

## CHAPTER SIX

### FINDINGS AND ANALYSIS

#### 6.1 INTRODUCTION

This chapter is divided into two parts. The first part presents the findings from interviews conducted with regulators, Shariah committee, internal auditors, external auditors and Shariah auditors related to reasonableness gap in Shariah auditing. The findings answer the first research objectives which is to examine the perceptions of the internal auditors (Shariah auditors), regulators (BNM), Shariah committee, Shariah officers, external auditors and depositors concerning the Shariah audit practices in the Islamic banks in Malaysia. The first objective represents findings in Part A. As mentioned in the previous chapter, the purpose of interviews is to explore the perceptions of the respondents on the practice of Shariah audit in the IFIs specifically regarding framework, scope, processes, reporting and competency.

The following chapter reports the findings from the analysis of Part B on the Shariah audit performance gap. It answers second research objective which is to determine the existence of expectations-performance gap between internal auditors (Shariah auditors), regulators (BNM), Shariah committee, Shariah officer's, external auditors and depositors concerning the Shariah audit practices in the Islamic banks in Malaysia.

The findings in Part C discusses the factors that affect the expectations gap in Shariah audit practices on Shariah audit responsibility and Shariah auditors performance. The findings answer the third research objective which is to identify

factors that affect the expectation gap on performance in Shariah audit (i.e.; Shariah audit responsibility and Shariah auditor's performance).

## 6.2 QUALITATIVE FINDINGS

The findings from interviews enable the researcher to identify the causes and components of the gap. This research arrived at the findings where most of the respondents consistently agree on the issues highlighted during the interview sessions. According to Selltiz et. al (1976), reliability in qualitative research is concerned with the consistency, stability and repeatability of the informant's accounts as well as the investigators' ability to collect and record information accurately. Therefore, the selection of 14 respondents for the interview sessions are reliable since the findings from the interview consistently the same results over repeated testing periods. The researcher have used the same methods and obtained the same results every time uses the methods on the same or comparable subjects. The researcher also has developed consistent responses or habits in using the method and scoring or rating its results and that factors related to subjects and testing procedures have been managed to reduce measurement error. This shows the reliability and consistency of the qualitative data on the ability of a method to yield consistently the same results over repeated testing periods (Selltiz et al 1976). The following paragraphs briefly highlight the profiles of participants and data analysis process for interviews. The profile of the respondents and its label are as follows:

Designation	No.	Label
1) Shariah officers	3	SO1,SO2,SO3
2) Head of Shariah department	3	HS1,HS2,HS3
2) Shariah committee	3	SC1,SC2,SC3
3) Internal auditors	3	IA1,IA2,IA3
4) External auditors	2	EA1,EA2

During the interview, the participants are guided by a series of questions on Shariah audit practices. The questions are developed based on the internal audit guidelines. The overall questions for the interview are as follows:

**Table 13: Interview questions**

<b>Research question:</b>
<i>“What are the perceptions of the regulators (BNM), the practitioners (Shariah committee, Shariah officer, internal and external auditor) and the stakeholders on Shariah audit practices in the IFIs of Malaysia”?</i>
<b>6) ‘Where’ to be placed - Framework of Shariah audit</b>
<b>Validation Objective:</b> To determine the model of Shariah audit practices
<ul style="list-style-type: none"> <li>a) Define Shariah audit from your perspectives.</li> <li>b) Do Shariah audit and Shariah review a misunderstood concept?</li> <li>c) Do Shariah audit and the existing audit a misunderstood concept?</li> <li>d) How do the Islamic banks respond to the implementation of Shariah audit functions?</li> <li>e) What are the current issues in Shariah audit practices face by the Islamic banks in Malaysia?</li> <li>f) Shariah audit function should be attached to the internal audit department of an Islamic bank or a standalone (independent) department?</li> <li>g) Do external Shariah audit necessary apart from having it as internal Shariah audit only?</li> <li>h) To what extent the external audit shall support the Shariah audit function in the Islamic bank?</li> </ul>
<b>7) ‘What’ to do - Processes in Shariah audit</b>
<b>Validation Objective:</b> To identify the coverage of Shariah audit processes
<ul style="list-style-type: none"> <li>a) Should Shariah audit processes be included in the Shariah Compliance Manual of each Islamic bank?</li> </ul>

- b) Who shall involve directly in determining the Shariah audit planning? Shariah committee or the audit committee of Islamic banks (or both)?
- c) What should be the key area in developing Shariah audit programmes in the Islamic banks?
- d) What type of evidence shall be collected during the Shariah audit process?
- e) Shall the Shariah auditor include procedures in his examination to ensure that all new fatwas, rulings and guidance and modifications to existing fatwas, are identified and reviewed for each period under examination?

**8) 'How' much the department has to do - Audit Scope in Shariah audit**

**Validation Objective:** To explore the extent of the scope of Shariah audit function apart from what has been addressed in the Shariah Governance Framework.

- a) Is the current scope of Shariah audit function highlighted in the SGF sufficient?
- b) In the case of audit of financial statements, shall the internal auditors attest the items presented and disclosed in the financial statements to be compliant with the Shariah requirements?
- c) How is Shariah audit on financial statement wanted by shareholders and management to enhance the credibility of financial statements?
- d) What should be the coverage of Shariah audit of compliance audit on organisational structure, people, and process and information technology applications systems?
- e) What should be the best approach in Shariah audit of internal control system in the Islamic banks?
- f) Shall Shariah auditor audit the findings of the Shariah review carried out by the Shariah officer?
- g) What should be the extension of the scope of audit on Review of the adequacy of the Shariah governance process?
- h) How should be the relationship of Shariah Auditor with the Board of Directors, Management, Shariah Committee and Audit Committee of the Islamic banks to ensure independence in the organisations?

**9) 'When' Shariah audit have to be reported - Reporting and audit timing**

**Validation Objective:** To determine the type of Shariah audit report

- a) Shall the findings of Shariah audit be reported in the annual report?
- b) Shall Shariah audit findings be disclosed in a separate Shariah audit report?
- c) Who will benefit from the disclosure of Shariah audit report?

**10) 'Who' has to do it - Independence and Competency**

**Validation Objective:** To determine the level of competency of a Shariah auditor in Islamic Banks.

- a) What should be the role of the Shariah auditor?
- b) How important is the role of the Shariah auditor in the development of Islamic banking and finance?
- c) What are the possible impacts if Shariah audit becomes a separate unit in the Islamic banks?
- d) How does the Shariah auditor maintain his/her independence?
- e) What are the most preferred criteria of a Shariah auditor?
- f) What are the necessary skills to enhance the competency of Shariah auditor?
- g) Do Shariah auditors need to undergo specified training in Islamic banking course?

**6.2.1 'Where' to Be Placed - Framework of Shariah Audit Practices**

During the interview sessions, the interviewee did not answer the questions one by one. Most of them prefer to summarise the answer according to the section; framework, processes, scope, reporting and competency. This is due to time constraints and tight schedule of the interviewees. To address the issue of time constraints, the series of interview questions were sent to the respondents one week earlier before the interview sessions. Therefore, the interview session was done efficiently.

In terms of Shariah audit definition, the respondents agree on the definition in the SGF (BNM, 2010). As defined in the Shariah Governance Framework (BNM, 2010), Shariah audit refers to “the 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". Shariah audit as required by this framework shall be performed by the internal Shariah auditors. Apart from the definition as per SGF (BNM, 2010), respondent IA1 added that:

*"The definition of Shariah audit should incorporate the definition in the internal audit guideline which well referred by the Internal audit department. Moreover, the guideline is established and be referred in other institutions as well".*

IA2 response the framework of Shariah audit and Shariah review is different. He mentioned:

*"Shariah audit framework should differ from Shariah review practice; that is Shariah audit is to lend credence and give credibility to the Shariah governance system practised in the Islamic banks. It is also to guide and strengthen the Shariah compliance framework of the IFIs which will, in turn, enhance the integrity and deepen the Shariah competence of the IFIs. It will also to enhance the degree of confidence and faith in the Islamic financial solutions provided by the IFIs".*

HS1 responded that Shariah audit should expand on the definition. He highlights that the definition of the Shariah audit to include:

*"a systematic and critical process of obtaining, ascertaining, evaluating and examining sufficient and reliable information and evidence as to whether any scope of the operations, activities or businesses of the IFIs, whether partially or totally, is in compliance with the established Shariah criteria. The Shariah audit also includes verifying and confirming the level of compliance with the Shariah Governance Framework and other regulators' requirements".*

Apart from that, EA1 stressed the importance of independent assessment in the Shariah audit:

*“Shariah audit should focus on Shariah assurance and independent assessment to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of Shariah governance process”.*

According to respondent EA1, Shariah audit should support the Shariah governance system in the IFIs. Shariah governance is relatively new to the discourse of Islamic finance but is significant to lead the market confidence on the credibility of the industry (Chik, 2013). Therefore, Shariah audit functions shall complement and support the existence governance structure in the IFIs.

SC1 and SC2 highlighted that the framework of Shariah audit should refer to the established criteria.

*“The function of Shariah audit should refer to the established criteria apart from the internal audit guideline. Established criteria such as Shariah resolutions; decisions of the Shariah Advisory Council (SAC) of BNM, the resolutions and decisions of the Shariah Committee of the IFI; and the approved product manuals and the standard operating procedures (SOPs) of the IFI”.*

Respondent EA2 proposed that:

*“The external Shariah audit is necessary to complement the present practices of the Internal Shariah audit to increase the independence in the Islamic banks....”.*

In terms of Shariah audit functions to be attached to the internal audit department, as per Shariah Governance Framework (BNM, 2010), IA3 responded:

*“...the current practice in my institutions, the Internal Shariah Audit is part of the group audit. However, if in the future if the Shariah Audit functions to become a separate unit and accountable directly to the Board Audit Committee it should not be the problem... and it still depends on the policy of the human resource and the availability of manpower.*

IA2 viewed:

*“It is up to the Islamic banks to decide whether to make it as a separate unit or not. If the banks have enough resources, it should not be a problem. However, at current the market is a lack of expertise in this area, which makes it difficult to separate the functions of Shariah audit in the banks”.*

IA1 mentioned that:

*“It is difficult to make it separate because there is also normal audit being conducted than the need to undergo for Shariah audit. However, if the IFIs combined the normal audit and Shariah audit, the issue of focus will arise. Some bank might want to focus on the audit, but some bank might want to focus on the business. Thus, it depends on the management on how it want the practice to be. If the management wants to spend more on audit, it can go for separate unit. However, if the bank thinks otherwise, it is up to the management to decide”.*

Respondent EAI has a different view. He argued that Shariah audit should be treated at par with the statutory audit.

*“There should be an enforcement to conduct external Shariah audit which equivalent to statutory audit. Because it will ensure the Shariah assurance and attestation in the operations of the Islamic banks. There are Islamic banks that voluntarily conducted Shariah audit by outsourcing to the external auditors which I think it increases the level of*

*independence in reporting. I think other Islamic banks should also go for external Shariah audit since it promotes greater transparency in Shariah operations... ”.*

To conclude the above interview findings, the view of respondents on the placement of Shariah audit framework can be divided into three group:

- a. Shariah audit framework should be different from Shariah review framework.
- b. Shariah audit framework should complement the internal audit framework in the Islamic banks.
- c. Shariah audit framework should be treated at par like a statutory audit.

#### 6.2.2 ‘What’ to Do - Processes in Shariah Audit

Regarding Shariah audit processes, most of the respondents view that it is important for each Islamic bank to have their Shariah Compliance Manual. However, there are different points of views as to what should be included in the Shariah Compliance Manual.

IA2 responded that:

*“In our bank, Shariah Compliance Manual are the responsibility of Shariah department. Shariah audit process should not be included in the Shariah Compliance Manual since the process of the audit is different and it involves planning, internal control, risk-based, audit programme and other aspects. In my opinion, Shariah audit process should be included in its auditing handbook.”.*

SC1 responded:

*“We are still in the process of strengthening the Shariah Compliance Manual in our bank. There are still a lot to be done. How can we*

*include the Shariah audit processes in the compliance manual? It should be two separate manuals; Shariah Compliance Manual and Shariah audit manual...”*

IA1 suggested that the responsibility of the Shariah Committee to develop Shariah policy should be included in Shariah Compliance Manual. However according to SC1, the responsibility of the Shariah Committee is to endorse or approved but not to develop policy in the institutions. Shariah policy should be drawn up by the institutions Shariah department, with the recommendations and support from the Shariah Committee.

IA2 suggested that the following are essential matters of the Shariah audit process:

- a) Formulation of audit plan to include auditable area (Shariah review findings, internal control for Shariah compliance, Shariah risk).
- b) Assessment the adequacy of overall operations according to Shariah.
- c) Establishment and implementation of risk-based audit process and procedures.
- d) Audit documentation in the form of the audit programme, audit objectives.
- e) Formulation of audit opinion through Shariah committee report.

The overall view of the Shariah audit processes from the respondents is:

- a) Shariah audit processes should be separated from Shariah Compliance Manual.
- b) Shariah committee and Audit committee should involve directly in determining the Shariah audit planning.
- c) It is necessary to developed Shariah audit programmes that represent the procedures in conducting Shariah audit for each auditable area.
- d) Shariah auditor should ensure that all new fatwas, rulings and guidance and modifications to existing fatwas are identified and reviewed during Shariah audit practices.
- e) The Shariah auditor, in consultation with the Shariah Committee, shall recommend to the Board Audit Committee the auditable areas when submitting

the audit plan. The Board Audit Committee shall thereafter determine the deliverables of the Shariah audit function in the IFIs.

- f) The Shariah auditing process should be conducted in accordance with the established auditing standards that already exists. This is to align the relevance and compliance of the auditing function with the globally or nationally accepted standards.

### 6.2.3 'How' Much the Department Has to Do - Audit Scope in Shariah Audit

There are different views on the scope of Shariah audit whether to expand the scope not only limited as per Shariah Governance Framework (BNM, 2010). There are also suggestions that the scope of Shariah audit shall improve the effectiveness of Shariah risk management, an internal control for Shariah compliance and Shariah governance process. According to IA1;

*“The scope of Shariah audit shall expand to cover the risk area, internal control system for Shariah compliance and not forget the Shariah governance process as well. These are some of the areas that not been covered in the Shariah Governance Framework. Shariah audit also must address risk area...and the most fundamental principle in keeping the Shariah in place lies in the internal control system of the Islamic banks”.*

HS1 added that;

*“The scope of the Shariah audit shall also include assurance processes of IFIs' Shariah compliance. Since Shariah audit should be an independent assessment, therefore there should be an assurance of the Shariah compliance”.*

EA2 responded that the scope of Shariah audit should also include examining the obstacles which impede the efficient application/implementation of Shariah solutions be such as on legal, tax, documentation or the Shariah governance itself. The Shariah

auditor shall propose relevant solutions at the regulators level or the institutions itself.

This can be value added services to the IFIs. EA1 highlighted on the scope of Shariah audit on the audit of financial statements of IFIs. He mentioned that this need to be emphasised more on the purpose and the reporting structure after auditing the financial statement. He also argued that this is similar to an audit conducted by the external auditors. He suggested that the Shariah audit scope on the audit of financial statements shall cover a specific area such as income purifications, zakat, profit equalisation reserve and other Shariah issues arise. The task should not be overlapping with what the external auditor did during the normal audit.

IA1 mentioned that the Shariah auditors should not perform the audit of the financial statement but can only review the financial statements. He further debated that the Shariah auditor does not attest to the veracity of the financial statements of the IFIs. He argued that the internal auditors/Shariah auditors only review the process since the audit of financial statements was performed by the external auditors. Thus, the scope of Shariah audit on the audit of financial statement is not the area of the Shariah auditors. It has already been done during the statutory audit.

Different feedback was received from EA2 on the scope of Shariah audit on the audit of financial statements of the IFIs. According to EA2 during an audit of financial statements of the IFIs, the external auditors did not attest the Shariah issues arises in financial statements. It is important for the Shariah auditors/internal auditors of the IFIs to audit on the Shariah issues in the financial statements.

SO1 seeks clarification on the idea of auditing human resource policy in Shariah audit. SO1 mentioned that:

*“It shall depend on the organisation structure of the Islamic banks..if the human resource function report to management, the management*

*will have the power on the human resource. If the Shariah committee have the power on the human resources then to include the human resource policy as one of the scopes in Shariah audit seems fine to me... again like I said, it shall depend on the reporting structure of the IFIs”.*

According to IA2, it is difficult to audit the staff in the Islamic banks on their attitudes such as dress code, *jumaat* prayer, smoking cigarettes and others since it is not within the job scope of internal auditing.

