
Expectation vs Reality: A Study on the Perceptions of Shariah Committee on the Shariah Audit Practice in Malaysian Takaful Industry

Jangkaan vs Realiti: Kajian Mengenai Persepsi Jawatankuasa Syariah terhadap Amalan Audit Syariah dalam Industri Takaful Malaysia

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ABSTRACT

The growth in the development of Islamic financial system is contributing to the positive demands of the goods and services provided by Islamic financial institutions. Some of them could, however, have overlooked certain factors that could influence the enforcement of goods and services with Shariah. The occurrence of a risk of shariah non-compliance may adversely affect the credibility of Islamic finance and the trust among market participants. This is where shariah audit function play an important role in ensuring the good internal control for shariah compliance. Shariah Committee also as one of the components of Shariah governance have to be responsible for every Shariah matters in IFI. The aim of this study is to examine the existence of the gap between the expectations of Shariah Committee and the actual practice of shariah audit. Twenty one (21) semi-structured interviews were conducted involving selected auditors and Shariah committee members from each of Takaful Operators. Thematic analyses were adopted to analyse the data. It can be deduced that there is a gap between the expectations of Shariah Committee and the actual practice of shariah audit which provide the area of improvement in the future.

Kata Kunci:

[Audit Syariah;
Takaful; Analisis
Jurang;
Jawatankuasa
Syariah]

ABSTRAK

Pertumbuhan dalam pembangunan sistem kewangan Islam menyumbang kepada permintaan yang positif bagi produk dan perkhidmatan yang disediakan oleh institusi kewangan Islam. Walau bagaimanapun, faktor tertentu yang boleh mempengaruhi penguatkuasaan produk dan perkhidmatan patuh syariah tidak diberi perhatian sepenuhnya oleh beberapa pihak. Oleh itu, terdapat kejadian dimana telah berlakunya risiko ketidakpatuhan syariah yang boleh menjejaskan kredibiliti kewangan Islam dan kepercayaan di kalangan

pelanggan. Maka, di sinilah fungsi audit syariah memainkan peranan penting dalam memastikan kawalan dalaman yang baik untuk pematuhan syariah. Jawatankuasa Syariah yang dilantik juga merupakan salah satu komponen tadbir urus Syariah perlu bertanggungjawab ke atas setiap perkara Syariah di Institusi kewangan Islam itu sendiri. Objektif utama kajian ini adalah untuk mengkaji wujudnya jurang antara jangkaan Jawatankuasa Syariah dan amalan sebenar audit syariah. Dua puluh satu (21) temu bual separa berstruktur telah dijalankan melibatkan juruaudit terpilih dan ahli jawatankuasa Syariah daripada setiap Pengendali Takaful. Daya Analisis tematik telah digunakan untuk menganalisis data. Melalui hasil kajian, ia dapat disimpulkan bahawa terdapat jurang antara jangkaan Jawatankuasa Syariah dan amalan sebenar audit syariah yang menyediakan ruang penambahbaikan pada masa hadapan.

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INTRODUCTION

In the development of Islamic Financial Institutions (IFIs), compliance with Shariah is the most important feature that distinguishes IFIs from other subdivisions of the global financial system. Failure to comply with Shariah can damage public trust in the purity of IFI activities and thus reduce their market capitalization. Shariah non-compliance risk is the possibility of loss resulting from the failure of the IFIs to comply with the rules and principles of Shariah laid down by the Shariah Board or the relevant authority in the jurisdiction in which the IFI works.

In regard with ensuring the shariah compliance for IFIs, shariah audit function demonstrates an additional governance framework in accordance with its Islamic financial accountability and the interest of stakeholders. On the same ground, Shariah Committees (SCs) play a crucial role for the issuance of a quality Shariah compliance assurance in the annual Shariah report of IFIs. Due to prior to the issuance of SGF 2011(now replace with Shariah Governance Policy Document 2019), the role of ensuring Shariah compliance is under the responsibility of the Shariah committee. Moreover, Shariah Committee is the one who will assess the work carried out by Shariah audit in order to ensure compliance with Shariah matters which forms part of their duties in providing the assessment of Shariah compliance and assurance information in the annual report. Due to this, any insight and recommendation from the Shariah committee are very useful in enhancing the current practices.

Main focus for this study is Takaful industry because most of the previous studies focused on Islamic banking sector. Besides, the Takaful area is deemed to be the leading field because Malaysia has emerged as the world's largest family Takaful market. Previously, there are a few issues which have been determined with regard to the Takaful industry such as shortage of human capital, inadequate technology capabilities, lack of innovation in the business model for new market niches, and ineffective governance practices (Moheeb, 2011; Deloitte,

2015; Mohd Fauzi et al., 2016). These highlighted issues of Shariah governance in the Takaful industry have also become a motivational factor in selecting Takaful Operators as the main attention. The issue associated with this research is ineffective governance practices, which subsequently expose the Takaful Operators in their operations and activities to the risk of shariah non-compliance.

