodology, audit, and governance for IFIs. On the other hand, IBFIM offers Certified Professional Shariah Auditor (CPSA) program, which offers technical knowledge and professional skills for the IB and financial industry's shariah compliance review and audit procedures. The NASBA offers Certified Islamic Specialists in shariah auditing, which prepares participants with specific skills and knowledge in the area of shariah audit required for professionals to carry out the task in the most efficient way.

As only a few institutions offer training in both auditing and shariah law, a more structured and systematic approach to the education and training of shariah scholars and experts is needed [25]. Besides formal training and qualification, researchers suggest using a postgraduate program as a platform to provide an appropriate and effective way of educational discipline in producing well-recognised shariah scholars and shariah auditors. A mentor-mentee program is

also viewed as informal to produce more competent shariah auditors where experience mentors can guide the new auditors.

HIGHER PAY DEMANDS BY SHARIAH AUDITORS

Unlike conventional auditors, shariah auditors are new professions and still lack proper standards and guidelines. In general, competent shariah auditors require knowledge in both areas of shariah and auditing. The ability to converse in a language like English and Arabic and vast experience and knowledge concerning modern dealings in the transaction of financial matters will be an advantage.

As discussed in training for competent shariah auditors, the industry faces challenges in obtaining suitable candidates with both shariah and audit knowledge. The current accounting or auditing system and procedures do not fully comply with Islamic Shariah. This personnel has limited knowledge of shariah [26]. As a solution, the potential candidates will have to undertake proper training and programs conducted in-house and those offered by established training institutions such as IBFIM, CERT, INCEIF, and several other institutions in related areas. The additional cost and time sacrificed by the candidates cause the personnel in this profession to demand higher pay in co-compensation for their effort to be an expert in the areas, especially the senior individuals.

REGULATORY AUTHORITIES FOR SHARIAH COMPLIANCE

Accounting standards guide auditing work. The International Financial Reporting Standards (IFRS) is commonly referred to as the basic auditing guidelines. The audit work is also expanding to shariah compliance, namely shariah auditing with the expansion and growth of IFIs. In Malaysia, BNM is the main regulatory body of Malaysian IFIs, besides several other local institutions supporting BNM. Furthermore, this regulatory body established the SGF in 2010 and embeds shariah auditing as one of the shariah functions. The framework is widely accepted and followed by most IFIs operating in Malaysia.

The SGF is introduced with the aim to be utilized and referred by all IFIs, including banking and takaful operators. The SGF assures the industry players of the importance and the authenticity of financial reporting as per the shariah law framework. Proper monitoring and a well-established framework enable IFIs to reach the actual objectives of shariah subservience in IFIs, enabling them to serve society at large [27]. The Malaysian government issued new regulations under the Islamic Financial Services Act (IFSA) in 2013. The new regulation emphasizes the necessity of shariah compliance in all businesses and operations of IFI. In addition, it stresses the need of promoting shariah compliance and financial stability. The IFSA ensures that the operations of companies' internal policies and processes conform with BNM's SGF guidelines. Although SGF has been used and well-accepted as a guideline for IFIs, overall, the industry still needs good governance and direction to achieve its potential best. The SGF is a framework prepared for all. Hence, some have claimed the framework of IFIs to be too general and 'does not fit all size'. The framework is unclear concerning the suitable due process to be undertaken before voicing an opinion. An opinion can be issued without proper guidelines and instructions about every situation or type of situation. Therefore, the auditor has to rely a lot on his knowledge, experience, and the presence of a professional

mind in securing the shariah audit rules, especially in an unpredictable economy [28].

Furthermore, the current practice refers to a framework and guidelines from various bodies which are not standardized. Thus, a structured shariah auditing framework is required to assist all parties involved in conducting such audits [29]. The regulatory body is suggested to synchronize shariah auditing practices as one standardized or structured framework. A standardized or structured framework would assist IFIs in preparing shariah auditing flows, programs, and procedures. Yahya [30] supported the suggestion for a standardized framework of shariah audit, as highlighted by internal auditors in their study. Moreover, the conventional auditing system relies on an established set of guidelines, documented and nearly universal globally. In contrast, shariah auditing relies on an informal and largely unstructured process to certify the next generation.

This limitation further builds the bridge between the two systems and requires attention from the regulatory bodies to close the gap between the two areas, hence completing the process.

PROFESSIONAL BODY FOR THE SHARIAH PROFESSION

Unlike conventional auditors, shariah auditors, also known as Muhtasib, are responsible to all the stakeholders, such as investors, creditors, regulators, government, the general public, and, most importantly, Allah SWT. It serves more than the assurance of financial statements, internal control systems, and governance [30]. Farook and Farooq [25] suggested that a professional body oversees, recognizes, and certifies this profession due to its significant responsibilities and vast knowledge requirement. If conventional accountants have their professional bodies, such as the Institute of Chartered Accountants in England and Wales (ICAEW), Association of Chartered Certified Accountants (ACCA), Certified Public Accountant (CPA), and Malaysian Institute of Accountants (MIA), regulate the profession, the shariah auditor also requires such institutions.