*“it is difficult to audit people in terms of their attitude towards Shariah principles such as covering the aurat’, attend the jummat prayer, smoking and others. In internal auditing, we audit the capabilities and technical skills of the people, not their attitudes”.*

In addition, according to SC3, the scope of Shariah audit should be according to the relevant laws and regulations. He mentioned:

*“The procedures required to conduct an audit in accordance to the Shariah rulings and it should be determined by the auditor having regard to the requirements of appropriate Islamic Rules and Principles, relevant professional bodies, legislation, regulations, which do not contravene Islamic Rules and Principles.”*

Overall, the respondents suggested that the scope of the Shariah audit should be extended to cover human resource management, business policies, process and procedures, zakat calculations and payments, contracts and agreements, environmental impact of operations, social contributions, marketing and advertising, income purification, assessment of financial resource management and compliance with the Shariah rulings such as *bakhs* (any voluntary effort to diminish or decrease the value of the product or services being sold) *tatfif* (taking in an excess in measure and giving out a short measures) *uqud* (contract), *khiyanah* (embezzlement of funds), *Israf* (the propriety of expenditure), *tanajush* (bidding), speculation and *gharar* (uncertainty).

#### 6.2.4 ‘When’ Shariah Audit Has to Be Reported - Reporting and Audit Timing

Some of the respondents proposed that the Shariah audit findings should be reported in the annual report of the Islamic banks, and it shall contain the observations and the assessment of systems, Shariah noncompliance risks and controls. The report shall also provide recommendations for potential improvements and corrective actions when relevant.

According to IA1;

*“Shariah audit report is the communications of the findings of the Shariah audit conducted which include recommended rectifications to improve Shariah compliance. But I do not see the important to publish the findings in the annual report. For me, the Shariah Committee report is sufficient for the public to know. In the Shariah Committee report highlights that the operations of the Islamic banks are according to Shariah principles. I think it is enough to circulate the findings internal rather than exposed it to the public. Besides, Shariah compliance issues are private and confidential. It involves reputational risks. What important is that the Shariah noncompliance issues must be identified and rectified immediately and of course in consultation with the Shariah committee approval. Therefore, it is not necessary to have a specific section on Shariah audit report in the annual report.... well that is my opinion.”*

One respondent suggested that the Shariah audit report should be separated from the Shariah committee report. The findings should be reported in its section. This is to promote transparency to the stakeholders. According to EA2:

*“The findings of the Shariah audit should have their separate report in the annual report. The stakeholders are starved with the information on*

*the Shariah compliance of the Islamic banks, and they have the rights to know on the performance of the banks. The report should extensively report the findings of Shariah compliance and noncompliance (if any), assess the degree of recurring of noncompliance and its systematic effect on the IFI as a whole, recommend corrective actions, improvements and rectifications. "*

In terms of the line of reporting of Shariah audit findings, the majority of the respondents agree to maintain the existing practice in Islamic banks, which is to report the Shariah audit findings to the audit committee. According to respondent IA1:

*"It should be tabled to the audit committee of the bank as simple as that. I don't think this should be an issue. It is a standard practice that whatever findings during internal audit shall be reported to the audit committee. So, I believe that it shall be the same in the case of Shariah audit finding".*

IA3 responded that:

*"We shall maintain the existing practice held in the banks. Previously whatever findings related to internal audit are directly tabled to the audit committee. So I guess we should maintain the practice".*

One respondent suggested that the Islamic bank may invite the Shariah committee to discuss any uncertainties before tabling the findings to the audit committee. Respondent (HS1) suggested that:

*"I don't think it is practical for the Shariah audit findings to be reported to the Shariah Committee. Normally what we will do is if it needs further confirmation from the Shariah Committee, we will conduct special meetings to resolve the Shariah matters and invite the Shariah Committee to discuss the issues. Then only we will bring the outcome to the audit committee".*

Some argue that the audit committee of the Islamic bank may not have the expertise in Shariah leading to a need to table the findings to the Shariah committee. According to S3:

*“In my opinion it shall be tabled to both parties. The Shariah committee and the audit committee. Since the audit committee may not be aware of the Shariah issues due to their background. So we need to involve the Shariah committee in the Shariah audit”.*

Also, there is a view that the management of the Islamic bank shall decide since if the audit committee has the Shariah background, it is optional to report the Shariah audit findings to the Shariah committee. SO1 mentioned:

*“It should up to the Bank to decide. If the audit committee of the bank is from Shariah background, it should not be a problem to table the Shariah audit findings to the audit committee”.*

The discussions continue until the respondents agreed that for Shariah matters that need to be resolved by the Shariah expert, the Islamic bank shall invite the Shariah committee to discuss the Shariah audit findings with the audit committee.

The majority of the respondents agree that the Shariah audit function shall communicate results of any assessment or findings arising from the Shariah audit to the Board Audit Committee and Shariah Committee as per the SGF (BNM, 2010). In addition, the Shariah audit findings should be reported in the Shariah committee report instead of having a separate Shariah audit report.

### **6.2.5 ‘Who’ has to do it - Independence and Competency**

According to IIAM (2010), the internal audit unit should be appropriately staffed regarding numbers, grades, qualifications and experience, having regard to its

responsibilities and objectives. The internal auditor should be adequately trained to fulfil all his responsibilities (paragraphs 15 to 26). The effectiveness of the internal audit depends substantially on the quality, training and experience of its staff. The aim should be to appoint staff with the appropriate accounting and Shariah background, personal qualities and potential. Thereafter, steps should be taken to provide the necessary experience, training and continuing professional education. Most of the respondents agreed that the criteria of Shariah auditors shall be determined by each of the Islamic banks. Respondent IA1 mentioned that:

*“In the process of issuance BNM Shariah Governance Framework (SGF), the team wanted to include the qualifications of the Shariah Auditors in the framework. However, they decided to make it general since the industry people might not be able to cope with the requirements. Rather than to start it with strict requirements and industry cannot cope, better to make it general. Besides, we should give flexibility especially to the banks that offer only a window in Islamic banking. I recommend that the basic qualifications of a Shariah auditor be fine-tuned to take into account the current availability of talent in the market as well as Shariah training offered by Shariah training provider...”*

SO1 agreed with the criteria above, but highlighted that the Shariah auditor must be a person with a Shariah background:

*“I suggest that in terms of the competency, let the Board Audit Committee and the Shariah committee of the IFI decide the appropriate level of the Shariah auditor. I think the person must be qualified in Shariah criteria. The internal auditor should have Shariah background. Adequate is not enough. It must further elaborate on the Shariah criteria”.*

EA2 added to the criteria by saying that:

*“...not only the person must have Shariah background. Accounting qualification is also necessary to ensure the flow in auditing process... both qualifications accounting and Shariah is a must for a Shariah auditor”.*

In term of competency of the Shariah auditor, this study concludes that in the event of lack of expertise in performing Shariah audit functions, the internal auditors of the Islamic banks may invite the Shariah team to be part of the internal audit team to perform Shariah audit. However, if the person is an experienced staff but no qualification in accounting and Shariah, the banks shall send the staff for Shariah training. SO3 mentioned that:

*“In the SGF mentioned that Shariah officers can perform the Shariah audit function. So we can use their expertise in performing Shariah audit function. I think CIFP can be considered as one of the qualifications. Must have training as well. If the current auditor does not fulfil the fiqh muamalat courses they must undergo training related to fiqh muamalat”.*

IA3 has a different views:

*“If the Chief Internal Auditors are the controller, there should be no problem for the Shariah officers to help in doing Shariah audit. It is mentioned in the internal audit guideline on ‘guess review or peer review’. No independence issues will arise if the Shariah officer helps in performing the Shariah audit. However, if possible the Shariah auditor shall have qualifications in accounting and Shariah background. It is expensive to train. The practise in my bank is that we invite the Shariah team to be part of the internal audit team. The Shariah team will be given specific area to be audited. The intention is to expose the auditors to Shariah requirements and at the same time exposed the Shariah team to the audit line...”*

HS1 shared a different opinion on the competency level of a Shariah auditor:

*“I personally feel that the Shariah auditors should have experience is more important than the qualification. This is because Shariah knowledge is essential besides the qualifications based on the practises in my bank. Fiqh Muamalat and Usul-Fiqh degree or equivalent should not be made mandatory. Shariah knowledge can be acquired through relevant training programmes”.*

Based on the discussions above, it is summarised that the level of competency of Shariah auditor shall be as follows: (a) the criteria shall be determined by each of the Islamic banks, (b) shall be well equipped with accounting and Shariah knowledge, c) the internal auditors may invite the Shariah team to be part of the internal audit team to perform Shariah audit, d) if the person is an experience staff but no qualification in accounting and Shariah, the banks shall send the staff for Shariah trainings.

In terms of independence issues in Shariah audit, most of the interviewees responded to the position of Shariah audit function in an Islamic bank whether to be attached to the internal audit department or a standalone department. It is important to allocate the chain of command or the hierarchical system of Shariah audit function in an IFI. The Shariah audit function should be placed high in the institution to ensure independence and objectivity are not jeopardised.

According to SGF (BNM, 2010), Shariah audit is one of the functions performed by the internal auditors. This shows that Shariah audit function shall be attached to the internal audit department of an IFI. IA1 mentioned that:

*“It should not be a department. It should be a division of the internal audit department.”*

IA2 responded:

*“To open a separate department for Shariah audit will involve additional costs and human resources. At present, we do not have enough expertise in the area. May as well it is attached to existing department such as Shariah department or internal audit department”.*

IA3 commented:

*“The current practice in XYZ Bank, the Internal Shariah Audit is part of the group audit. However, in the future if the Internal Shariah Audit Unit to become a separate unit and accountable directly to the Board Audit Committee it should not be the problem but depending on the Human Resource of the Bank”.*

In a similar assertion, respondent (HS) stated that:

*“It shall depend on the staffing of the bank. If the staffing is enough, it can go for separate unit”.*

Apart from the discussions above, SC1 viewed the situation differently by saying:

*“I suggest that the requirement should be silent. It is up to the industry to decide whether to make it as a separate unit or not”.*

The preceding discussion concludes that the requirement to have Shariah audit function should be attached to the internal audit department. However, the Islamic banks shall prepare the resources from now to cater for future demand on having Shariah audit as an independent department as required by the stakeholders.

#### **6.2.6 Factors Affecting the Expectation Gap in Shariah Audit Practices**

This research seeks the opinions and confirmation on the possible factors contributing towards the expectation gap in the Shariah audit. These factor were gathered during the interview sessions and included in the questionnaire. The factors must be empirically tested to become evidence to the Shariah audit literature. By identifying the factors contributing to the gap, this study may propose ways to reduce and narrow the

expectation gap in Shariah audit. Hood and Bucheery (1999) investigated the awareness of religious and financial auditors of each other's role in Bahrain. Based on the survey questionnaires, it is found that financial and religious auditors in Bahrain seemed unaware on their responsibilities towards the Islamic organisations. In addition, Khan (2001) reasoned that since Islamic organisations are supposed to be operating under an Islamic worldview guided by divine revelation, it makes sense for the auditing system to be different from the Western one. They are expected to serve the needs of the Islamic society whose focus and priorities are different from other worldviews (Najeeb and Ibrahim, 2014). Therefore, this research promotes that the Shariah audit responsibility and Shariah auditor's performance in the Islamic banks are illustrated to the society. The respondents are also asked about their views pertaining to the responsibility and performance in Shariah audit. IA2 responded that:

*"... we must adhere to some sort of code of ethics, in terms of Shariah audit responsibility and performance because the one that existed is more on conventional audit and largely influenced by the American code of conduct which tends to go into minute details and quantifies everything and leaves nothing for expression of your religious and ethical views. We cannot adhere to codes that do not reflect our Islamic ethical values or regulations that do not fit local practice...."*

Based on the interviews, EA2 responded that related to the discussions on the framework of Shariah audit, the framework can be one of the factors that contribute to the gap in Shariah audit.

*"When the framework or guideline on the Shariah audit practices is clear, we are sure that it could reduce the gap between the society and industry. Since the functions are well addressed by the standards and regulators."*

The factor regarding the framework is also supported by other interviewees such as EA2, HS1 and HS2. IA1 and IA2 proposed that the criteria in the International Standards for the Professional Practices in Internal Audit should also be studied as factors that contribute to the expectation gap in Shariah audit.

*“According to the International Standards for the Professional Practices in Internal Audit, the standard clearly highlights the importance of independent, the scope of work, performance of the audit, competency and reporting channel on the internal audit work. If the Shariah audit functions are attached to the internal audit department, it is important for the Shariah auditors to follow the standards as well. Given the guideline and standard to comply with the internal audit work, it also could be a benchmark or factors that contribute to the gap in the practice.”*

HS1 responded that the discussion on independence and competence contributed to the existence of a gap in Shariah audit. Therefore, this research concludes that the debates on framework, scope, independence, competency, processes and reporting contribute to the expectation gap in Shariah audit and should be empirically tested in the survey questions.

### 6.3 QUANTITATIVE FINDINGS

The second part presents results of research from the quantitative study (i.e., survey). It first reports basic information about the dataset such as data profile, normality and outliers. To meet the purposes of this study, descriptive and inferential analyses will be applied. Descriptive analyses refer to the transformation of raw data into a form that would provide information to describe a set of factors in a situation that

will make it easy to understand and interpret (Cooper & Schindler, 2006). This analysis gives meaning to data through frequency distribution, mean, and standard deviation. A cross-tab and chi-square analysis will also be an added value to the discussions of findings. During descriptive analysis SPSS software is used as a tool to summarise data (frequency distribution, mean, and standard deviation), determine whether there are significant differences among groups of respondents (Kruskal-Wallis test) and examine relationships among variables.

In the next stage, the measurement research model must be analysed by assessing its reliability and validity. Reliability tests and exploratory factor analysis were carried out subsequently as a primary purification stage for the measures. Confirmatory factor analysis was used to verify whether all items in each construct are valid and reliable. SEM (PLS) was used at the last stage to check the full model. The use of SmartPLS in the study because of its flexibility concerning distributional assumption and its appropriate for theory development (Ramayah et al., 2006). The measurement model in SmartPLS shows the relationship between items and constructs. It defines the construct and assigns the items to them (Bollen, 1989; Gefen et al., 2000). The second step is the assessment of the structural model where the relationship between constructs will be tested (Fornell and Larcker, 1981). In the first step, the goodness of the measures will be assessed using validity and reliability. The purpose of the validity is to test how well an instrument measures the particular concept it is intended to measure (Sekaran and Bougie, 2010). The validity can be analysed using construct validity, convergent validity, and discriminant validity. The purpose of the reliability analysis is to test how consistently a measuring instruments to measures the concept in the study (Sekaran and Bougie, 2010). In this first step, only reflective measures are analysed for validity and reliability on its items. However, for formative

measure, the absolute value of the items weight will be examined (Moreno and Casillas, 2008).

### 6.3.1 Data Set

The researcher received a total of 172 questionnaires out of 340 questionnaires, which resulted in a response rate of 49%. While entering the raw data into an SPSS file, screening was the first method used to identify the completeness and quality of questionnaires. After screening, the dataset remained at 166 usable questionnaires. Table 14 reveals the demographic profiles. More scientific purification procedures were also carried out subsequently. This is discussed in the following sections:

**Table 14: Respondents Demographic**

<b>GENDER</b>		
	<b>Frequency</b>	<b>Percentage</b>
Male	81	48.8%
Female	85	51.2%
<b>AGE</b>		
Below 30	40	53%
31-40	88	24.1%
41-50	32	19.3%
Above 50	6	3.6%
<b>Designation</b>		
Shariah Committee	14	8.4%
Internal auditors	33	19.9%
External auditors	16	9.6%
Stakeholders (depositors)	43	25.9%
Shariah officers	32	19.3%
Regulators (BNM)	28	16.9%
<b>Years of Experience in Islamic Banks</b>		
1-2 years	73	44%
3-5 years	49	30%
6-10 years	32	19%
More than 10 years	12	7%

### 6.3.2 Test of Normality

In this study, the data normality test is examined using two statistical analyses: 1) Shapiro-Wilk test and 2) skewness and kurtosis. The results from the Shapiro-Wilk test show that all variables have significant values of 0.00. This indicates that the data are not normal (non-normal). Further tests are conducted by calculating the data skewness and kurtosis values. The result of this test confirms that the data distribution is non-normal, where about 80% of the data presented skewness and kurtosis above the recommended threshold, -3 to +3. Therefore, it shows that the data normality distribution assumption was violated; thus, further supporting the use of PLS-SEM.

### 6.3.3 Common Method Bias

This research also highlights the potential common method bias. In line with previous studies, it adopted Harman's one-factor test (Koh & Kim, 2003; Leimeister, Sidiras, & Kremer, 2006; Shen, Yu, & Khalifa, 2010). The objective of this test is to examine the result of the unrotated factor solutions to determine the number of factors in the Shariah audit for the variance in the variables (Koh & Kim, 2003). Common method biases is identified based on two conditions: 1) a single factor emerged from the factor analysis, and 2) one 'general' factor will account for a majority of the covariance in the independent and criterion variables. According to Podsakoff et al. (2006), the amount of variance accounting for common method biases varies according to the field of research (e.g., marketing, management, and psychology). For instance, studies that investigate behavioural-related topics, common method biases exists when the covariance accounted for that single factor is greater than 40.7%. For this study, based on Harman's one-factor test, five factors were presented and the most covariance

explained by one factor is 33.3%, indicating that common method biases is not a likely contaminant of the research results.