This study is undertaken based on the premise of the importance of having a good internal control of shariah non-compliance risks for the purposes of developing a robust shariah governance framework in the Islamic financial system. Hence, the main objective of this paper is to identify the gap between the expectations of shariah committee and the actual practice of the current shariah. This study is also conducted to address these three research questions; 1) What is the expectations of Shariah Committee on the Shariah audit practice?; 2) How is the actual practice of shariah audit? and 3) What are the gaps exist in the practice of shariah audit?

This paper is divided into four main sections. Literature review section discusses the development of Malaysian Takaful industry, regulatory framework for shariah governance, Shariah audit practices in Malaysia and the role of shariah committee. Section three features the elaboration on the methodology and design of study involved. Then, section four presents the substantial findings, and the final section contains the concluding comments.

LITERATURE REVIEW

Development of Malaysian Takaful Industry

The development of Takaful in modern times was initially undertaken in Sudan in 1979 and Malaysia in 1984. The Takaful industry development in Malaysia in the early 1980s was inspired by the prevailing needs of the Muslim public for a Shariah-compliant alternative to conventional insurance, as well as to complement the operation of the Islamic bank that was established in 1983. The first takaful operator, Syarikat Takaful Malaysia Berhad, was set up in 1984 to provide complementary services to Bank Islam.

The Malaysian government enacted the first dedicated act for Takaful in the world, known as the Takaful Act 1984, to regulate the Takaful and retakaful industry as a measure to ensure the orderly development of Takaful which is premised on a different legal and philosophical framework and to nurture Takaful into a strong and well-developed business on par with its conventional counterpart. As a result of the introduction of the Takaful Act 1984, Malaysia has been recognized as a pioneer of Takaful in Southeast Asia (Lambak & Tahir, 2013). The Takaful Act provides for the regulation of the Takaful business in Malaysia and other purposes related to Takaful.

Bank Negara Malaysia (BNM) initiated the Financial Sector Master Plan (2000–2010) with the aim that the Takaful industry and Islamic banking will contribute at least 20% of the total market share of the financial sector. Subsequently, the Financial Sector Blueprint (2011–2020) targeted to increase the market share of Islamic banking and finance in Malaysia to at

least 40% by the year 2020. The development of the Takaful industry in Malaysia has shown remarkable performance. From a single Takaful operator in 1984, BNM has extended the award of Takaful licenses to conventional financial institutions. To date, Malaysia has a total of fifteen (15) Takaful Operators for family and general Takaful businesses.

Regulatory Framework for Shariah Governance in Malaysia

The policy document on Shariah governance was introduced on 20th September 2019 and shall be effective starting 1st April 2020. In relation to the Takaful industry, this new policy will supersede a few other policy documents known as Shariah Governance Framework for IFIs issued on 22 October 2010 and Paragraph 13.5 of Financial Reporting for Takaful Operators issued on 2 February 2018. This policy document aims to further enhance the effectiveness of the implementation of Shariah governance and reinforce a closer integration of Shariah considerations into IFIs' business and risk strategies.

Before the introduction of these policy documents, IFIs have to comply with the Shariah Governance Framework (SGF) which was introduced back in 2010. The Shariah Governance Framework was found to be an important mechanism in ensuring that IFIs fulfill their roles in accordance with Shariah principles in the interests of depositors, investment account holders, shareholders and stakeholders (Mohamad et al., 2016). Among the aims of SGF 2010 is to provide a proper regulatory framework for IFIs to operate within the required Shariah framework that will further enhance international investor confidence in the country's rapidly growing Islamic Finance industry.

There are a few concepts which have been observed related to Shariah governance structure as revealed by Obid and Naysari (2014) in previous studies which include accountability, transparency and disclosure, competence, confidentiality and independence. According to Ismail and Abdul Razak (2014), this structure could be regarded as the most structured and prudent Shariah governance framework in the World Islamic Finance industry. It is also another landmark in strengthening the governance culture within the Islamic finance industry in Malaysia, while at the same time promoting and maintaining stakeholder market confidence. Among the important shariah governance organs in SGPD2019 include of shariah audit function which become the main concern in this study.

Empirical Studies on the Practice of Shariah Audit in Malaysia

The study on Shariah audit practice was started by Yahya and Mahzan in 2012 which found that the practices of shariah audit in Malaysia are acceptable since the Shariah audit function was just introduced during that period. Among suggested areas to be improved includes promoting understanding of Shariah auditing among internal auditors, enhancing Shariah knowledge of internal auditors, standardizing the Shariah audit structure, and providing general guidelines to develop an audit program for Shariah auditing.

There are other studies that were conducted to further explore the current audit practice (Kassim & Zuraidah, 2013; Ab. Ghani & Abdul Rahman, 2015; Yazkhiruni et al., 2018). Kassim et al. (2013) in their study assessed the current practice of auditing in IFIs in Malaysia and Indonesia. The research found that the practice of Shariah auditing either in

Malaysia or Indonesia was unregulated as each IFI had established its policies and a checklist in performing Shariah auditing and therefore the study emphasized the need for a comprehensive framework for Shariah auditing.

On the same ground, the study by Ab.Ghani and Abdul Rahman (2015) examined the extent of Shariah audit practices in Islamic banks. The results of the study indicated that the majority of Islamic banks have appropriately set audit objectives, governance structure, competency requirements, audit process, and reporting requirements even though some have not clearly outlined their audit scope and audit charter.