This professional body should better govern shariah auditors' role and function, resolve the mentioned difficulties, boost the supply of shariah scholars, and encourage the long-term growth of the IFI industry. It answers the question of who guards the guards themselves. The establishment of a professional body will clarify the scope of shariah audit, shariah auditors' qualifications, and enhance the integrity and interests of the profession. In the long term, the shortages of shariah auditors in the IFIs is believed to be filled up.

SCOPE OF SHARIAH AUDIT

Khalid, Haron and Masron [31] have highlighted four issues of shariah auditing, namely the audit scope, the auditor's qualification, the auditor's independence and the shariah audit framework. There is a conflict in the context of who should perform the scope of shariah audit as no clear guideline exists on whether shariah professional or professionally trained internal auditor should perform the shariah audit [27]. Nevertheless, earlier scholars Farooq and Tbeur [32] emphasized that if internal auditors were responsible for performing the shariah audit, they must be knowledgeable for performing the audit work under the rules of shariah law and expert enough to ensure the integrity expected from shariah

audit.

SHARIAH GOVERNANCE FRAMEWORK (SGF)

Shariah audit provides a higher assurance level by following the rules and regulations of Islamic Shariah. Shariah is the overarching framework for shariah audit, ensuring that all the activities of IFIs comply with shariah. While conventional auditors have limited liability towards investors and creditors, shariah auditors have more accountability to all the stakeholders, including Allah SWT, as Muslims believe their deeds are watched by Allah (Muraqabah concept) [33].

Thus, the shariah audit can ensure good governance, although a few challenges hinder the implementation of the shariah audit. Nevertheless, designing an appropriate SGF can resolve the issues [33]. Rahman [9] argued that conventional auditing and shariah auditing are two different areas. Under conventional auditing, the area and liability of the auditor are shorter than in shariah auditing because the auditor has liability only towards the clients and the owners in regular auditing. Nonetheless, in shariah auditing, the auditor is liable to a wider scope of people, such as the financiers and the related party, society, law, order, and Islamic rules and regulations [34]. The auditor must have explicit knowledge of Islamic Law and its practice to fulfill his contract with integrity, non-biasness, and faithfully [35]. Radzi [36] concluded that a framework for shariah audit must be developed to reach the actual objectives of shariah compliance in IFIs that might help serve society.

The SGF is mandatory to conduct a shariah audit because the external auditor faces difficulties to verify whether all transactions are done as per the Islamic financial law or keeping the norms of Al-Quran and Sunnah if the internal auditor or management fails to provide evidence [37]. Noordin and Kassim [27] concurred with the earlier scholars that the shariah regulated auditing could confirm to the public that the financial reporting is relevant and authentic as per the shariah law if Islamic accounting and Islamic finance are governed and regulated well in the country through proper monitoring and a well-established framework. A proper framework will assure the auditor's accessibility to the required documents of the company, and the management will be bound to provide them with all the evidence an auditor requires [23].

INDEPENDENCE OF SHARIAH AUDITOR

Shariah auditors must be independent in their appearance and work performance to generate fair audit results and provide correct feedback and opinions. Commonly, shariah auditors will have to depend too much on the shariah directions, which sometimes may fail to obtain the expected results of the owners or the management [38]. The auditors must have the access required to conduct the audit as the main objective of the shariah audit is to ensure greater benefit for the people and be unbiased as possible. Hence, the goal of the shariah audit will be achieved [31]. On another note, the usual internal auditor will also perform the additional shariah audit works on top of their usual audit work due to a lack of shariah auditor competency. Thus, this practice could adversely affect the shariah auditor's independence.

CHARACTERS AND ATTITUDE OF NEWLY TRAINED SHARIAH AUDITORS

Currently, the shariah audit is performed by internal auditors. The SGF provides the basic guideline for internal auditors to

perform the shariah audit work after gaining adequate shariah knowledge and training. In order to complete an audit work within the stipulated time and budget, sometimes the auditors may be required to work beyond office hours. They will have to stay back and work for long hours. The findings of Mohd Ali *et al.* [39] indicated that several firms had difficulty getting the right shariah auditors. New graduates trained as shariah auditors move to other institutions that offer better pay. A number of candidates were found to have less work commitment and were unable to cope with pressure. Consequently, they left after costs had been incurred in training the candidates.

CONCLUSION

The study has taken significant steps to examine the factors contributing to the shortages of shariah auditors from practitioners' views in IFIs via the interview method. Previous literature reviews have not studied the comprehensive factors (more than one factor) of shortages of shariah auditors. Previous scholars merely focused on one area of the factors only. Therefore, this paper intends to gauge holistic factors on the issues to be studied. Furthermore, previous studies were conducted using questionnaires, case studies and desk-based studies. Very few studies have used interview methods in different research scopes. Hence, this research aims to enrich the previous findings by interviewing practitioners, particularly the shariah auditors.

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