#### 6.3.4 Descriptive Analysis

Based on the findings, out of 257 questionnaires distributed this study received 166 which arrived at 64 per cent response rate. The respondents are grouped according to their designation such as Shariah committee, internal auditors, external auditors Shariah officers, regulators (BNM) and stakeholders (depositors) of the Islamic banks. These are the individuals involved in the Shariah audit practices in the Islamic banks. Kasim's (2009) study of Shariah audit included a sample of approximately 155 respondents using a similar target group and managed to receive 55 per cent response from the total sample. Previously studies on audit gap (Teck Heang et al., 2007, Azham et al., 2008, AlJaaidi, 2009, Chau, 2001) had response rates between 25 per cent to 33 per cent. Since the response rate for this study is 64 per cent, it can be considered an adequate reflection of the estimated total population.

Based on Table 15, 85.7 per cent of the Shariah committee members who responded to the questionnaires hold legal qualifications apart from the existing Shariah qualification that they already possess. This shows that out of 14 Shariah committee members, 12 have legal and Shariah qualification. Also, most of the internal auditors are qualified in accounting which is 48.5 per cent. Surprisingly 18.2 per cent of the internal auditors are qualified in Shariah, and only 9 per cent have a background in law. The internal auditors of the Islamic banks who responded to the survey are from backgrounds not limited to accounting since the internal auditors of the Islamic banks are responsible for performing the Shariah audit function. 100 per cent of the external auditors involved in the survey are qualified in accounting, and only two of them holds

a dual qualification in accounting as well as Shariah. Apart from that, 32 Shariah officers of which five are the Shariah manager of the Islamic banks participated in the survey. 75 per cent of them hold Shariah qualifications while 34.3 per cent are qualified in law. 17.8 per cent of the Shariah officers are qualified in both areas Shariah and law. However, none is qualified in accounting and auditing. Also, 28 respondents from BNM participated in the study from various departments such as Jabatan Perbankan Insurans dan Takaful (JPIT) and departments related to Islamic banking operations. 42.9 per cent of the regulators who participated in the survey are qualified in accounting, 10.7 per cent are qualified in law and 28.6 per cent are qualified in Shariah. The qualifications of the respondents is illustrated in Table 15:

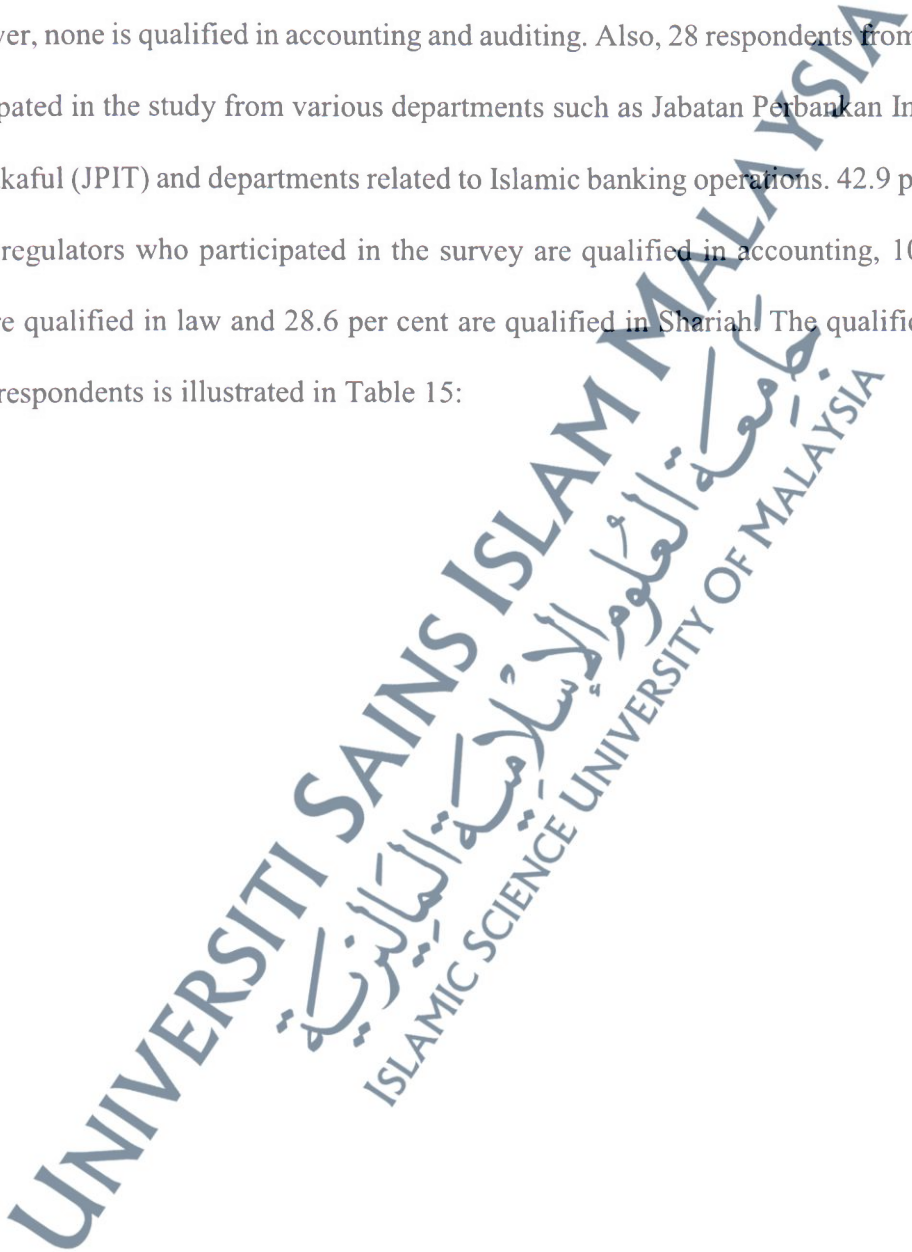


Table 15: Qualifications of respondents

Designation	No. of respondents / % representative	Accounting qualification	Legal qualification	Shariah qualification	Shariah audit involvement	Awareness in Shariah audit	Mean Years of experience in Islamic Banking
<b>Shariah Committee</b>	14 8.4%	0 (0%)	12 (85.7%)	13 (92.9%)	1 (7%)	14 (100%)	10
Internal auditors	33 19.9%	16 (48.5%)	3 (9%)	6 (18.2%)	28 (84.8%)	33 (100%)	3
<b>External auditors</b>	16 9.6%	16 (100%)	0 (0%)	2 (12.5%)	4 (25%)	16 (100%)	5
Stakeholders (depositors)	43 25.9%	5 (11.6%)	6 (13.9%)	5 (11.6%)	0 (0%)	19 (44.1%)	0
<b>Shariah officers</b>	32 19.3%	0 (0%)	11 (34.3%)	24 (75%)	9 (28.1%)	32 (100%)	5
Regulators (BNM)	28 16.9%	12 (42.9%)	3 (10.7%)	8 (28.6%)	4 (14.3%)	28 (100%)	3
<b>Total</b>	<b>166</b> <b>100%</b>	<b>59</b> <b>29.5%</b>	<b>85</b> <b>21%</b>	<b>58</b> <b>34.9%</b>	<b>46</b> <b>(27.7%)</b>	<b>142</b> <b>85.5%</b>	

To determine the existence of an expectation gap in Shariah audit; Kruskal-Wallis test is used. Kruskal-Wallis test is used to find a statistically significant difference between two or more groups of an independent variable on a continuous or ordinal dependent variable. It is considered the nonparametric alternative to the one-way ANOVA, and an extension of the Mann-Whitney U-test to allow the comparison of more than two independent groups. Since this study involves few respondents Kruskal- Wallis test fit with one of the objectives of the research which is to determine the existence of an expectation-performance gap in Shariah audit practices among the respondents.

As discussed earlier, Porter (1993) detailed the definition of reasonableness gap as a gap between what societies expects on the practices of audit and what it can reasonably be expected to accomplish. This study looks from the perspectives of Shariah audit regarding exploring the gap between what societies (i.e. regulators, Shariah committees, Shariah officers, Shariah managers, internal and external auditors and the depositors) expect of the practices of Shariah audit and what it can reasonably be expected to accomplish. Most of the questions in the questionnaires use the 5-point Likert scale measurement (1=Strongly disagree to 5=Strongly agree). The present study utilised the Kruskal-Wallis to assess whether there was a significant difference among six groups of respondents. The data were ranked in nature, and the Kruskal-Wallis analysed the differences based on the mean rank of each group. For the purpose of comparing among those surveyed, mean value is used to reflect the accuracy of the score for each group of respondents. The mean value was analysed at the descriptive stage and reported in the table below. This research observes that the findings based on mean value and mean rank are the same. The findings on expectation gap highlight the mean value while the mean rank table is available in the appendices.

The reasonableness gap in Shariah audit is measured based on the framework, scope, competency, processes, independent and reporting of Shariah audit in the Islamic banks. Table 16 highlights the existence of an expectation gap in each of the components (framework, scope, competency, processes, independent and reporting) among the respondents. The respondents (Shariah committee, internal auditors, external auditors, depositors, Shariah officers and regulators (BNM)) share different views on Shariah audit practices, which results in significant differences in the expectations.

### 6.3.5 Expectation Gap in Shariah Audit Practices on Framework

There are six statements pertaining to the framework of Shariah audit practices in the questionnaires. Three out of six statements on the framework of Shariah audit practices in the Islamic banks are significant regarding the existence of the expectation gap. For instance, in discussing issues related to the framework of Shariah audit practices, there is a significant difference among the respondents that the Shariah review framework should differ from the Shariah audit framework. Among the respondents, the Shariah officers agree that the framework should be different between review and audit with the score of mean 4.25 and mean rank of 106.91. The internal auditors and external auditors agree with the statement since the mean value is 3.82 and 3.87 with the mean rank of 85.69 and 89.5. The finding is significant since the p-value is 0.01, which is less than 0.05.

The next statement showing the existence of an expectation gap is '*Shariah auditor should audit the findings of Shariah review done by Shariah officers*'. On the basis of the results, the average mean for the statement among the group falls between 3.15 to 4.44. The mean score for internal auditors group is 3.15 with the mean rank

50.92 which shows the lowest mean rank among the respondent. This shows that the internal auditors do not agree with the statement. However, comparing the means among the respondents, the external auditors, the depositors and the Shariah officers agree with the statement with the score of 4.0 and above. The Shariah committee and the regulators rank the second and third lowest mean rank for the above statement. This statement proved the existence of an expectation gap in Shariah audit since the p-value is  $<0.05$  which shows the significance of the statement among the respondents.

Most of the respondents agree that the *'Professional training and Continuous Professional Development (CPD) in Shariah audit is necessary'*. There is a significant gap among the respondents. The internal auditors strongly opine that the CPD is necessary for Shariah audit to ensure the professionalism of the function with the mean value of 4.78. The other three statements in the survey questions on the framework in Shariah audit practices received the same view among the respondents. *'Shariah audit framework should differ from current statutory audit framework'* scored an average mean value of 3.64 among the respondents with the highest mean rank of 97.41 from the external auditors. The external auditors agree with the statement since the mean score is 4.00. Further clarification is required for this statement since another group of respondents did not strongly agree with it. *'The external Shariah audit is necessary to complement the present practices of the Internal Shariah audit to increase the independence in the Islamic banks'* shows that the overall respondents 'agree to strongly agree' with an average mean value of 4.55.

**Table 16: Existence of Expectation Gap in Shariah Audit Practices on Framework**

Statements:	SC	IA	EA	DEP	SO	REG	Avg. Mean
	Mean / Mean Rank						
a) Shariah audit framework should differ from Shariah review framework	32.8	3.82	3.87	3.58	4.25	3.46	3.740/ 0.011*
b) Shariah auditor should audit the findings of Shariah review done by Shariah officers	62.79	85.69	89.50	74.43	106.91	72.71	3.933/ 0.000*
c) Professional training and Continuous Professional Development (CPD) in Shariah audit is necessary	3.71	3.15	4.44	4.44	4.18	3.60	4.409/ 0.016*
d) Shariah audit framework should differ from current Statutory audit framework	80.75	50.92	100.47	104.42	94.89	68.43	3.644/ 0.346
e) The external Shariah audit is necessary to complement the present practices of the internal Shariah audit to increase the independence in the Islamic banks	3.92	4.78	4.18	4.41	4.34	4.39	4.554/ 0.070
f) Shariah audit framework should complement the internal audit framework in the Islamic banks.	14.11	106.56	66.03	82.69	76.33	80.45	
	3.85	3.63	4.00	3.37	3.84	3.53	
	92.04	83.18	97.41	73.10	91.64	78.32	
	4.28	4.33	4.37	4.07	4.03	4.10	
	86.31	92.85	97.42	79.93	68.19	80.27	
	4.57	4.18	4.06	4.37	4.15	4.14	4.241/ 0.123
	104.64	79.62	70.5	93.55	78.5	75.21	

**QUANTITATIVE FINDINGS**

Shariah audit Framework different from Shariah Review Framework and existing audit framework.

**Summarised interview findings:**

The view of interview repondents on the placement of Shariah audit framework can be divided into three group:

- a) Shariah audit framework should be different from Shariah review framework
- b) Shariah audit framework should complement the Internal audit framework in the Islamic banks.
- c) Shariah audit framework should be treated at par like statutory audit.

**H1:** There is an expectation gap among the respondents on the framework of Shariah audit in the Islamic banks in the following area:

**QUANTITATIVE FINDINGS**

\*Significantly different among overall respondents  $p < 0.05$  based on Kruskal-Wallis test. IA: Internal auditors; SA: Shariah auditors; SC: Shariah Committee; EA: External auditors; DEP: Depositors; SO: Shariah officers; REG: Regulator

Table 16 also compares the findings from the survey questions and during the interview sessions. The majority of the respondents agreed that the Shariah audit framework should be different from the Shariah review framework. The findings from the interview sessions are different from the survey since the p-value is below 0.05 reflects the existence of an expectation gap among the respondents. Not all the respondents agree with the idea of differentiating the Shariah audit framework with the review framework. According to AAOIFI, the Shariah review function is similar to the Shariah audit function. Due to that, the outcome from the interview sessions is not supported empirically through the questionnaire since not all the respondents agreed with the proposition. The survey findings support that the treatment of Shariah audit framework should be the same with the statutory audit. This matches with the statement in the questionnaire that *'The external Shariah audit is necessary to complement the present practices of the Internal Shariah audit to increase the independence in the Islamic banks'*. The last statement on the framework in Shariah audit *'Shariah audit framework should complement the Internal audit framework in the Islamic banks'* supports the qualitative and quantitative findings. This is because, at present, the Shariah audit function is attached to the internal audit department.

This research extends the findings by performing the Mann-Whitney *U*-test to find which specific groups are statistically different. The Kruskal-Wallis H test is an omnibus test statistic and does not highlight which specific groups of the independent variable are statistically significantly different from each other. Thus, this study expands the significant findings from Kruskal-Wallis H test and performs Mann-Whitney *U*-test to compare the significant different between two groups. The comparison is between the internal auditors group and other respondents such as i) internal auditors vs. Shariah committee, ii) internal auditors vs. external auditors, iii)

not have a significant difference with the internal auditors' view.

Comparing finding on framework with Kasim (2009), most IFIs are using a conventional auditing framework due to the lack of a Shariah auditing framework. Presently, no standard Shariah audit framework exists in Malaysia. However, the practice is highlighted in the SGF (2010) as one of the important functions in ensuring Shariah governance in the IFIs. Yahkiruni and Nurmazilah (2012) studies the role of internal auditing in ensuring governance in IFIs and found that IFIs are struggling to establish an effective Shariah auditing framework. Due to the lack of a structured Shariah auditing framework, the practice of Shariah audit has not made a serious impact on IFIs in Malaysia (Yusof, 2013). The existing internal audit structures in banks and *Takaful* companies are either leveraged on the Group Internal Audit (based on conventional audit framework with modification) or outsourced to professional Shariah-compliant auditing firms. The current framework used by a majority of IFIs is a shared model but with certain modifications, and the respondents indicated the need for one general framework that can be used to standardise the practices of Shariah auditing among IFIs. As such, the internal audit units are not organised to exist as a standalone or independent function to undertake Shariah audit, and may lack cohesion or are too fragmented for a comprehensive audit to be undertaken on Shariah compliance.