Meanwhile, the study conducted by Yazkhiruni et al., (2018) can be regarded as the latest study on Shariah audit practice which explored present Shariah auditing practices among IFIs (IFIs) in Malaysia through semi-structured interviews. The findings of the study showed that the procedures are still evolving where further developments and improvements are needed with a particular focus on the standardization of the Shariah audit framework and guidelines for the design of the Shariah auditing audit program.

Role of Shariah Committee

The recruitment, removal and renewal of Shariah Committee members from the IFIs in Malaysia is directly supervised by the Central Bank. The IFI recommends the applicant to the Central Bank with the necessary information for appointments, and the Central Bank takes the final decision after due diligence. The IFI can only recommend that a member be changed or excluded from the Central Bank and the latter, after due deliberation, will have the final decision. Daily absences from scheduled meetings or health issues are usually the only reasons why the Central Bank removes a member from the committee before his term expires (Shamseer & Sori,2016).

The main responsibility of SC is monitoring and governing the operations of IFIs and functions as a control mechanism to ensure the Shariah compliance of the institutions in their services and management (Masruki et al.,2020). In monitoring the entire operations in IFIs, a successful SC must represent integrity, transparency and disclosure. Due to this, SC members are appointed from among the Shariah scholars in order to lead the IFIs with Islamic values and compliance with Shariah. SC also is one of the components of Shariah governance to ensure Shariah compliance in the banks' day-to-day operations and activities.

RESEARCH METHODOLOGY

The purpose of this study is to gain insight of shariah committee and shariah auditor on the current practice. This study employed a qualitative approach using in-depth interviews to gather evidence. Despite the issues can be examined in detail and in depth, the data collected on the basis of human experience is also more powerful and even more convincing than quantitative data (Rahman, 2017). On the same ground, by using in depth interviews, it allows the researcher to gather information about participants' experiences, views and beliefs concerning a specific research question or phenomenon of interest (Ryan et al., 2009). This study adopts a basic qualitative study or also known as a basic interpretive study for the

research design which is has the goals on understanding how people make sense of their experiences.

The researchers then employed a purposive sampling strategy whereby we engaged with the respondents whom are willing to participate in this study. Twenty one (21) interviews using semi-structured interview questions were undertaken which consist of Shariah auditor, Chief of Internal Auditor and Shariah committee which involved in the practice of Shariah audit for Takaful industry. The details of respondents are shown in Table 1 below. Based on the details of respondents, it can be considered that all of them are very highly knowledgeable, have vast experience and play a dominant role in their organizations. The interviews were conducted by the researcher via face-to-face sessions. A semi-structured interview approach was used, starting with a set of questions that was extended according to the circumstances.

The observation on how these respondents replied to the questions raised was made. The study used thematic analysis. It included transcriptions of interview recordings and the coding stages proceeded. After obtaining the data from the interview sessions, the data was transcribed to attain general ideas of what the interviewees were responding to and to further reflect on its meaning before the data was encoded. Coding of the data is the process of managing the data into segments of text before being generated into information and serves as the formal representation of analytic thinking. Before come out with the final themes, the researchers initially read and re-read transcripts to establish possible themes based on the research questions. The method chosen is inspired by Braun and Clarke's (2006) six-step approach that involves: getting familiar with the data through transcription; generating initial codes; searching for themes; reviewing themes; defining and naming themes; and producing the final written output.

Table 1.0: Details of Interviewees

| Interviewees | Gender | Highest Qualification | Role | Years of experience in industry |
|---------------------|---------------|------------------------------|---------------------------|--|
| Respondent 1 | Male | Bachelor degree | Shariah auditor | 16-20 years |
| Respondent 2 | Female | Bachelor degree | Shariah auditor | 6-10years |
| Respondent 3 | Female | Bachelor degree | Shariah auditor | 6-10 years |
| Respondent 4 | Male | Bachelor degree | Chief of Internal Auditor | 16-20 years |
| Respondent 5 | Male | Master degree | Shariah auditor | 11-15 years |
| Respondent 6 | Male | Bachelor degree | Shariah auditor | 6-10 years |
| Respondent 7 | Male | Bachelor degree | Shariah auditor | 11-15 years |
| Respondent 8 | Male | Bachelor degree | Shariah auditor | 11-15 years |
| Respondent 9 | Female | Bachelor degree | Shariah auditor | 6-10 years |
| Respondent 10 | Male | Master degree | Shariah auditor | 11-15 years |
| Respondent 11 | Female | Doctorate | Shariah committee | 16-20 years |
| Respondent 12 | Female | Doctorate | Shariah committee | 6-10years |
| Respondent 13 | Male | Doctorate | Shariah committee | 6-10years |
| Respondent 14 | Female | Doctorate | Shariah committee | 16-20 years |
| Respondent 15 | Male | Doctorate | Shariah committee | 11-15 years |
| Respondent 16 | Male | Doctorate | Shariah committee | 16-20 years |
| Respondent 17 | Female | Doctorate | Shariah committee | 11-15 years |
| Respondent 18 | Male | Doctorate | Shariah committee | 11-15 years |
| Respondent 19 | Male | Doctorate | Shariah committee | 11-15 years |

| | | | | |
|---------------|------|-----------|-------------------|-------------|
| Respondent 20 | Male | Doctorate | Shariah committee | 6-10years |
| Respondent 21 | Male | Doctorate | Shariah committee | 11-15 years |

FINDINGS AND ANALYSIS

This section discusses shariah committees' expectations of the shariah audit practices based on their feedback in the interview sessions. The actual current practices of shariah audit will be described afterwards. Analysis will be conducted at the end of the study to identify the gap between the expectations of the Shariah Committee and the actual practice of shariah audit.