### 6.3.6 Expectation Gap in Shariah Audit Practices on Scope

Table 18 highlights the existence of an expectation gap in the scope of Shariah audit. It also summarises the findings from the interview sessions. Three out of six statements regarding the scope of Shariah audit proved to be statistically significant due

internal auditors vs. depositors, iv) internal auditors vs. Shariah officers and v) internal auditors vs. regulators. The internal auditors group was chosen as the main comparison because the functions of the Shariah audit is attached to the internal auditors department as required in the SGF (BNM, 2010). Furthermore, 85% of the internal auditors who participated in this study are involved in the Shariah audit function. This justifies the comparison between individuals who perform Shariah audit with the perceptions of others on Shariah audit practices.

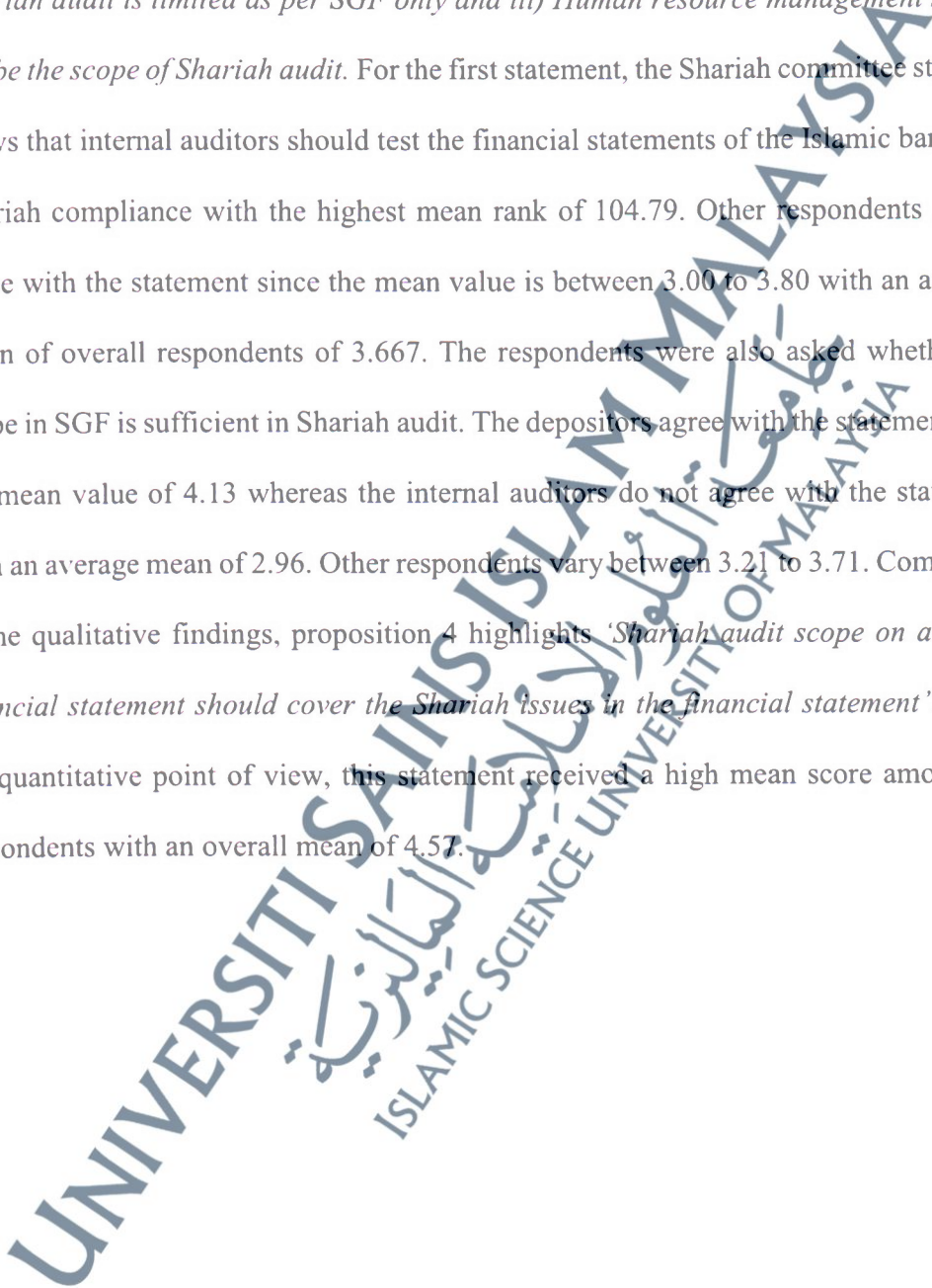
**Table 17: Overall Gap among the Respondents in Shariah Audit Practices on Framework**

STATEMENT	IA/SA	USERS GROUP (OVERALL GAP)				
		SC	EA	DEP	SO	REG
a) Shariah audit framework should differ from Shariah review framework	3.82	0.54**	-0.05*	0.24**	-0.43**	0.36**
b) Shariah auditor should audit the findings of Shariah review done by Shariah officers	3.15	-0.56	1.29**	-1.29**	-1.03**	-0.45
c) Professional training and Continuous Professional Development (CPD) in Shariah audit is necessary	4.78	0.86*	0.6**	0.37**	0.44**	0.39**

\*significantly different from internal auditors overall gap at  $p < 0.05$  and \*\*significantly different from internal auditors overall gap at  $p < 0.01$  based on Man-Whitney *U*-test. IA: Internal auditors; SA: Shariah auditors; SC: Shariah Committee; EA: External auditors; DEP: Depositors; SO: Shariah officers; REG: Regulators

Based on the table above, there is a significant different between the internal auditors and other respondents on the difference between Shariah audit framework and Shariah review framework. The external auditors and the Shariah officers exceed the expectation of the internal auditors since they strongly opine that the framework for review and audit should be separate and different from one another. Shariah auditors should audit the review findings; the significant different is between internal auditors and external auditors, depositors, Shariah officers and regulators. Shariah committee do

to the different expectation among the respondents. Among the statements that received different expectation among the respondents are i) *The internal auditors should attest the financial statements of the Islamic banks for Shariah compliance* ii) *The scope of Shariah audit is limited as per SGF only and* iii) *Human resource management should not be the scope of Shariah audit.* For the first statement, the Shariah committee strongly views that internal auditors should test the financial statements of the Islamic banks for Shariah compliance with the highest mean rank of 104.79. Other respondents do not agree with the statement since the mean value is between 3.00 to 3.80 with an average mean of overall respondents of 3.667. The respondents were also asked whether the scope in SGF is sufficient in Shariah audit. The depositors agree with the statement with the mean value of 4.13 whereas the internal auditors do not agree with the statement with an average mean of 2.96. Other respondents vary between 3.21 to 3.71. Comparing to the qualitative findings, proposition 4 highlights '*Shariah audit scope on audit of financial statement should cover the Shariah issues in the financial statement*'. From the quantitative point of view, this statement received a high mean score among the respondents with an overall mean of 4.57.



**Table 18: Existence of Expectation Gap in Shariah Audit Practices on Scope**

<p><b>QUANTITATIVE FINDINGS</b>  <i>Shariah audit scope should cover wide area and not only limited to scope addressed in the Shariah Governance Framework issued by BNM</i></p>		<p><b>QUANTITATIVE FINDINGS</b>  <i>Shariah audit in the Islamic banks in the following area:</i></p>							<p><b>Summarised interview findings:</b></p>
		SC	IA	EA	DEP	SO	REG	Avg. Mean/	
<b>Mean / Mean Rank</b>									
a) The internal auditors should attest the financial statements of the Islamic banks for Shariah compliance	4.35 104.79	3.30 91.08	3.50 83.09	3.81 60.00	3.87 96.55	3.35 85.34	3.667/ 023*	Overall the respondents suggested that the scope of Shariah audit shall extent to cover:	<p>a) the overall operations in the Islamic bank (i.e. human resource management, business policies, process and procedures, zakat calculations and payments, contracts and agreements, environmental impact of operations, social contributions, marketing and advertising, income purification, assessment of financial resource management)</p> <p>b) compliance with the Shariah issues in the financial statements (i.e. PER, zakat, income purification)</p> <p>c) Internal control system for Shariah compliance</p>
b) The scope of Shariah audit is limited as per SGF only	3.71 114.86	2.97 70.71	3.69 75.81	4.13 88.62	3.22 89.69	3.21 72.36	3.466/ 0.000*		
c) Human Resource management	4.50 109.5	3.90 82.97	3.87 81.47	4.23 98.66	3.68 74.98	3.42 58.73	3.915/ 0.002*		
d) Shariah audit should cover the internal control system of an Islamic bank.	4.57 98.57	4.00 70.47	4.31 79.28	4.46 95.73	4.31 82.14	4.21 76.50	4.295/ 0.111		
e) Shariah audit on financial statements should include zakat disclosure, Profit Equalisation Reserve, purification of income.	4.64 95.43	4.64 77.00	4.56 75.75	4.58 94.93	4.59 78.84	4.57 77.39	4.578/ 0.993		
f) Other possible scopes of Shariah audit should cover business policies, contracts and agreements, environment impact of operations, social contribution, marketing and advertising, assessment of financial resource management.	4.50 108.90	4.48 106.60	4.50 107.90	4.37 95.80	4.06 84.35	4.29 88.70	4.343/ 0.348		

\*Significantly different among overall respondents  $p < 0.05$  based on Kruskal-Wallis test. IA: Internal auditors; SA: Shariah auditors; SC: Shariah Committee; EA: External auditors; DEP: Depositors; SO: Shariah officers; REG: Regulator

The respondents agree that the Shariah audit scope on financial statements should support one and another, which reflects the proposed coverage for Shariah audit scope.

The quantitative findings support the proposition and the qualitative findings proposed that the Shariah audit scope should also encompass human resources, business policies, process and procedures, zakat calculations and payments and in the financial statements and internal control for Shariah compliance.

**Table 19: Overall Gap among the Respondents in Shariah Audit Practices on Scope**

STATEMENT	IA/SA	USERS GROUP (OVERALL GAP)				
		SC	EA	DEP	SO	REG
a) The internal auditors should attest the financial statements of the Islamic banks for Shariah compliance	3.30	-1.05**	-0.2	-0.51**	-0.57**	-0.05
b) The scope of Shariah audit is limited as per SGF only	2.97	-0.74**	-0.72**	-1.16*	-0.25	-0.24
c) Human resource management	3.90	-0.6	0.03	-0.33	0.22	0.48*

\*significantly different from internal auditors overall gap at  $p < 0.05$  and \*\*significantly different from internal auditors overall gap at  $p < 0.01$  based on Mann-Whitney *U*-test. IA: Internal auditors; SA: Shariah auditors; SC: Shariah Committee; EA: External auditors; DEP: Depositors; SO: Shariah officers; REG: Regulators

With regard to scope in auditing, it involves public concerns and pressures from various sectors on different kinds of audits (Flint, 1998; Harahap, 2002; Gray et.al, 1996; and Hood and Buchery, 1999). Based on Kasim (2009), there is a need to extend the scope of Shariah audit due to the lack of expertise in Shariah auditing. The scope should be clear and concise to narrow the gap that exists in the industry.

This research further extends the findings by performing Mann-Whitney *U*-test to find which specific groups statistically differ as highlighted in Table 19. It is important to realise that the Kruskal-Wallis H test is an omnibus test statistic and does not highlight which specific groups of the independent variable are statistically

significantly different from each other. Thus, this study expands the significant findings from Kruskal-Wallis H test and performs Mann-Whitney U-test to compare the significant difference between two groups. The comparison is between the internal auditors group and other respondents such as i) internal auditors vs. Shariah committee, ii) internal auditors vs. external auditors, iii) internal auditors vs. depositors, iv) internal auditors vs. Shariah officers and v) internal auditors vs. regulators. The internal auditors group was chosen as the main comparison due to the functions of Shariah audit is attached to the internal auditors department as required in the SGF (BNM, 2010). Furthermore, 85% of the internal auditors who participated in this study are involved in the Shariah audit function. This justifies the comparison between individuals who perform Shariah audit with the perceptions of others on Shariah audit practices.

There is a significant difference of expectation among the internal auditors with the Shariah committee on the statement '*The internal auditors should attest the financial statements of the Islamic banks for Shariah compliance*'. This is the same with the Shariah officers and the depositors. The internal auditors score an average mean of 3.3 which reflects a neutral response to disagreeing with the statement. The Shariah Committee, the depositors and Shariah officers agree with the statement that the internal auditors should attest the financial statements of the Islamic banks.

There is also significant difference among the respondents between the i) internal auditors and Shariah Committee, ii) internal auditors and external auditors and iii) internal auditors and depositors on the scope of Shariah audit. The respondents' views on the scope of Shariah audit and whether it should be limited to the SGF varies.

### 6.3.7 Expectation Gap in Shariah Audit Practices on Competency

Referring to Table 20, the first statement highlights on the qualification of Shariah auditor. Most of the respondents agree that a Shariah auditor should be a qualified accountant. The group of respondents that agree with the statement are Shariah committee members, the external auditors, stakeholders and Shariah officers. The means score for each group that agrees is 4.0 and above which shows agree and strongly agree. However, the internal auditor's group which also holds the responsibility to conduct the Shariah audit in the Islamic banks and the regulators are neutral with the statement that a Shariah auditor should be a qualified accountant. The mean score is at 3.44 which is 'somewhat agree' with the statement. This implies that for the internal auditors and regulators, a Shariah auditor may not be a qualified accountant.

The second statement discussed that a Shariah auditor should be appointed among Muslims only. Only the Shariah committee members and depositors agree with this statement with the mean scores of 4.3 and 4.29 respectively.

**Table 20: Existence of Expectation Gap in Shariah Audit Practices on Competency**

Statements:	SC		IA		EA	DEP	SO	REG	Avg. Mean/
	IA	EA	IA	EA					
	Mean / Mean Rank								
a) A qualified accountant	4.44	3.44	4.00	4.07	4.39	4.07	3.50	3.915/	
	92.21	62.14	83.53	87.02	106.27	87.02	65.32	0.001*	
b) Appointed among Muslims only	4.30	2.80	3.70	3.82	4.29	3.82	3.21	4.138/	
	108.25	48.74	90.97	100.25	97.77	100.25	69.27	0.000*	
c) Qualified in Shariah and accounting	4.14	3.96	4.40	4.25	4.39	4.25	3.78	4.168/	
	77.57	70.24	90.25	92.56	99.44	92.56	63.39	0.006*	
d) Qualified in Shariah only	3.28	2.44	2.20	3.50	3.65	3.50	2.57	3.042/	
	92.57	59.32	48.72	103.25	109.58	103.25	64.71	0.000*	
e) Fully subscribe to the principles and Shariah rulings upon engagement and execution of the audit task	4.57	4.36	4.40	4.50	4.8	4.50	4.14	4.494/	
	86.79	79.24	66.72	86.23	105.58	86.23	59.43	0.002*	
f) The internal auditors of the IFIs	3.92	3.36	3.10	4.07	4.51	4.07	3.32	3.813/	
	97.00	60.05	54.53	99.95	113.33	99.95	56.34	0.000*	
g) Competent in Shariah, auditing, finance and law	4.28	4.45	4.62	4.21	4.65	4.21	4.28	4.524/	
	73.50	83.06	91.31	72.30	96.38	72.30	75.57	0.175	

\*Significantly different among overall respondents  $p < 0.05$  based on Kruskal-Wallis test. IA: Internal auditors; SA: Shariah auditors; SC: Shariah Committee; EA: External auditors; DEP: Depositors; SO: Shariah officers; REG: Regulator

**QUANTITATIVE FINDINGS**

**H1c:** There is an expectation gap among the respondents on the competency of Shariah audit in the Islamic banks in the following area:

**QUALITATIVE FINDINGS**  
 Shariah auditor/internal auditor in the Islamic bank who performs Shariah audit function should have the accounting and Shariah qualification to achieve competency level

**Summarised interview findings:**

There are different views regarding the competency of Shariah auditors. Thus, it is summarised that the level of competency of Shariah auditor shall be as follows:

- a) the criteria shall be determined by each of the Islamic banks,
- b) shall be well equipped with accounting and Shariah knowledge,
- c) the internal auditors may invite the Shariah team to be part of the internal audit team to perform Shariah audit,
- d) if the person is an experience staff but no qualification in accounting and Shariah, the banks shall send the staff for Shariah trainings.

The internal and external auditors, Shariah officers and the regulators are neutral with the statement with an average mean score of 3.0. Thus, a Shariah auditor may not be appointed among Muslims only.

The third and fourth statement also shows a variance of response among the six groups. The internal and external auditors and the regulators disagree with the statement that a Shariah auditor should be a person qualified in Shariah only. However, in the next statement not including the external auditors; the internal auditors and the regulators were neutral with the statement that a Shariah auditor should be a person qualified in accounting and Shariah. These two groups share the opinion that a Shariah auditor does not have to be a person qualified in accounting and Shariah only.

The Shariah committee members, stakeholders (customers) and the Shariah officers neither agree nor disagree with the statement that a Shariah auditor should be a person qualified in Shariah only. These groups together with the internal auditors share the view that a Shariah auditor should be a person qualified in accounting and Shariah.

Hassan et al. (2010) showed that 83% of the Shariah committee agree that accounting is a necessary branch of knowledge in the composition of the Shariah committee. They also agree that each Shariah committee member must possess adequate knowledge of the Shariah. It shows that for a composition of Shariah committee to be adequate, they must be knowledgeable in both Shariah and accounting. Hassan et al. (2009) argued that it indicates that the Shariah committee should also be involved in the auditing process of the bank. With that, it is suggested that the Shariah auditor should possess adequate knowledge in accounting and Shariah. However, the expected level needed in Shariah and accounting aspect and its responsibilities in the institutions should be made clear to the Shariah auditor.

The discussion continues with the next statement that a '*Shariah auditor should be competent in Shariah, auditing, finance and law*'. This statement receives a good response and all groups share the same opinion with an average mean of 4.53 that they strongly agree with the statement. Although the internal auditors and regulators were either neutral or disagree on the qualification of a Shariah auditor, they all strongly agreed that the Shariah auditor should be competent in Shariah, auditing, finance and law. This implies that a Shariah auditor should be competent in Shariah, auditing, finance and law to ensure the quality.

The other four statements in the survey received the same opinion among the six groups. '*Shariah auditor should fully subscribe to the principles and Shariah rulings upon engagement and execution of the audit task*' received a response with an average score of 4.49 shows that majority of the respondent strongly agree with the statement. '*Shariah auditor should continuously upgrade knowledge in Shariah, auditing and Islamic accounting*' received a response 4.74 signals that the respondents agree that the Shariah auditor shall continuously upgrade knowledge in Shariah, auditing and Islamic accounting.

'*Shariah auditor should be the internal auditor of the IFI*' receives disagreement among the respondents since the mean score is 3.84. Based on table 20 the stakeholders and the Shariah officers support that the internal auditors should be the Shariah auditor of an IFI. The Shariah committee, internal auditors, external auditors and the regulators have a different view. They suggested that the Shariah auditor should be an independent person in the IFI with his/her job description and specific task to perform the Shariah audit functions. This statement also reflects that the respondents disagreement with the Shariah Governance Framework (BNM, 2010) and the tasks included therein regarding the Shariah audit function by the internal auditor.

In terms of interview findings, proposition seven highlights 'Shariah auditor/internal auditor in the Islamic banks who performs Shariah audit function should have the accounting and Shariah qualification to achieve competency level'. The survey findings support the proposition since most of the p-values for each of statement is significant. The majority of the interviewees mentioned that the Shariah auditor qualifications may vary. The competency of a Shariah auditor shall be determined by each of the Islamic banks and be well equipped with accounting and Shariah knowledge. In terms of lack of expertise to perform the Shariah audit function, the internal auditors may invite the Shariah team to be part of the internal audit team to perform the Shariah audit. If the person is an experienced staff with no qualification in accounting and Shariah, the banks shall send the staff for Shariah training.

**Table 21: Overall Gap among the Respondents in Shariah Audit Practices on Competency**

STATEMENT	IA/SA	USERS GROUP (OVERALL GAP)				
		SC	EA	DEP	SO	REG
a) A qualified accountant	3.44	-0.7*	-0.56*	-	-	-0.06
b) appointed among Muslims only	2.80	-1.5**	-0.9**	-	-	-0.41
c) qualified in Shariah and accounting	3.96	-0.18	-0.44	-0.43	-0.29	0.18
d) qualified in Shariah only	2.44	-0.84*	0.24	-	-	-0.13
e) Fully subscribe to the principles and Shariah rulings upon engagement and execution of the audit task	4.36	-0.21	-0.04	-0.44	-0.14	0.22
f) the internal auditors of the IFIs	3.36	-0.56*	0.26	-	-0.71*	0.04

\*significantly different from internal auditors overall gap at  $p < 0.05$  and \*\*significantly different from internal auditors overall gap at  $p < 0.01$  based on Man-Whitney U-test. IA: Internal auditors; SA: Shariah auditors; SC: Shariah Committee; EA: External auditors; DEP: Depositors; SO: Shariah officers; REG: Regulators

Based on Kasim (2009), the finding shows that there is a difference between the desired and the actual qualification of Shariah auditors as the proportion of those respondents qualified in both Shariah and accounting is only 5.9% as compared to those respondents who practice Shariah auditing in IFIs in Malaysia (69%). This is an indication that the practice lacks people of both qualifications as indirectly they are important in determining the vision and mission of Islam is preserved within the IFIs. Shariah auditors are expected to reflect their responsibility and accountability not only to the management and stakeholders but more importantly to God. This will promote the foundations for building public confidence and assurance that the IFIs are Shariah-compliant in all of their activities. According to Yusof (2013), increased accountability of internal Shariah auditors will necessitate a comprehensive training programme to ensure that they are qualified and competent to undertake the new multidisciplinary role as internal Shariah auditors, possessing both audit and Shariah qualifications (*usul al-fiqh* or *fiqh muamalat*), to boost public confidence and give objective assurances of the integrity of the Shariah audit profession. This is supported through the annual AAOIFI Shariah Conference (2012), one of the presenters, Mufti Aziz Ur Rahman, recommended that the industry needs i) proper official training of Shariah auditors and the ii) strengthening of the certification process.

#### **6.3.8 Expectation Gap in Shariah Audit Practices on Processes**

Referring to Table 22, out of ten statements involve in Shariah audit processes, eight have a p-value of  $<0.05$  which leads to significant findings to the existence of an expectations gap among the respondents. There were different views regarding the process of Shariah audit thereby highlighting the need for standardised Shariah audit processes.

Table 22: Existence of Expectation Gap in Shariah Audit Practices on Processes

		QUANTITATIVE FINDINGS										QUALITATIVE FINDINGS
		Mean / Mean Rank										Shariah audit processes should cover Shariah audit evidence, Shariah audit Programme and Shariah audit Planning
Statements:		SC	IA	EA	DEP	SO	REG	Avg. Mean				Summarised interview findings:
H <sub>1d</sub> : There is an expectation gap among the respondents on the processes of Shariah audit in the Islamic banks in the following area:												Overall view on the Shariah audit processes from the respondents are:
a)	Audit committee should not determine the Shariah audit planning	4.85	2.18	2.31	2.69	3.06	2.40	2.602/0.012*				a) Shariah audit processes should be separated from Shariah Compliance Manual.
b)	Shariah audit programme is necessary for evidence purpose	100.75	64.23	72.03	87.29	101.19	78.11	0.012*				b) Shariah committee and Audit committee should involve directly in determining the Shariah audit planning.
c)	Shariah auditor should ensure that all new fatwas, rulings and guidance and modifications to existing fatwas are identified and reviewed for each period under examination	4.42	3.93	3.81	4.37	4.28	3.92	4.144/0.001*				c) It is necessary to developed Shariah audit programme that represent the whole procedures in conducting Shariah audit for each auditable area.
d)	Shariah committees are aware of the income purification issues and disclosed in the Shariah committee report	101.93	70.30	60.31	98.86	92.88	68.79	0.001*				d) Shariah auditor should ensure that all new fatwas, rulings and guidance and modifications to existing fatwas are identified and reviewed during Shariah audit practices.
e)	The bank may appoint or employ external party or person to conduct Shariah audit	4.35	4.18	4.25	4.58	4.34	4.14	4.331/0.035*				
f)	Shariah audit engagement should be endorsed by the Shariah committee	89.86	73.82	73.50	100.91	83.39	70.84					
g)	Shariah audit engagement should be recommended by the audit committee	4.57	3.93	4.18	4.41	4.43	4.14	4.124/0.002*				
h)	Shariah audit engagement should be approved by the board	111.50	62.74	72.91	94.33	91.56	74.18					
		3.50	3.66	4.06	4.46	4.37	4.00	4.084/0.000*				
		49.43	57.20	82.44	109.01	98.97	75.29					
		3.78	4.12	4.06	4.27	4.31	4.00	4.144/0.039*				
		61.46	79.55	74.53	96.23	94.69	71.96					
		3.64	3.90	3.81	4.41	4.03	3.78	4.012/0.000*				
		59.04	74.02	69.22	108.47	89.05	70.39					
		3.85	3.66	3.87	4.39	4.00	3.78	3.975/0.002*				
		75.43	64.95	76.31	105.52	90.69	71.46					

i) Shariah audit processes should be included in the Shariah Compliance Manual of each Islamic bank	4.14	3.96	4.31	4.27	4.46	4.00	4.234/	e) The Shariah auditing process should be conducted in accordance with the established auditing standards that already exists. This is to bring relevance and compliance of the auditing function with the globally or nationally accepted standards.
j) Shariah committee should involve directly in determining the Shariah audit planning	86.57	75.15	86.16	85.34	98.20	70.66	0.186	
	4.07	4.03	3.75	4.09	4.09	3.67	3.944/ 0.121	
	87.57	85.42	67.75	92.42	90.56	66.43		

\*Significantly different among overall respondents  $p < 0.05$  based on Kruskal-Wallis test. IA: Internal auditors; SA: Shariah auditors; SC: Shariah Committee; EA: External auditors; DEP: Depositors; SO: Shariah officers; REG: Regulator



The statements that need to be further clarified comprise:

- a) Audit committee should not determine the Shariah audit planning,
- b) Shariah audit programme is necessary for evidence purpose,
- c) Shariah committees are aware of the income purification issues and disclosed in the Shariah committee report,
- d) The bank may appoint or employ external party or person to conduct Shariah audit,
- e) Shariah audit engagement should be endorsed by the Shariah committee and recommended by the audit committee and last but not least
- f) Shariah audit engagement should be approved by the board.

The respondents agree with only two statements concerning the process of Shariah audit with an overall average score of 4.23 and 3.94. The two statements support the qualitative findings that '*Shariah audit processes should be separated from Shariah Compliance Manual*' and '*Shariah committee should involve directly in determining the Shariah audit planning*'

'*Audit committee should not determine the Shariah audit planning*' received different views from the respondents. With the mean rank of 101.19 and average mean of 3.06, most of the Shariah officers were unsure on the arrangement in determining the Shariah audit planning. The other group of respondents scored an average mean between 2.31 to 2.85 which showed that most of them do not agree with the statement. In practice, the audit committee performs an oversight role during auditing. To put the responsibility on the audit committee to determine the Shariah audit planning is not a monitoring task. Therefore, the Shariah audit planning should be determined by the responsible person at the operations level. However, based on the interview finding, Shariah committee and audit committee should be directly involved in determining the

Shariah audit planning. According to the interview session, Shariah audit function is a new area that needs proper planning, guidance and monitoring from the board. The function should be closely monitored by the board to ensure the governance are in place.

In terms of the importance of having Shariah audit programme as evidence, even though there is an expectation gap among the respondents, the average mean score is between 3.81 to 4.42. The Shariah committee group scored mean rank of 101.93 which ranks the first among the respondents to agree with the statement. This statement also supports the interview findings that it is necessary to develop a Shariah audit programme that represents the procedures of conducting Shariah audit for each auditable area.

'Shariah auditor should ensure that all new fatwas, rulings and guidance and modifications to existing fatwas are identified and reviewed for each period under examination' scored an average mean of 4.33 which showed the respondents agreed with it. The expectation gap exists in terms of the level of agreement between the respondents whether 'agree' to 'strongly agree'. Besides supporting the findings from the interview session, additional input from the interview posited that the Shariah auditing process should be conducted in accordance with the established auditing standards that already exists. This is to bring relevance and compliance of the auditing function with the globally or nationally accepted standards.

In terms of *'the bank may appoint or employ external party or person to conduct Shariah audit'* the statement results in disagreement among the respondents. The Shariah committee group and internal auditors were unsure with the statement since the mean value is 3.5 and 3.63 respectively.

**Table 23: Overall Gap among the Respondents in Shariah Audit Practices on Processes**

STATEMENT	IA/SA	USERS GROUP (OVERALL GAP)				
		SC	EA	DEP	SO	REG
a) Audit committee should not determine the Shariah audit planning	2.18	-0.67	-0.13	-0.38*	-0.37*	0.66**
b) Shariah audit programme is necessary for evidence purpose	3.93	-0.49**	0.12	-0.56**	0.09	0.36*
c) Shariah auditor should ensure that all new fatwas, rulings and guidance and modifications to existing fatwas are identified and reviewed for each period under examination	4.18	-0.17	-0.07	-0.33*	0.24	0.2
d) Shariah committees are aware of the income purification issues and disclosed in the Shariah committee report	3.93	-0.64**	-0.25*	-0.23	-0.02	0.29*
e) The bank may appoint or employ external party or person to conduct Shariah audit	3.63	0.13	-0.43*	-0.4	0.09	0.37*
f) Shariah audit engagement should be endorsed by the Shariah committee	4.12	0.34*	0.06	-0.21	-0.04	0.31*
g) Shariah audit engagement should be recommended by the audit committee	3.90	0.26	0.09	-0.6	0.38*	0.25*
h) Shariah audit engagement should be approved by the board	3.66	-0.19	-0.21	-0.52*	0.39*	0.22

\*significantly different from internal auditors overall gap at  $p < 0.05$  and \*\*significantly different from internal auditors overall gap at  $p < 0.01$  based on Man-Whitney U-test. IA: Internal auditors; SA: Shariah auditors; SC: Shariah Committee; EA: External auditors; DEP: Depositors; SO: Shariah officers; REG: Regulators

Another statement that caused disagreement between survey findings and interview findings is 'Shariah audit processes should be included in the Shariah Compliance Manual of each Islamic bank'. Most of the survey respondents agree with the statement with an overall average of mean score 4.23. However, the respondents prefer Shariah audit processes should be separated from the Shariah Compliance Manual. Based on the qualitative findings the overall respondents view that i) Shariah audit processes should be separated from Shariah Compliance Manual, ii) Shariah committee and audit committee should be directly involved in determining the Shariah audit planning, iii) it

is necessary to develop a Shariah audit programme that represents the procedures in conducting Shariah audit for each auditable area, iv) Shariah auditor should ensure that all new fatwas, rulings and guidance and modifications to existing fatwas are identified and reviewed during Shariah audit practices and v) the Shariah auditing process should be conducted in accordance with the established auditing standards that already exists. This is to bring relevance and compliance of the auditing function with the globally or nationally accepted standards. Therefore, this creates a gap between what people perceived and what is delivered in the industry.

#### 6.3.9 Expectation Gap in Shariah Audit Practices on Reporting

Referring to Table 24 concerning whether it is important to standardise reporting the findings of Shariah audit in all Islamic banks, six statements were asked in the survey questionnaire. All of the statements contribute to the expectation gap among the respondents since the p-value is  $<0.05$ . Only one statement carries an overall mean of 4.10 which shows agree with the statement '*Shariah audit report is a formulation of audit opinion on the degree of assurance of timely and comprehensive adoption or implementation of Shariah principles and rulings*'. Even though the level of agreeing with the statement varies according to the group of respondents, it still contributes to the definition of Shariah audit report to the existing practices. This may fill in the gap on the definition of Shariah audit reporting in practice.

**Table 24: Existence of Expectation Gap in Shariah Audit Practices on Reporting**

Statements:		SC	IA	EA	DEP	SO	REG	Avg. mean	QUALITATIVE FINDINGS Shariah audit report should differ from Shariah Committee report
		Mean / Mean Rank							
a) Shariah audit report should be communicated on a monthly basis to the Shariah committee and quarterly reporting to the Audit committee	4.31 105.37	3.80 58.89	4.03 91.47	3.92 97.18	3.43 84.19	4.13 66.73	3.88/ 0.000*		Summarised interview findings:  a) The majority of the respondents agree that the Shariah audit function shall communicate results of any assessment or findings arising from the Shariah audit to the Board Audit Committee and Shariah Committee as per Shariah Governance Framework (BNM, 2010). b) The Shariah audit findings should be reported in the Shariah committee report instead of having a separate Shariah audit report.
b) Shariah audit report is a formulation of audit opinion on the degree of assurance of timely and comprehensive adoption or implementation of Shariah principles and rulings	4.06 102.89	3.82 68.83	3.50 65.09	4.46 101.14	4.18 95.02	4.00 61.36	4.10/ 0.000*		
c) Report should include reporting on <i>ihsan</i> , <i>ithar</i> , <i>ta'awun</i> , <i>sabr</i> , <i>syukur</i> and <i>silaturohrahim</i>	3.58 82.03	3.80 94.00	3.98 60.28	4.33 100.88	4.03 68.25	3.81 75.41	3.71/ 0.000*		
d) The findings of Shariah audit should be reported in the annual report of the IFI.	2.85 54.11	2.18 71.87	2.31 101.04	2.69 80.48	3.06 114.34	2.46 84.21	3.11/ 0.001*		
e) Shariah audit findings should be disclosed separately from Shariah Committee report i.e., Shariah audit report.	3.31 84.07	3.24 73.00	3.81 106.72	3.28 66.12	3.78 98.75	3.50 91.59	3.35/ 0.005*		
f) The findings of Shariah audit should be included in the Shariah Committee report.	3.59 70.36	4.10 86.53	4.25 91.88	4.15 87.92	2.53 65.88	4.35 95.07	3.82/ 0.012*		

\*Significantly different among overall respondents  $p < 0.05$  based on Kruskal-Wallis test. IA: Internal auditors; SA: Shariah auditors; SC: Shariah Committee; EA: External auditors; DEP: Depositors; SO: Shariah officers; REG: Regulator

Another statement that received various views from the respondents is *'the findings of Shariah audit should be reported in the annual report of the IFI'*. The average mean value of the respondents ranges from 2.18 to 3.06 which is 'disagree' to 'not sure'. On average, the internal and external auditors do not agree that the findings of Shariah audit be reported in the annual report of the IFI. However, *'The findings of Shariah audit should be included in the Shariah Committee report'* is agreed by the internal and external auditor as well as the regulators. This statement supports the interview findings that the Shariah audit findings should be reported in the Shariah committee report instead of having a separate Shariah audit report. This showed that it is more practical to report the findings of the Shariah audit through the existing channel rather than to create a new report to communicate the findings. In terms of *'Shariah audit report should be communicated ongoing basis with a monthly report to Shariah committee and quarterly reporting to Audit committee'* the overall respondents mean average score from 3.43 to 4.31. The Shariah committee mean rank of 10537, which is the highest rank among the respondents, showed that the Shariah committees are agreeing with the statement to report to them on a monthly basis and quarterly to the audit committee. However, referring to the Shariah officers and the internal auditors, their overall mean score ranges from 3.43 to 3.80 showed that it is difficult to report the Shariah audit findings on a monthly basis to the Shariah committee. According to the interview findings, the majority of the respondents agree that the Shariah audit function shall communicate results of any assessment or findings arising from the Shariah audit to the Board Audit Committee and Shariah Committee as per Shariah Governance Framework (BNM, 2010). Therefore, the Shariah auditor of the Islamic bank needs to consult with their Shariah committee and decide when is the best time to report to the Shariah committee weekly, monthly, quarterly or whenever necessary.