Expectations of Shariah Committee on Shariah Audit Practices

1. *Qualification of the Shariah Auditor*

Based on the interview analysis, all Shariah Committee agreed that in order to become competent shariah auditors, they must possess both shariah and accounting knowledge. However, there are few shariah committee emphasized on the importance of having shariah background auditors rather than accounting background of auditor and they also agreed a Shariah auditor must have Shariah background, be it at first degree level or master's degree level or doctorate level. Auditors with Shariah background have a capability to trigger any issues of Shariah non-compliance risk.

Having a solid Shariah background is very essential to assist the auditor in recognizing the existence of Shariah risk and the confusion between operational issues, legal issues and Shariah issues. Sometimes, the Shariah training conducted for the auditor is not sufficient to make the auditor an expert in the Shariah field as normally Shariah training is only conducted for one or two days, whereas a longer period is needed for someone to become acquainted with Shariah knowledge.

In some cases, the auditors without Shariah background found the issues by accident only and it is very harmful as there might be possibilities of Shariah non-compliance risk to occur. Besides, an auditor with Shariah background normally will have a different level of thinking rather than just referring to the manual or to the Shariah standards which would give much advantage to the Shariah auditor. Below is among the respond from Shariah Committee on the qualifications of shariah auditor:

“the most important thing is that they must have Shariah background. Otherwise, how can they decide whether this area is a trigger for the issue of Shariah non-compliance risk. Because they do not know what is the requirement for the contract of tabarru’? what is tabarru’? what is the difference of tabarru’ and exchange contract? what happens to the surplus? What is the purpose of the surplus? There are many more Shariah issues that we need to look at. But it really requires someone who has the solid Shariah background.” (R3)

“for a non-Muslim auditor or non-Shariah background auditor, when they perform Shariah audit, they will just refer to guidelines only. A Muslim or someone with Shariah background might see out of the box rather than just referring to guidelines”. (R5)

“Confusion between operational issues, legal issues and Shariah issues might happened because of this...” (R5)

“they don’t have Shariah expertise that make the Shariah issues cannot be detected. And sometimes they find the issues just by accident. because as you know, they are using sampling...” (R10)

“...the expertise of the talent, in doing the Shariah audit practice is an issue...if you check on qualification, on the talent of the expertise, then you will find an issue...” (R12)

2. Engagement with Shariah Committee during Shariah Audit

Based on the analysis, most of Shariah committees perceive that auditors should have good engagement with Shariah committee starting from the initial stage of Shariah audit. In other words, shariah Committee should be involved in the process of shariah audit especially during the planning stage. The engagement with Shariah committee should start at the earliest stage or the crucial stage of auditing which is at the planning stage because at this stage, Shariah committee can give their input on Shariah especially on the scope of audit that should be covered throughout the financial year. The engagement with shariah committee also include of communication of audit planning during planning stage and the reporting of audit findings during reporting stage.

One of the Shariah Committee claimed that she expects that there should be engagement from Shariah auditor during the planning stage until the reporting stage and according to her, in reality most of the time, the Shariah auditor will only report the audit finding to Shariah committee. As a result, Shariah committee might not be able to share their point of view regarding the necessary scope of Shariah audit during the initial stage and this might affect the process of Shariah audit as a whole. This is among the responds of the participants:

“My wish list is that Shariah audit can work together with us in terms of audit planning. I think this is what they are supposed to be doing...” (R18)

“My expectation is that the auditor will engage more with us especially during audit planning, not just come with result of findings...” (R16)

“There is not so much engagement between Shariah committee and auditor in audit planning...” (R19)

“more regular meetings should be held with Shariah committee...at least quarterly meetings with Shariah committee if there is no report. This is just to maintain the engagement. At least update us on the plan, update on the adequacy of the framework, any comment on the scope or procedures, if there is nothing, just have a short engagement...”(R21)

3. Scope of Shariah Audit

In order to enhance the current practice, majority of Shariah committee agreed that the scope of Shariah audit should be widened. Among the suggested areas of scope that must be included when conducting Shariah audit besides the items suggested in SGF includes audit on the agent which can be considered as a marketing strategy, Shariah governance and so on. Although majority of Takaful Operators have successfully followed the suggested requirements of the scope that should be covered when performing Shariah audit function, some of them still did not include auditing financial statements as their audit scope because the financial statement part has been covered by the external auditor.