**Table 25: Overall Gap among the Respondents in Shariah Audit Practices on Reporting**

STATEMENT	IA/SA	USERS GROUP (OVERALL GAP)				
		SC	EA	DEP	SO	REG
a) Shariah audit report should be communicated on an ongoing basis with monthly report to Shariah committee and quarterly reporting to audit committee	3.80	-0.51*	-0.23	0.11	0.49*	-0.7
b) Shariah audit report is a formulation of audit opinion on the degree of assurance of timely and comprehensive adoption or implementation of Shariah principles and rulings	3.82	-0.24	0.32*	-0.96**	0.28	0.18
c) Report should include reporting on <i>ihsan, ithar, ta'awun, sabr', syukur</i> and <i>silaturahmi</i>	3.80	0.22*	-0.18	-0.35*	0.3	0.22*
d) The findings of Shariah audit should be reported in the annual report of the IFI	2.18	-0.67**	-0.13	-0.38*	-0.37*	0.6*
e) Shariah audit findings should be disclosed separately from Shariah Committee report i.e., Shariah audit report	3.24	-0.07	-0.57**	0.53**	-0.5	0.28*
f) The findings of Shariah audit should be included in the Shariah Committee report	4.10	0.51*	-0.15	0.1	1.62**	-1.82**

\*Significantly different from internal auditors overall gap at  $p < 0.05$  and \*\*significantly different from internal auditors overall gap at  $p < 0.01$  based on Man-Whitney *U*-test. IA: Internal auditors; SA: Shariah auditors; SC: Shariah Committee; EA: External auditors; DEP: Depositors; SO: Shariah officers; REG: Regulators

Based on the Table 25 there is a significant difference between i) internal auditors and Shariah committee and ii) internal auditors and Shariah officers on the reporting of Shariah audit findings whether to be done monthly report to Shariah committee and quarterly reporting to the audit committee. The Shariah committee and Shariah officers agree that the Shariah audit findings should be reported on a monthly basis and quarterly reporting to the audit committee. There is also significant difference between i) internal auditors and external auditors and ii) internal auditors and depositors on the definition of Shariah audit report. The external auditors and the depositors agree that Shariah audit

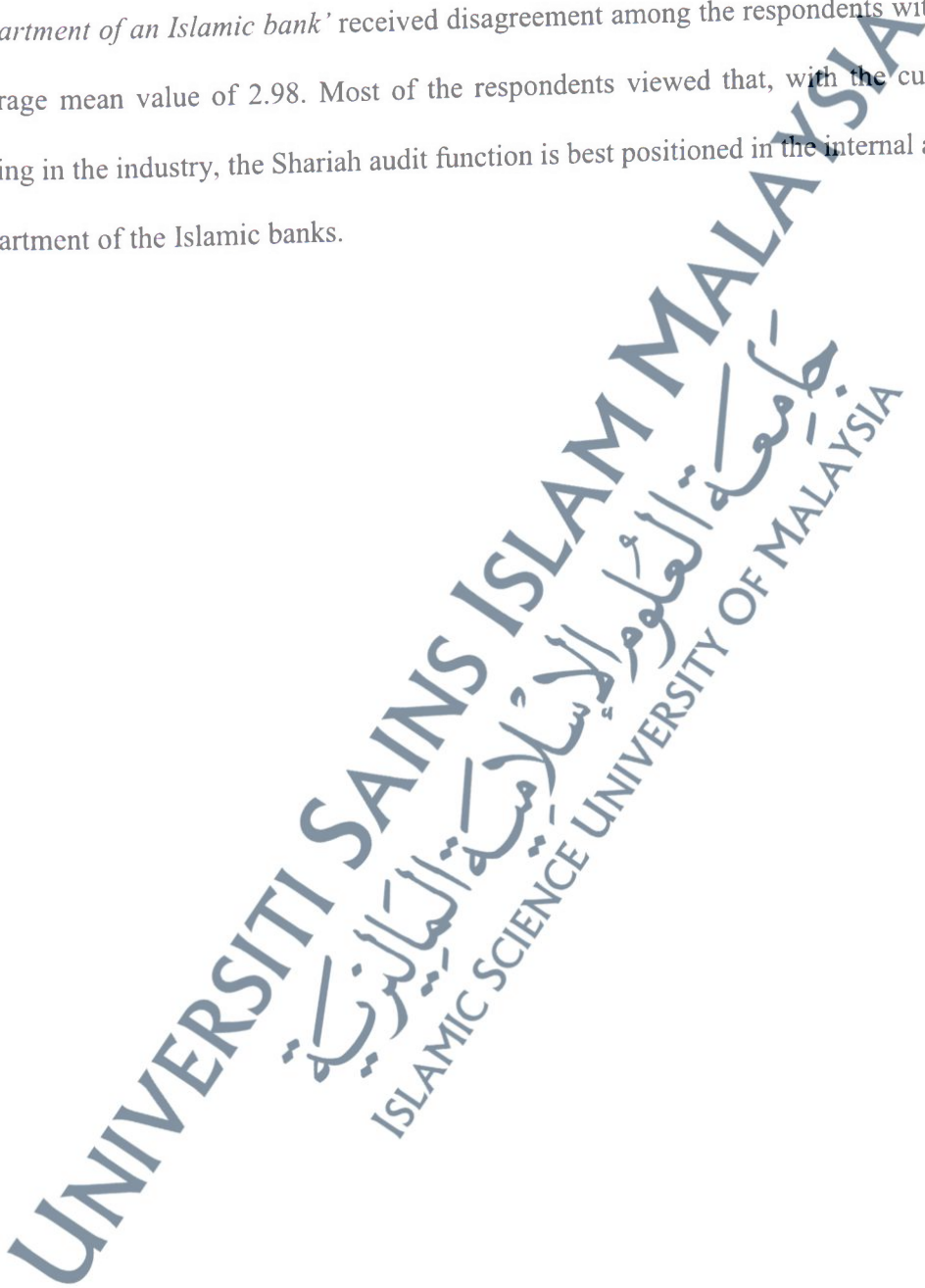
report is a formulation of the audit opinion on the degree of assurance of timely and comprehensive adoption or implementation of Shariah principles and rulings whereby the overall internal auditors are approaching to agree on the statement with the mean average of 3.82.

Regarding Shariah audit findings should be reported in the annual report, there is a significant difference between i) internal auditors and Shariah committee ii) internal auditors and depositors, iii) internal auditors and Shariah officers and iv) internal auditors and regulators. Internal auditors disagree that the reporting should be included in the annual report. This may be due to the previous findings of internal audit is not being made to the public. In the internal audit practices, the findings of internal audit work are only communicated internally and not published in the annual report. This finding is also in line with another statement that Shariah audit findings should be disclosed separately from Shariah committee report. Another statement that wraps up the conclusion on Shariah audit findings is that the results of Shariah audit should be included in the Shariah Committee report. Based on this statement, even though there is a significant difference among the respondents, but the average mean is 4.0 except for the Shariah officers who do not agree that it should be reported in the Shariah committee report.

#### **6.3.10 Expectation Gap in Shariah Audit Practices on Independence**

The findings are summarised in Table 26. There are four statements related to the issue of independent in Shariah audit. Three out of four statements have a p-value of  $<0.05$ . It shows that there is an expectation gap among the respondents on the independence of the Shariah audit in the Islamic banks. On average, it is agreed that a Shariah auditor

should be independent in the execution of the audit, a person who always thinks of justice in discharging responsibilities and should act independently without regard to self-interest. 'The Shariah audit function should not be attached to the internal audit department of an Islamic bank' received disagreement among the respondents with an average mean value of 2.98. Most of the respondents viewed that, with the current setting in the industry, the Shariah audit function is best positioned in the internal audit department of the Islamic banks.



**Table 26: Existence of Expectation Gap in Shariah Audit Practices on Independence**

Statements:		SC	IA	EA	DEP	SO	REG	Avg. mean
		Mean / Mean Rank						
a) A Shariah auditor should be independent in the execution of the audit	3.80	4.00	4.03	4.05	4.05	3.43	3.90	3.942/ 0.000*
b) A Shariah auditor is a person who always thinks of the concept justice in discharging responsibilities	4.06	3.82	3.50	4.46	4.18	4.18	4.00	4.006/ 0.000*
c) A Shariah auditor should act independently without regard to self-interest	3.58	3.80	3.98	4.33	4.03	4.03	3.81	3.927/ 0.000*
d) Shariah audit function should not be attached to the internal audit department of an Islamic bank.	55.20	59.92	88.63	132.93	108.15	108.15	61.91	2.981/ 0.122

\*Significantly different among overall respondents  $p < 0.05$  based on Kruskal-Wallis test. IA: Internal auditors; SA: Shariah auditors; SC: Shariah Committee; EA: External auditors; DEP: Depositors; SO: Shariah officers; REG: Regulator

**QUALITATIVE FINDINGS**  
 The External Shariah audit is necessary to complement the present practices (Internal Shariah audit) and to increase the independence and transparency in the Islamic Banks.  
 Shariah audit should be a separate unit in Islamic Banks rather than attach to internal audit department to ensure independence.

**Summarised interview findings:**  
 Based on the interview it can be concluded that the requirement to have Shariah audit function currently shall be attached to the internal audit department. However, the Islamic banks shall prepare the resources from now to cater the future demand on having Shariah audit as an independent department as required by the stakeholders

The findings from the survey support the qualitative findings. It can be concluded that the requirement to have a Shariah audit function should be attached to the internal audit department. However, the Islamic banks should prepare the resources from now to cater for the future demand for Shariah audits as an independent department as required by the stakeholders.

**Table 27: Overall Gap among the Respondents in Shariah Audit Practices on Independence**

STATEMENT	IA/SA	USERS GROUP (OVERALL GAP)				
		SC	EA	DEP	SO	REG
a) A Shariah auditor should be independent in the execution of the audit	4.00	0.2	-0.03	-0.02	0.62**	-0.47*
b) A Shariah auditor is a person who always thinks of the concept justice in discharging responsibilities	3.82	-0.24	0.32*	-0.96**	0.28	0.18
c) A Shariah auditor should act independently without regard to self-interest	3.80	0.22*	-0.18	-0.35*	0.3	0.22*
d) Shariah audit function should not be attached to the internal audit department of an Islamic bank	2.96	-0.89**	0.15	0.05	-0.3	0.17

\*significantly different from internal auditors overall gap at  $p < 0.05$  and \*\*significantly different from internal auditors overall gap at  $p < 0.01$  based on Man-Whitney U-test. IA: Internal auditors; SA: Shariah auditors; SC: Shariah Committee; EA: External auditors; DEP: Depositors; SO: Shariah officers; REG: Regulators.

In terms of the statements related to concept of justice in Shariah audit, the average score is 4.00 which shows that the respondents agree that a 'Shariah auditor should be a person who always thinks of the concept justice in discharging his responsibilities'.

However, the level of agreement with the statement varies according to group of respondents. Comparing the findings based on Table 5.27 among the internal auditors and other respondents, the significant difference is between the depositors and the

Shariah officers. According to Khan (1982), one of the roles of the *muhtasib* is to be responsible for the implementation of *adl* (justice) in the society. 'Muhtasib' is also known as Islamic auditor, who previously played an important role in *Hisbah* institutions. Yahya and Mahzan (2012) summarised that the functions of *Hisbah* in the past is similar to the role of Shariah auditing where the aim is to preserve the activities of Islamic banking to benefit society and uphold Shariah principles. Thus, it can be assumed that the main responsibility of the *muhtasib* is parallel to the functions of the Shariah audit at a broader level.

### 6.3.11 Expectation Gap in Shariah Audit Practices on Shariah Audit Responsibility

Performance gap – deficient standards is a gap between the duties which can reasonably be expected of Shariah auditors and Shariah auditors' as defined by the SGFBNM, 2010), Islamic Financial Services Act (2013), and IPPF. In this segment, the Shariah audit responsibilities are segregated into three areas, which is regulator, Shariah rulings and Shariah assurance. The hypothesis for this segment is **H<sub>2c</sub>**: *There is an expectation gap among the respondents concerning Shariah audit responsibility as prescribed by regulator BNM. The four statements in this section are derived from the SGF (BNM, 2010). Two out of four statements have a p-value of <0.05 which rejects the null hypothesis. The audit responsibilities that have a significant effect among the respondents are i) the Shariah audit function shall be performed by internal auditors who have acquired adequate Shariah-related knowledge and training ii) the audit committee upon consultation with the Shariah committee shall determine the deliverables of the Shariah audit functions. Not all of the respondents agree on the view*

that the internal auditors should acquire adequate Shariah knowledge and training to perform the Shariah audit function.



**Table 28: Existence of Expectation Gap in Shariah Audit Practices on Shariah audit responsibility**

Statements:		SC	IA	EA	DEP	SO	REG)	Avg. mean/
<b>H<sub>12c</sub>: There is an expectation gap among the respondents concerning Shariah audit responsibility as prescribed by regulator BNM.</b>								
<b>1) Regulator</b>								
a)	The Shariah audit function shall be performed by internal auditors who have acquired adequate Shariah-related knowledge and training	3.64	3.93	3.87	4.51	4.37	3.82	4.1205/ 0.002*
b)	Shariah audit may be conducted as part of the FIs thematic audit on specialised areas such as management audit and Anti-Money Laundering Audit (AMLA).	3.85	4.03	3.81	4.46	4.15	3.82	4.0964/ 0.105
c)	Shariah audit on critical areas shall be conducted at least once a year depending on the risk profile of the IFI.	4.14	4.33	4.06	4.25	4.53	4.00	4.2530/ 0.062
d)	The Audit committee upon consultation with the Shariah Committee shall determine the deliverables of the Shariah audit functions.	4.07	4.03	3.93	4.39	4.06	3.75	4.0783/ 0.004*
<b>H<sub>26b</sub>: There is an expectation gap among the respondents concerning Shariah audit responsibility on Shariah rulings (bakhs, tatfif, 'uqud, khiyannah, israf, tanajush, speculation and gharar).</b>								
<b>2) Shariah Rulings</b>								
<b>H<sub>26c</sub>: There is an expectation gap among the respondents concerning Shariah audit responsibility on Shariah rulings (bakhs, tatfif, 'uqud, khiyannah, israf, tanajush, speculation and gharar).</b>								
<b>Statements:</b>								
a)	Shariah audit should cover Shariah rulings such as bakhs (any voluntary effort to diminish or decrease the value of the product or services being sold), tatif (taking in an excess in measure and giving out a short measure), 'uqud (contract), khiyannah (embezzlement of funds), Israf (the propriety of expenditure), tanajush (bidding), speculation and gharar (uncertainty).	4.42	4.00	4.00	4.37	4.04	3.85	4.1115/ 0.018*
b)	Shariah auditor should obtain and make references to relevant sources, including the SACs published rulings, the Shariah committee decisions, fatwas, guidelines, the Shariah audit results and the internal Shariah checklist.	4.30	3.85	3.98	4.05	4.02	3.95	4.027/ 0.000*
c)	Shariah auditor should attest and provide assurance that the Shariah audit conducted have met Shariah objectives and comply with Shariah requirements	4.00	4.39	4.00	4.58	4.50	3.89	4.221/ .004*

### 3) Shariah Assurance

H<sub>2c</sub>: There is an expectation gap among the respondents concerning Shariah audit responsibility to attest and provide Shariah assurance in the Islamic Banks.