The issue here is to what extent an external auditor could cover on Shariah issues in financial statements as we know that normally external auditors would just touch on the operation part when performing audit on financial statements. This is among the respond from the participants on the scope of shariah audit:

“In terms of the scope of Shariah, they might need some improvement and some wider coverage since we rely on the parent company’s group internal audit. However, there are a lot of things that they need to cover for the scope...” (R17)

“normally, audit covers the operation part only. They also should be looking into other activities organized by the Takaful operator such as charity run or trips for agents. Other than that, currently Shariah audit scope does not cover the agent...in fact, many Shariah non-compliance cases come from the agent which is related to misrepresentations of the product...” (R21)

“Takaful should be looking more on governance for their audit scope such as on the structure of Shariah compliance or human resources. This scope is more suitable and relevant for the Takaful industry...” (R10)

“current Shariah audit is more towards operational audit...still might not able to see clearly the elements of Shariah in the audit practice...” (R16)

“Scope of audit should cover the agent part which represents the marketing elements of Takaful Operators...” (R17)

“Scope sometimes is not adequate, they should improvise it from time to time...” (R28)

“The audit process and scope for this company is about 70% to achieve the objectives of Shariah audit. This is because most of the time during the presentations of audit report, I can see that they only touch the surface when it comes to Shariah findings”. (R16)

4. Structure and Approach of Shariah Audit

The structure of Shariah audit or model adapted by Takaful Operators for conducting Shariah audit will also affect the effectiveness of Shariah audit function. As recommended by most of

respondents, Takaful Operators should have one specific auditor which specifically performs the duty of Shariah auditor. Below are among the statement from the respondents:

“For some non-full-fledged institutions, conventional side normally will perform the Shariah audit. So, they are wearing two hats by conducting the normal internal audit and at the same time conducting Shariah audit exercise. They argue that they have embedded Shariah audit inside internal audit. That kind of structure for me, I can’t see the effectiveness because they are doing two things at one time and most of the time, they will not find any Shariah finding...” (R30)

“the most important thing is they must have one specific person who conducting shariah audit..” (R10)

5. Discrepancy in the Practice Between Takaful Operator and Islamic Bank

These themes emerge when some Shariah committees responded to this interview question by indirectly comparing to the banking industry and most of them agreed that the practice by Islamic banking is way better than the Takaful industry in terms of the process and scope. During the presentations of the audit finding, there are respondents who agreed that the Shariah issues highlighted by the bank is clearer, more comprehensive and more detailed than Takaful.

Based on the answers from the respondents, it shows that respondents realize the inconsistencies of the audit practice whereby the audit practice in the banking sector is more organized and well planned compared to the Takaful industry. In relation to that, one respondent proposed that in order to ensure effectiveness for the Shariah audit function in the Takaful sector, there should be a separate audit group at the group level which focuses on insurance auditing although they are sharing the same resources. This can avoid the Takaful Operator from incurring additional cost by setting up the new department/unit. The Takaful Operator just needs to hire a specific person which has sound knowledge in the insurance area. These among the respond from the participants:

“the bank is more organized than Takaful industry in terms of the Shariah audit process...” (R26)

“...the frequency of the audit conducted by group level, I won’t say is an issue but because of the nature of the company, it is blended into the banking business. But if let’s say we have like an insurance group, group insurance for Takaful, maybe then the distribution would be somehow fair...” (R28)

“for me, based on my observation, probably because Islamic banking business is more rigorous compared to the Takaful business, as far as communicated to us, seems like the Shariah audit process is less comprehensive than the banking business. No matter what size of business, Takaful industry should be at par with banking industry in terms of the practice...” (R24)

“In terms of the scope, I can see the scope covered by Islamic banks is very detailed and the checklist provided by Shariah review is also very in depth and based on my observation, this Takaful Operator have not reached to that level yet. As a result, the auditor might miss out important Shariah elements when performing the Shariah audit exercise. For example, the formula of calculation in the system...” (R19)

“I am also a Shariah committee for one of the Islamic banks. But I can see that although Islamic banks also adapt the framework from the conventional framework, but the detailing on Shariah is very in depth compared to the one practised in this Takaful operator. During the presentation in the meeting, we can also see clearly what are the Shariah issues that have been highlighted in the report and it is improvised from year to year...”(R19)

Current Practices of Shariah Audit

1. Qualification of the Shariah Auditor

The diagram below illustrates the qualification of shariah auditors in eleven Takaful auditors in Malaysia.