Statements:	SC	IA	EA	DEP	SO	REG)	Avg. mean/
	Mean						
a) Shariah auditors are responsible towards the outside financiers (i.e. capital contributor; mudharib)	3.78	3.21	3.43	4.18	3.84	3.07	3.632/ 0.000*
b) Shariah auditor should have a clear understanding of the business activities of the IFI to allow for better scoping of an audit exercise, i.e. auditability and relevance of activities;	4.50	4.36	4.31	4.69	4.50	4.17	4.451/ 0.022*
c) Shariah auditor should develop a comprehensive internal audit program or plan.	4.07	4.42	4.00	4.60	4.50	4.10	4.361/ 0.000*
d) Shariah auditor should provide recommendations on rectification measures taken as well as following up on the implementation by the IFI.	4.42	4.69	4.18	4.51	4.06	4.03	4.506/ 0.035*
e) Shariah auditor should attest and provide assurance that the Internal Shariah Control System (ISCS) established by the IFIs have met Shariah objectives and comply with Shariah requirements.	4.57	4.69	4.00	4.58	4.50	4.35	4.494/ 0.004*
f) Shariah auditor should assess the adequacy of Shariah review as a basis to determine the authenticity of Shariah rulings, adoption of Shariah requirements and validity of Shariah-complaint transactions.	2.00	3.45	3.56	2.86	3.34	3.42	3.162/ 0.003*
g) Shariah auditor should detect fraud related to Shariah.	4.28	3.66	3.18	4.34	4.31	3.42	3.578/ 0.014*
h) Shariah auditor should communicate results of any assessment or findings arising from the Shariah audit to the Board Audit Committee and the Shariah Committee	4.00	4.12	4.25	4.32	4.06	4.03	4.133/ 0.082
i) Shariah auditor should include objectives, scope, personnel assignment, sampling, control and duration in the Shariah audit planning.	4.07	4.45	4.25	4.48	4.28	4.25	4.035/ 0.353

\*Significantly different among overall respondents  $p < 0.05$  based on Kruskal-Wallis test. IA: Internal auditors; SA: Shariah auditors; SC: Shariah Committee; EA: External auditors; DEP: Depositors; SO: Shariah officers; REG: Regulator

Based on the competency findings discussed in the previous section, it is difficult to ensure that the internal auditors are well equipped with Shariah skills and knowledge. However, the Islamic banks will slowly train the staff to ensure the compliance with the SGF (2010) on equipping the internal auditors with adequate Shariah-related knowledge and training.

The next hypothesis is  $H_{2b}$ : *There is an expectation gap among the respondents concerning Shariah audit responsibility on Shariah rulings (bakhs, tatif, 'uqud, khiyanah, israf, tanajush, speculation and gharar).* There is an expectation gap among the respondents since all three statements in this section has a p-value < 0.05. *'Shariah audit should cover on Shariah rulings such as bakhs (any voluntary effort to diminish or decrease the value of the product or services being sold) tatif (taking in an excess in measure and giving out a short measures) uqud (contract), khiyanah (embezzlement of funds), Israf (the propriety of expenditure), tanajush (bidding), speculation and gharar (uncertainty) received an average mean value of 4.41 which shows agreement with the statement. The Shariah committee group scored an average mean of 4.42 which illustrates the importance of Shariah rulings in operations. Even though there is an expectation gap among the respondents, the gap is due to the level of agree to strongly agree with the statement. For the statement 'Shariah auditor should obtain and make references to relevant sources, including the SACs published rulings, the Shariah committee decisions, fatwas, guidelines, the Shariah audit results and the internal Shariah checklist' Shariah committee, depositors and the regulators agree with the statement with an average mean value of 4.02 to 4.30. The internal and external auditors and the regulators have a variety of responses among them which result in the average mean value of 3.85 to 3.95. The average mean showed that there are individuals who do not agree and not sure with the statements. For 'Shariah auditor should attest and*

provide assurance that the Shariah audit conducted have met Shariah objectives and comply with Shariah requirements' the average mean is between 3.89 to 4.58 indicating an expectations gap exists among the respondents.

The other significant difference is that Shariah auditors and internal reviewers have an added layer of religious accountability, and while assessing the Shariah adherence of an entity's financial statements, they are additionally expected to carry out their main religious responsibility of "amr bil ma'ruf wa nahi 'an al- munkar" (enjoining the proper and forbidding the improper). This means that all audit dimensions or parameters designed to evaluate Shariah compliance must have the spiritual ingredient of God consciousness, that is, a fear of sanctions in the hereafter for not complying with Shariah. Due to the religious requirements prescribed for Muslims under Shariah law implicit in the objectives of the Shariah, it can be inferred that the auditors and reviewers are required to be Muslims, to give the certification on permissible (*halal*) financing. This is comparable to issuing of *halal* certification by relevant religious authorities for food and pharmaceuticals and of religious edicts/decrees (*fatwas*) of Shariah advisors, who likewise must be Muslims.

The next hypothesis is H<sub>2c</sub>: *There is an expectation gap among the respondents concerning Shariah audit responsibility to attest and provide Shariah assurance in the Islamic banks.* There are nine statements related to this section. Among the questions that received p-value < 0.05 that shows significant finding and support the hypothesis are as follow:

- a) Shariah auditor is responsible towards the outside financiers (i.e. capital contributor; *mudharib*).
- b) Shariah auditor should have a clear understanding of the business activities of the IFI to allow for better scoping of an audit exercise, i.e. auditability and relevance of activities.

- c) Shariah auditor should develop a comprehensive internal audit programme or plan.
- d) Shariah auditor should provide recommendations on rectification measures taken as well as following-up on the implementation by the IFI.
- e) Shariah auditor should attest and provide assurance that the Internal Shariah Control System (ISCS) established by the IFIs have met Shariah objectives and comply with Shariah requirements.
- f) Shariah auditor should assess the adequacy of Shariah review as a basis to determine the authenticity of Shariah rulings, adoption of Shariah requirements and validity of Shariah-complaint transactions.
- g) Shariah auditor should detect fraud related to Shariah.

The statements highlight the Shariah audit responsibility in the Islamic banks. Seven statements received different views from the respondents. For *'Shariah auditor are responsible towards the outside financiers (i.e. capital contributor; mudharib)'* the average mean score for the overall respondents is 3.63. This shows that the respondents' feedback ranges from 'disagree to not sure'. However, this statement is agreed by the depositors with the mean score of 4.18 since it favours the depositors as a capital contributor. Another statement not agreed by the overall respondents is *'Shariah auditor should assess the adequacy of Shariah review as a basis to determine the authenticity of Shariah rulings, adoption of Shariah requirements and validity of Shariah-complaint transactions'*. The overall mean score for this statement is 3.16. The Shariah committees do not agree with the statement since the mean score is 2.00. This research assumes that the overall respondents do not agree with the statement since for the Shariah auditor to assess the Shariah review work seems redundant and not cost efficient. For some Islamic banks, the Shariah auditor is assisted by the Shariah officers to perform the Shariah audit function since they do not have adequate expertise in Shariah. *'Shariah auditor should detect fraud related to Shariah'* received a variety of

responses. The average mean value for overall respondents is 3.57. The internal and external auditors and the regulators did not agree with the statement since the mean value is between 3.18 to 3.66. However, the depositors and Shariah officers agree with the statement with an average score of 4.00 and above.



**Table 29: Overall Gap among the Respondents in Shariah Audit Practices on Shariah Audit Responsibility**

STATEMENT	IA/S A	USERS GROUP (OVERALL GAP)				
		SC	EA	DEP	SO	REG
<b>Regulatory</b>						
a) The Shariah audit function shall be performed by internal auditors who have acquired adequate Shariah-related knowledge and training.	3.93	0.29*	0.06	-0.64**	0.14	0.55**
b) The audit committee upon consultation with the Shariah Committee shall determine the deliverables of the Shariah audit functions.	4.03	-0.04	0.1	-0.46**	0.33*	0.31*
<b>Shariah Rulings</b>						
a) Shariah audit should cover on Shariah rulings such as <i>bakhs</i> (any voluntary effort to diminish or decrease the value of the product or services being sold) <i>tatfif</i> (taking in an excess in measure and giving out a short measures) <i>uqud</i> (contract), <i>khiyanah</i> (embezzlement of funds), <i>Israf</i> (the propriety of expenditure), <i>tanajush</i> (bidding), speculation and <i>gharar</i> (uncertainty).	4.00	-0.42*	0	-0.37*	0.33*	0.19
b) Shariah auditor should obtain and make references to relevant sources, including the SACs published rulings, the Shariah committee decisions, fatwas, guidelines, the Shariah audit results and the internal Shariah checklist.	3.85	-0.45**	-0.13	-0.07	0.03	0.07
c) Shariah auditor should attest and provide assurance that the Shariah audit conducted have met Shariah objectives and comply with Shariah requirements.	4.39	0.39*	0.39*	-0.58**	0.08	0.61
<b>Shariah Assurance</b>						
a) Shariah auditor is responsible towards the outside financiers (i.e. capital contributor; i).	3.21	-0.57**	-0.22	-0.75**	0.34*	0.77**
b) Shariah auditor should have a clear understanding of the business activities of the IFI to	4.36	-0.14	0.05	-0.38*	0.19	0.33*

allow for better scoping of an audit exercise, i.e. auditability and relevance of activities;						
c) Shariah auditor should develop a comprehensive internal audit programme or plan.	4.42	0.35*	0.42*	-0.6**	0.1	0.4
d) Shariah auditor should provide recommendations on rectification measures taken as well as following-up on the implementation by the IFI.	4.69	0.27	0.51**	-0.33*	0.45*	0.03
e) Shariah auditor should attest and provide assurance that the Internal Shariah Control System (ISCS) established by the IFIs have met Shariah objectives and comply with Shariah requirements.	4.69	0.12	0.69**	-0.58**	0.08	0.15
f) Shariah auditor should assess the adequacy of Shariah review as a basis to determine the authenticity of Shariah rulings, adoption of Shariah requirements and validity of Shariah-complaint transactions.	3.45	1.45**	-0.11	0.7**	-0.48**	-0.08
g) Shariah auditor should detect fraud related to Shariah.	3.66	-0.62**	0.48*	-1.16**	0.03	0.89**

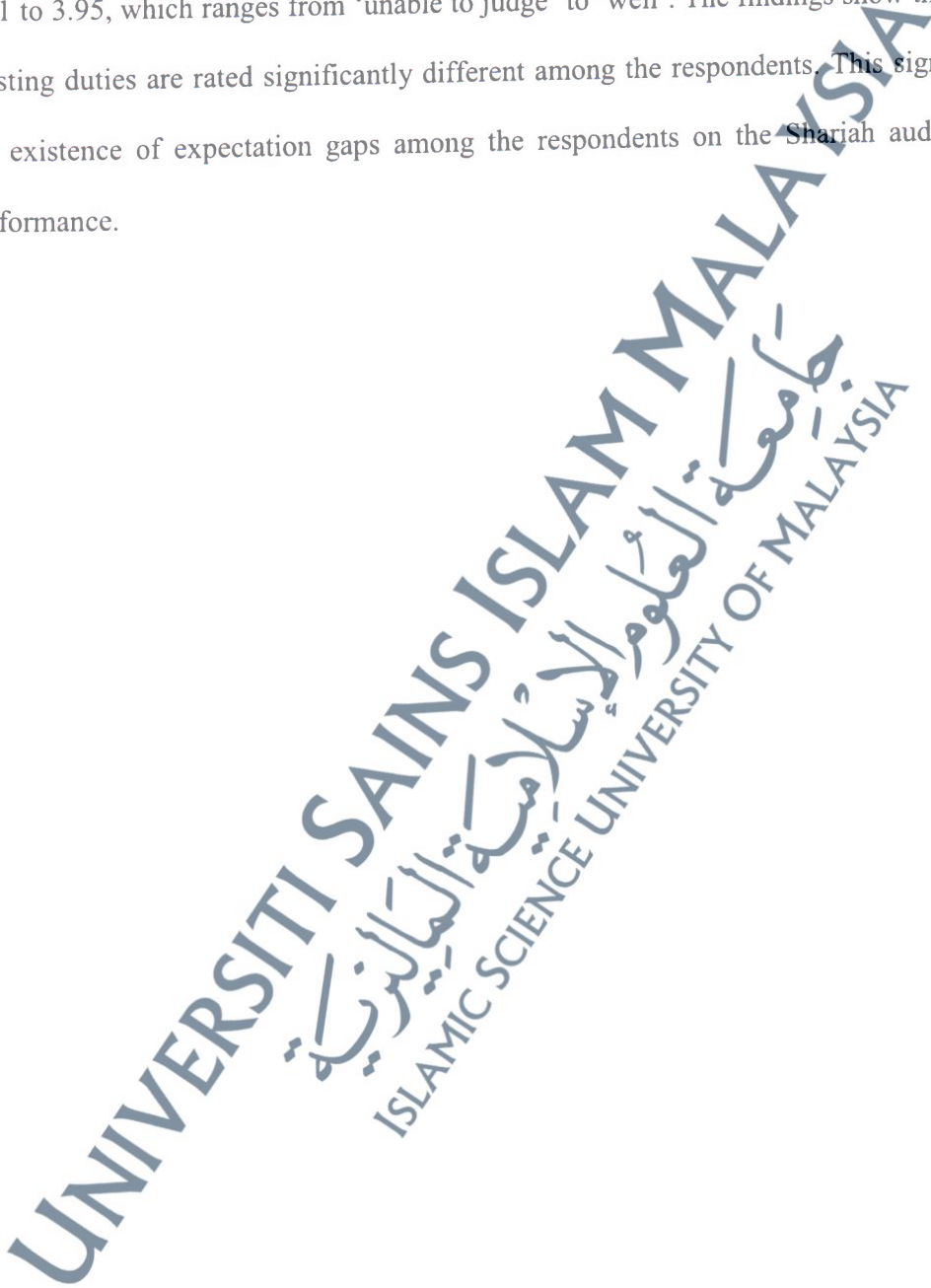
\*significantly different from internal auditors overall gap at  $p < 0.05$  and \*\*significantly different from internal auditors overall gap at  $p < 0.01$  based on Man-Whitney  $U$ -test. IA: Internal auditors; SA: Shariah auditors; SC: Shariah Committee; EA: External auditors; DEP: Depositors; SO: Shariah officers; REG: Regulators

### 6.3.12 Expectation Gap in Shariah Audit Practices on Shariah Auditors

#### Performance

Performance gap - deficient performance is a gap between the expected standard of performance of Shariah auditor's existing duties and Shariah auditor's perceived performance, as expected and perceived by society. Based on the Table 30 the findings support the hypothesis that  $H_3$ : *There is an expectation gap among the respondents on Shariah auditor's performance in Islamic banks.* The respondents were asked to evaluate the Shariah auditors performance in the Islamic banks. There are 15 statements related to Shariah auditor's performance in the Islamic bank. The rating for this section

is based on a five-point Likert scale which '1' represent 'poorly', '2'=adequately, '3'=average, '4'=well and '5'=excellent. The overall average mean score among the respondents for each of the statements on Shariah auditors' performance range between 3.31 to 3.95, which ranges from 'unable to judge' to 'well'. The findings show that all existing duties are rated significantly different among the respondents. This signifies the existence of expectation gaps among the respondents on the Shariah auditor's performance.