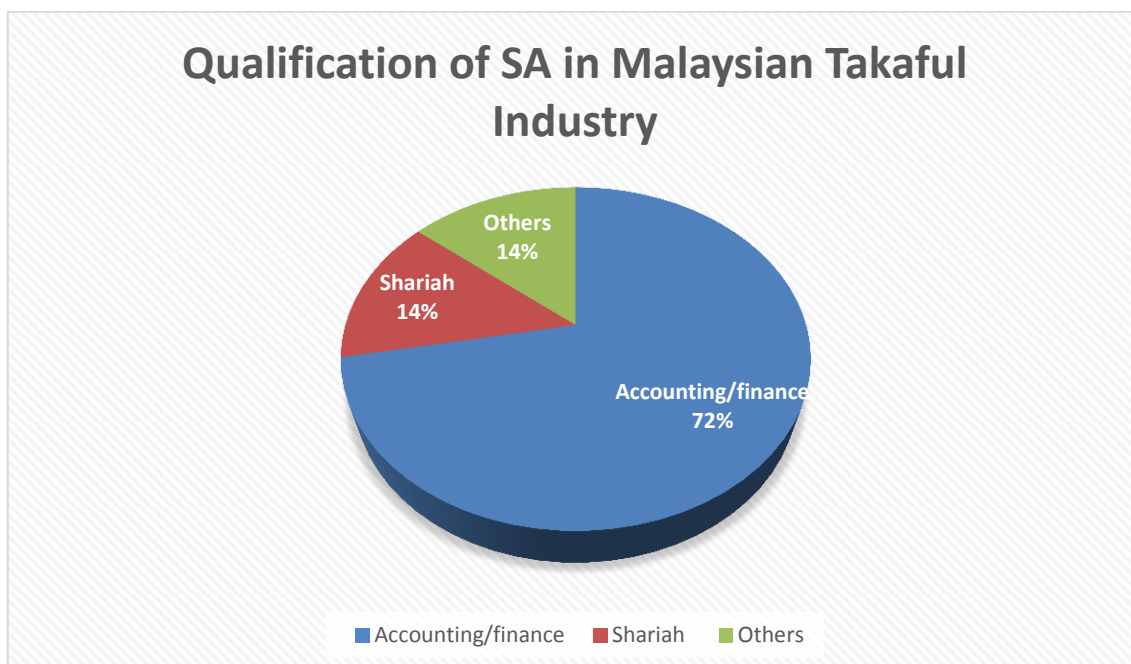


Figure 1.0: Qualification of Shariah Auditors

The diagram above shows that 72% of the auditors come from accounting or finance background, whereas only 14% come from shariah background and another 14% of the auditor neither from accounting/finance nor shariah background.

2. Engagement With Shariah Committee During Shariah Audit

In term of communication of audit planning, there is no specific obligation on this matter as the basic requirement in the guidelines is shariah auditor must report to Boards of Audit Committee (BAC). Diagram below illustrates the practice of Takaful operators in term of communication of audit planning in shariah audit.

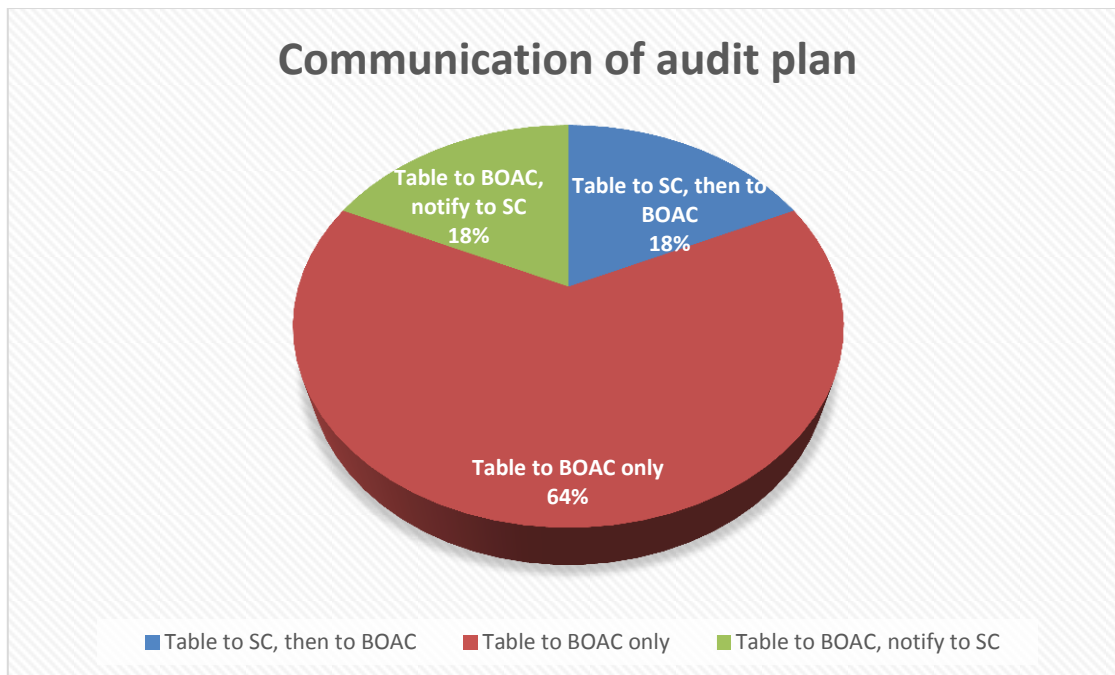


Figure 2.0: Communication of Audit Plan

Based on the above diagram, during planning stages, majority of operators did not communicate their audit plan to SC. There is no requirement in SGF mentioning that the audit plan should be communicated or should be notified to SC. However, the practice of communicating audit plan to SC is the one of the alternatives to get SC's involvement during planning stages.

The similar things happened for the reporting stages where based on the analysis, it is found that majority of Takaful Operators comply with the reporting line as stipulated in SGF which means that they have a reporting line to BAC, then they issue a notification to their SC. The issue here is the dotted line between Shariah audit function and SC, which does not have a detailed explanation in SGF. Because of this, each Takaful Operator translates the dotted line differently, and as a result, there are various practices adopted by the Takaful Operators.

3. Scope of Shariah Audit

By referring the scope of shariah audit that have been highlighted in SGPD (2019), it is found that all Takaful Operators are following the requirements at minimum. They have developed their scope of audit based on the requirement, but not in depth. First, in developing the scope for auditing the financial statements, majority of Takaful Operators which is approximately

about 55% of Takaful Operators do not include the review of financial statements in their Shariah audit scope. This is because they rely on external auditors to check on their financial statements which is allowed in SGF. On the other hand, 45% of the operators perform audit on their financial statements and look into certain elements which can lead to potential Shariah non-compliance risk.

In terms of compliance audit on organizational structure, people, process and information technology application systems, based on interview, all operators did perform audit on these elements but also at minimum. For organizational structure, normally the auditors will check on the job descriptions and the functions for each of the departments. Sometimes, it happens that there is a confusion between the job function of compliance and risk management. The segregation of duties and the job scope for each function must be clarified from the start. In terms of staffing, normally the auditors will check whether they have the appropriate skills or not. The table below summarizes the elements that will be reviewed by the auditors when performing this audit scope:

Table 2.0: Audit Elements for Organizational Structure, People, Process and IT

| No. | Scope | Elements |
|-----|--------------------------|--|
| 1 | Organizational structure | Reporting line, Job descriptions, Functions, Authority, Responsibility |
| 2 | People | Background, experience, skills, awareness, training |
| 3 | Process | SOP, manual |
| 4 | IT | System (Integrate with IT auditor) |

Sources: (Interview, July 2020)

4. Structure and Approach of Shariah Audit

Based on the analysis, it is found that majority of Takaful Operators did appoint one shariah auditor to conduct shariah audit. However, the appointed auditor still need to respond to the internal mandatory audit and most of the time they are adopting integrated approach in conducting their shariah audit. Integrated audit approach means that the auditors embed Shariah audit with their mandatory audit. This integrated audit comes in different forms as there are different practices by Takaful Operators.

There are few Takaful Operators which develop the Shariah scope for every audit universe whereas the second form of integrated audit is where the audit is jointly executed with other mandatory audits such as operational audit and compliance audit. In one of the Takaful Operators, Shariah audit is included under the operational audit which is then categorized as core audit. Core audit means that it is a regulatory requirement and must be covered in every financial year.

The analysis shows that there are number of Takaful Operators which practise integrated audit at the introduction phase of Shariah audit function, and recently started conducting

stand-alone Shariah audit. However, there are still few of Takaful Operators conduct integrated Shariah audit at the introduction phase until now.

Analysis of the Gap

To begin with, the analysis section start with the first theme derived which is on the qualification of shariah auditors. Most respondents either the auditors or Shariah Committee agreed that competency is one of the important factors in ensuring effectiveness of Shariah audit function. This is in line with a study done by Khalid et al. (2018) which revealed that competence is one of the important characteristics of internal Shariah audit and among the important elements in competency includes knowledge, quality, training, skills and experience. In fact, competency is among the major issues that have been discussed a lot in the previous study (Kassim, 2009; Rahman, 2011; Kasim & Sanusi, 2013; Mohd Ali et al., 2015).

The reason for competency becomes a major issue because as at to date, competency requirements for Shariah auditors were still not developed even though there is a need for it. Since there is no competency requirement framework for Shariah auditors issued by BNM, there are a few industry experts who urged Malaysia Institute of Accountant (MIA) to take action on this as currently the Shariah auditor is part of internal auditors. In fact, MIA has already formed an Islamic Finance Committee to deliberate on this matter and this is an ongoing project. Perhaps the industry can see the output in another two or three years.

The second gap exist in term of the engagement of Shariah Committee in the whole process of shariah audit. This is one of the aspect where the current practice need be improvised especially the engagement during the planning stage. Although some might argue that the engagement of Shariah auditor with Shariah committee might relate to the issues of independency, but the engagement is very important since Shariah committee is the one who has the expertise in Shariah and could give advice as required.

A study by Khalid et al. (2017) found out that independence of internal Shariah audit does not have a positive and significant relationship with the effectiveness of the internal Shariah audit. In fact, there is also a clause in SGF that stated “obtaining and making reference to relevant sources, including the SAC’s published rulings, the Shariah Committee’s decisions, fatwas, guidelines, the Shariah audit results and the internal Shariah checklist”. Based on the statement, it proves that an auditor may obtain and refer to the Shariah committee if there is any query regarding Shariah matters as the decision for Shariah comes from Shariah committee itself.

Since the practice of Shariah audit aims to assess the control of the risk for Shariah compliance, then it would be appropriate if there are any audit findings, it would be reported to the SC before being reported to BAC. This is because if the reporting has been done to BAC, and the report has already been approved, no changes can be made although the auditors notify the SC afterwards. The ultimate decisions will be made by BAC. As a solution, it would be better if the auditors can discuss the findings related to Shariah to the SC first before presenting them to the BAC. This would enhance the Shariah audit process at the

reporting stage by getting the Shariah experts' review before obtaining the approval from BAC so that the changes can be made earlier if any.

In term of the development of the scope, since all Takaful Operators are adopting conventional framework, it was acknowledge that there is a limitation of scope in conventional auditing framework which merely focused on the assurance and attestation services only while actually Shariah audit should be more than that (Abdul Rashid et al., 2016; Khalid et al.,2017). This also matches with the finding of the study by Yussof (2013) which indicate that the shortcomings of adopting the mainstream techniques of auditing is in terms of the restrictive focus on financial audit, whereas Shariah audit should have a wider scope to cover not only an audit of financial statements, but also to undertake a compliance audit on organizational structure, people, process and IT application systems, including a review on the adequacy of Shariah governance process.

Moreover, a study done by Ab Ghani and Abdul Rahman (2015) indicates that only 55.5% of the respondents have established audit of financial statements as part of their internal Shariah audit and this practice mostly comes from full-fledged Islamic banking. This result is quite similar with this study which found that only several Takaful Operators cover financial statements when performing Shariah audit function. The others would just let the external auditor audit their financial statements without bothering on what is the Shariah element that should be checked out in their financial statements.

In term of structure and approach of shariah audit, it is proved that most financial institutions would have the same person conducting mandatory audit while at the same time play a role as a Shariah auditor (Yazkhiruni et al., 2018). As a result, the auditor might not be able to focus on the scope of Shariah while doing the Shariah audit process as normally they would conduct the normal audit together and there is a chance that the auditor might overlook some important issues or at some other time, they might find the Shariah issues by accident.

In order to avoid this situation, IFIs especially Takaful Operators should have one specific auditor which specifically performs Shariah audit function although the Shariah auditor is placed in internal audit department. It is not deniable that many Takaful Operators might not be able to provide one separate and specific Shariah audit department to cater for the need of having a Shariah audit function due to limited resources such as limited cost and limited human resources. Management also doesn't want to incur high cost in setting up a separate Shariah audit department. As a solution, in the short run, to ensure the function of Shariah audit is effective, one dedicated person should be hired for conducting Shariah audit which still can be placed in internal audit department to avoid Takaful operators from incurring so much cost.

Finally, the issue of discrepancies between the Shariah audit practice of Takaful industry and Islamic banks has also been highlighted many times during the interview session because majority of Shariah committee that became the respondents are also Shariah committee for Islamic banks. Regardless of what type of business that they are involved in or the size of business, as long as their main principles is based on Shariah compliance, they should put the

practice at par. In fact, the auditors are also of the opinion that the Takaful industry is not getting the attention as much as banking industry.

Among the reasons is due to the absence of social resources with both assurance and Shariah experts and the scarcity of Shariah intellectuals with suitable knowledge (Saeed, 2019). There are also a few Takaful operators which are a subsidiary of conventional banks which also offer an Islamic banking window. As Shariah committee, usually they can detect imbalance in the practices as most of them feel that the organizations are focusing more on Islamic banking due to the greater size of the banking business.

RECOMMENDATIONS AND CONCLUSIONS

The findings of this study indicate that there are few gaps exist between the expectations of Shariah Committee and the actual practice of shariah audit. The identified gap are as following: i) Qualification of the shariah auditor ii) Engagement with shariah committee during shariah audit iii) scope of shariah audit iv) structure and approach of shariah audit and v) discrepancy in the practice between Takaful Operator and Islamic bank. This gap however provides the area of improvement in the shariah audit practices. Acknowledging the gap is very important as Shariah Committee is the one who will make the decision at the end of the day on the Shariah matters.

The main reason behind all these gaps is due to the insistence of specific shariah audit framework to accommodate the lacking aspect in the current shariah audit process where the current available guidelines speaks very brief on the shariah audit function. Due to this, the practice of the Takaful Operators may differ and would be based on their interpretation. In addition, there are talent development issues in Islamic finance area which become the challenges for the Takaful industry for appointing qualified shariah auditor whom is competent in both shariah and audit knowledge. Therefore, based on the identified gaps, few recommendations could be made for Takaful Operators to achieve the robustness in their current audit practice which includes; (i) develop specific Shariah audit charter for their Shariah audit function; (ii) prepare Shariah audit manual rather than depends on internal audit manual; (iii) develop the scope which specifically covers financial statements and internal control systems related to Shariah objectives and (iv) appoint one shariah background auditor in the internal audit division.

As with most other empirical studies, there are also some limitations of this study. First, this research has a limitation in generalizing the views from all Takaful Operators' main players as this study only offers insightful knowledge concerning one shariah committee and one shariah auditor for every Takaful Operator. Therefore, a holistic debate on Shariah audit practices in Takaful Operators needs to obtain more views and opinions. Secondly, the scope of the study is limit to the Takaful industry only. Thirdly, this study does not take into considerations the view from the policymaker such as Bank Negara Malaysia which opens up the room for future research.

Although this study comes with limitations, the findings provide significance contributions to the theory of shariah audit in term of the compliance and qualifications of the auditor. The limitations of the study also provide the opportunity for the future research. Future researches could explore the policymaker perspectives on this matter. Future research could also evaluate the effectiveness of current audit practice of the Islamic finance industry especially the Takaful industry. Despite all the limitations, the analysis of the study is important in enhancing the current Shariah audit practice especially for Takaful industry player.

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