**Table 30: Existence of Expectation Gap in Shariah Audit Practices on Shariah Auditor's Performance**

**H<sub>3</sub>: There is an expectation gap among the respondents on Shariah auditor's performance in Islamic banks.**

(Expectation of Shariah auditors' performance in the Islamic bank)	SC	IA	EA	DEP	SO	REG)	Avg. mean
a) Providing a useful service to the stakeholders.	4.14	3.18	3.00	4.00	3.71	3.10	3.54*
b) Reporting truthfully.	4.14	2.81	3.12	3.91	3.72	3.10	3.46*
c) Providing a useful service to the IFIs.	4.21	2.87	3.91	3.88	3.72	2.92	3.42*
d) Detecting errors and irregularities pertaining to Shariah.	4.42	3.12	3.12	3.97	3.56	3.51	3.51*
e) Acting independently without regard to self-interest	4.21	3.21	2.87	3.81	3.62	3.47	3.47*
f) Communicating effectively	2.85	2.90	2.87	4.04	3.56	3.31	3.31*
g) Prescribing remedies in the event of Shariah non-compliance issues.	3.57	3.03	2.81	3.91	3.53	2.96	3.36*
h) Preventing errors and irregularities pertaining to Shariah.	3.50	3.21	2.87	3.90	3.31	3.14	3.39*
i) Coping with risk and uncertainty in the transactions related to Shariah.	4.14	3.81	2.62	4.06	3.56	4.07	3.95*
j) Diagnosing problem.	3.85	3.06	2.68	3.76	3.37	3.00	3.32*
k) Predicting the future in the event of Shariah litigation.	4.14	3.27	3.06	3.88	3.43	3.21	3.50*
l) Acquiring information related to Shariah non-compliance.	3.57	3.39	3.06	3.97	3.62	3.14	3.53*
m) Enforcing Shariah legal requirements.	3.42	3.33	2.93	4.00	3.53	3.10	3.47*
n) Forming correct judgements.	3.57	3.18	3.06	4.11	3.75	3.07	3.53*
o) Coping with professional rules and Shariah rulings.	3.21	3.33	2.93	3.81	3.28	3.10	3.36*

\*Significantly different among overall respondents  $p < 0.001$  based on Kruskal-Wallis test. IA: Internal auditors; SA: Shariah auditors; SC: Shariah Committee; EA: External auditors; DEP: Depositors; SO: Shariah officers; REG: Regulator

The statements that received  $p\text{-value} < 0.05$  are as follows:

- a) Providing a useful service to the stakeholders.
- b) Reporting truthfully.
- c) Providing a useful service to the IFIs.
- d) Detecting errors and irregularities pertaining to Shariah.
- e) Acting independently without regard to self-interest.
- f) Communicating effectively.
- g) Prescribing remedies in the event of Shariah noncompliance issues.
- h) Preventing errors and irregularities pertaining to Shariah.
- i) Coping with risk and uncertainty in the transactions related to Shariah.
- j) Diagnosing problem.
- k) Predicting the future in the event of Shariah litigation.
- l) Acquiring information related to Shariah noncompliance.
- m) Enforcing Shariah legal requirements.
- n) Forming correct judgements.
- o) Coping with professional rules and Shariah rulings.

The results reveal that the external auditors and the internal auditors find a deficiency in the performance of Shariah auditors concerning communicating effectively, prescribing remedies in the event of Shariah noncompliance issues, enforcing Shariah legal requirements, acquiring information related to Shariah noncompliance, forming correct judgements and coping with professional rules and Shariah rulings. This is due to the average mean score of 2.00 to 3.50. The external auditors also score an average mean value of 2.81 to 3.33 for all of the statements above. The table obviously indicated that the null hypothesis was rejected in favour of the alternative hypothesis.

**Table 31: Overall Gap among the Respondents in Shariah Audit Practices on Shariah Auditor's Performance**

STATEMENT	IA/SA	USERS GROUP (OVERALL GAP)				
		SC	EA	DEP	SO	REG
a) Providing a useful service to the stakeholders.	3.18	-0.96**	0.18	-1**	0.29	0.61**
b) Reporting truthfully.	2.81	-1.33**	-0.31	-0.79**	0.19	0.62**
c) Providing a useful service to the IFIs.	2.87	-1.34**	1.04**	0.03	0.16	0.8**
d) Detecting errors and irregularities pertaining to Shariah.	3.12	-1.3**	0	-0.85**	0.41*	0.05
e) Acting independently without regard to self-interest.	3.21	-1**	0.34	-0.94**	0.19	0.15
f) Communicating effectively.	2.90	0.05	0.03	-1.17**	0.48*	0.25
g) Prescribing remedies in the event of Shariah noncompliance issues.	3.03	-0.54**	0.22	-1.1**	0.38	0.57*
h) Preventing errors and irregularities pertaining to Shariah.	3.21	-0.29	0.34*	-1.03**	0.59**	0.17
i) Coping with risk and uncertainty in the transactions related to Shariah.	3.81	-0.33*	1.19**	-1.44**	0.5*	-0.51*
j) Diagnosing problem.	3.06	-0.79*	0.38	-1.08*	0.39	0.37
k) Predicting the future in the event of Shariah litigation.	3.27	-0.87**	0.21	-0.82**	0.45*	0.22
l) Acquiring information related to Shariah noncompliance.	3.39	-0.18	0.33*	-0.91**	0.35*	0.48**
m) Enforcing Shariah legal requirements.	3.33	-0.09	0.4	-1.07**	0.47*	0.43*
n) Forming correct judgements.	3.18	-0.39*	0.12	-1.05**	0.36*	0.68**
o) Coping with professional rules and Shariah rulings.	3.33	0.12	0.4*	-0.88**	0.53**	0.18

\*significantly different from internal auditors overall gap at  $p < 0.05$  and \*\*significantly different from internal auditors overall gap at  $p < 0.01$  based on Man-Whitney *U*-test. IA: Internal auditors; SA: Shariah auditors; SC: Shariah Committee; EA: External auditors; DEP: Depositors; SO: Shariah officers; REG: Regulators

Based on past study on the effectiveness of internal audit in Malaysian public sectors (Ahmad et. al., 2009), the main problems faced by the internal auditors which affect the performance of the internal auditors are due to lack of audit staff, internal audit function does not have full support from top management, lack of training, lack of independence, lack of competency, lack of experience staff and limited resources. Thus, the internal

auditors and the management involved in the organisations must ensure that causes of gaps must be identified to boost the auditor's performance.

Regarding extended analysis on significant findings based on Man-Whitney U-test, there are significant differences between internal auditor's expectation with Shariah committee, depositors and regulators. Based on the average mean, the internal auditors are neutral on the statement '*Shariah auditor's provide a useful service to the stakeholders*'. The Shariah committee and the depositors agree with the statement. Unlike the Shariah committee and the depositors, the regulators score an average mean of 3.10, which shows the Shariah auditor's performance to the stakeholders is at the average level.

Even though Shariah auditors are directly involved with the Shariah audit functions, the internal auditors are unsure of their roles in the Shariah audit. This is evident since most of the questions on Shariah auditor's performance answered by the internal auditors scores an average mean between 2.81 to 3.39, which reflects that the internal auditors believe that they have 'adequately' and 'averagely' accomplished the task. The internal auditors also rated 2.81 on 'reporting truthfully', which reflect that they adequately report the Shariah audit findings. The Shariah committee, Shariah officers, depositors and regulators expect the Shariah auditors to perform well regarding performance. As such, the Shariah committee perceived that the Shariah auditors are able to predict the future in the event of Shariah litigation. Unfortunately, a significant gap exists of -0.87, which exceeds the expectation of the internal auditors on the statement. Also, the internal auditors score an average mean of 3.39 on diagnosing problems which means they averagely agree with the statement. This statement also involves a significant gap of -0.79 between the internal auditors and the Shariah committee.

Based on Table 31, it can be concluded that among the respondents, the Shariah committee, depositors, Shariah officers and regulators have a high expectation of the Shariah auditor's performance in the Islamic banks whereby the internal auditors believe that they have adequately accomplished the task in Shariah audit function.

## **6.4 SEM PLS FINDINGS**

The third part of the study involves testing the factors that contribute to expectation gaps in Shariah audit practices specifically on Shariah audit responsibility and Shariah auditor's performance. The research model for the second part is tested using partial least squares (PLS). Smart PLS 2.0 M3 (Ringle et al., 2004) is used to assess the measurement and structural model for this study.

### **6.4.1 Measurement Model**

This statistical programme assesses the psychometric properties of the measurement model and estimates the parameters of the structural model. The validity and reliability of the measurement model for this study are evaluated using the following analyses: internal consistency reliability, indicator reliability, convergent validity and discriminant validity. The following subsections present the findings for each of the analysis used to evaluate the validity of the measurement model for this study.

### **6.4.2 Internal Consistency Reliability**

A measurement model has satisfactory internal consistency reliability when the composite reliability (CR) of each construct exceeds the threshold value of 0.6. Bagozzi and Yi, (1998) mentioned that all constructs that have the composite reliability of more

than 0.6 demonstrating a high internal consistency of the data exists. Table 32 shows that the CR of each construct for this study ranges from 0.6 to 0.9695, and this is above the recommended threshold value of 0.6. Thus, the results indicate that the items used to represent the constructs have satisfactory internal consistency reliability.

**Table 32: Measurement Model for Independent Variables**

Construct	Item	Loadings	Cronbach alpha	CR	AVE
Framework	F 1	0.732	0.790	0.732	0.860
	F 2	0.861			
	F 3	0.747			
	F 4	0.810			
	F 5	0.852			
Independence	I 1	0.7539	0.737	0.671	0.838
	I 2	0.7931			
	I 3	0.7543			
Competency	C 1	0.8031	0.966	0.9695	0.6802
	C 2	0.7728			
	C 3	0.7611			
	C 4	0.808			
	C 5	0.903			
	C 6	0.785			
	C 7	0.773			
	C 8	0.835			
Reporting	R 1	0.7492	0.658	0.781	0.545
	R 2	0.7712			
	R 5	0.7643			
	R 6	0.789			
Scope	S 1	0.7003	0.936	0.603	0.994
	S 2	0.7672			
	S 3	0.7164			
	S 4	0.7804			
	S 5	0.7157			
Processess	P 5	0.789	0.835	0.604	0.876
	P 6	0.7353			
	P 7	0.7455			
	P 9	0.7111			
	P 11	0.7606			
	P 1	0.6855			
	P 2	0.7345			
	P 3	0.6563			

### 6.4.3 Indicator Reliability

Indicator reliability of the measurement model is measured by examining the items loadings. A measurement model is said to have satisfactory indicator reliability when each item's loading is at least 0.7. On the same note, item for factor loading should be at least 0.707 with no measurement item loading more highly on other constructs than the construct it intends to measure (Teck Heang and Kozar, 2008; Barclay et al., 1995). As reported in Table 32 and 33, all factor loadings are higher than 0.707, indicating acceptable item reliability. Any item loading that falls below 0.707 was removed from the data since it does not reflect the reliability of the item. Based on Tables 32 and 33, Cronbach's alpha for each construct is reported. All  $\alpha$  values are above the recommended value of 0.6 indicating that the tested constructs are reliable and appropriate for the current research's model.

The measurement model for dependent variables is shown in the Table 33 below. Scores of Cronbach's alpha for all the variables were consistent with what have been suggested by Hair et al. (2006) and Nunnally (1978), with the range of 0.658 – 0.936. All values were above the suggested threshold. Detailed results for Cronbach's alpha are presented in Tables 32 and 33 together with the summary of items loading for reliability, CR to measure on the internal consistency and average variance extracted (AVE).

### 6.4.4 Discriminant Validity

Concerned with discriminant validity, based on the guideline suggested by Fornell and Larcker (1981) that is the square root of the AVE from the construct should be greater

than the correlation shared between that constructs and others in the model. The Appendix presents the correlations between the constructs with the square root of the AVE on the diagonal. The diagonal values are found to be superior when they are compared with the inter-construct correlations, which indicate the test for discriminant validity, which is acceptable. The assessment of discriminant validity does not reveal any problems owing to the fact that the AVE for each construct is larger than the correlation of that construct with all other constructs in the model (Sang et al., 2010). All of the diagonal values exceed than the recommended value of 0.707 (Teck Heang and Kozar, 2008).

The second assessment of discriminant validity is to examine the indicators' loadings with respect to all construct correlations. The SmartPLS algorithm function produces the output of cross loadings. The appendix shows the output of cross loading between constructs and indicators. It also shows that all measurement items loaded higher against their respective intended latent variable compared to other variables. The model also demonstrated that the loading of each block is higher than any other block in the same rows and columns. The loading clearly separates each latent variable as theorised in the conceptual model. Thus, the cross loading output confirmed that the second assessments of the measurement model's discriminant validity are satisfied. This study, therefore, concludes that the measurement model has established its discriminant validity.

**Table 33: Measurement Model for Dependent Variables**

Construct	Item	Loadings	Cronbach alpha	CR	AVE
*SAR – Regulatory	SGF_1	0.7804	0.758	0.812	0.850
	SGF_2	0.7157			
	SGF_3	0.7648			
	SGF_4	0.789			
*SAR – Shariah rulings	SR_1	0.7648	0.658	0.654	0.785
	SR_2	0.7891			
	SR_3	0.8031			
*SAR – Attestation & Assurance	AA_1	0.8103	0.936	0.932	0.884
	AA_2	0.8522			
	AA_3	0.8812			
	AA_4	0.7056			
	AA_8	0.7804			
	AA_9	0.7157			
	AA_10	0.7455			
**SAP	AP_1	0.7111	0.773	0.733	0.856
	AP_4	0.7606			
	AP_6	0.7539			
	AP_7	0.7931			
	AP_9	0.7543			
	AP_12	0.8031			
	AP_13	0.8331			
	AP_14	0.7682			
	SAR	0.7545			

\*SAR - Shariah Audit Responsibility

\*\*SAP – Shariah Auditor’s Performance

#### 6.4.5 Convergent Validity

In this model, AVE explains the variance that is measured by the construct in relation to the measurement error (Shi et al., 2008). Tables 32 and 33 show that all AVE values are above the recommended value of 0.5 (Fornell and Larcker, 1981). Hence, all constructs demonstrate adequate convergent validity. Convergent validity is adequate when constructs have an average variance extracted (AVE) value of at least 0.5 or more. Table 32 and 33 shows that all constructs have AVE ranging from 0.545 to 0.994, which exceeded the recommended threshold value of 0.5.

Overall, the reliability and validity tests conducted on the measurement model

are satisfactory. All reliability and validity tests are confirmed, and this is an indicator that the measurement model for this study is valid and fit to be used to estimate parameters in the structural model.

**Table 34: Summary of Items dropped during Factors Loading – Independent variables**

Items	Original no. of items	Final number of item	No. of items dropped during factor loading	Description of items dropped
Framework	6	5	1	The review of adequacy of the Shariah governance process should cover the roles, functions and reporting channel of the key organs of the IFIs (i.e. Board of Directors, Management, Shariah Committee & Audit Committee)
Scope	6	5	1	Other possible scopes of Shariah audit should cover business policies, contracts and agreements, environment impact of operations, social contribution, marketing and advertising, assessment of financial resource management
Competency	8	7	1	Fully subscribe to the principles and Shariah rulings upon engagement and execution of the audit task
Processes	10	8	2	a) Shariah committees are aware of the income purification issues and disclosed in the Shariah committee report b) Shariah audit engagement should be recommended by the Audit committee
Reporting	6	4	2	a) The findings of Shariah audit should be reported in the annual report of the IFI. b) Shariah audit findings should be disclosed

				separately from Shariah Committee report i.e., Shariah audit report
Independence	3	3	0	-

**Table 35: Summary of Items dropped during Factors loading – Dependent variables**

Items	Original no. of items	Final number of item	No. of items dropped during factor loading	Description of items dropped
Shariah audit responsibility:				
a) Regulatory	4	4	0	a) Shariah auditor should communicate results of any assessment or findings arising from the Shariah audit to the Board Audit Committee and the Shariah Committee
b) Shariah rulings	3	3	0	
a) Attestation & Assurance	9	7	2	b) Shariah auditor should include objectives, scope, personnel assignment, sampling, control and duration in the Shariah audit planning.
Shariah auditor's performance	15	8	7	<ul style="list-style-type: none"> <li>a) Reporting truthfully.</li> <li>b) Providing a useful service to the IFIs.</li> <li>c) Acting independently without regard to self-interest</li> <li>d) Preventing errors and irregularities pertaining to Shariah.</li> <li>e) Diagnosing problem</li> <li>f) Predicting the future in the event of Shariah litigation</li> <li>g) Coping with risk and uncertainty in the transactions related to Shariah.</li> </ul>

### 6.4.6 Structural Model

The following subsections discuss the tests assessing the validity of the structural model for this study. As discussed in Chapter 4, the validity of the structural model is assessed using the coefficient of determination ( $R^2$  and path coefficients).

### 6.4.7 Coefficient of Determination ( $R^2$ )

The  $R^2$  value indicates the amount of variance in dependent variables as explained by the independent variables. A larger  $R^2$  value increases the predictive ability of the structural model. In this study, SmartPLS algorithm function is used to obtain the  $R^2$  values, while the SmartPLS bootstrapping function is used to generate the t- statistics values. The result of the structural model is presented in Table 36.

**Table 36: Path Coefficient, Observed T- Statistics, Significant Level for All Hypothesised Paths**

Dependent construct	Hypotheses	Independent construct	Path coefficient	t-value	Significance level	Supported
*SAR – regulatory ( $R^2 = 0.561$ )	H <sub>4a</sub>	Framework	0.091	2.100	ns	No
	H <sub>5a</sub>	Independence	0.017	0.487	ns	No
	H <sub>6a</sub>	Competency	0.186	2.436	*	Yes
	H <sub>7a</sub>	Reporting	0.074	1.746	ns	No
	H <sub>8a</sub>	Scope	0.327	4.340	*	Yes
	H <sub>9a</sub>	Processess	0.019	0.274	ns	No
* SAR – Shariah rulings ( $R^2 = 0.545$ )	H <sub>4b</sub>	Framework	-0.153	3.473	ns	No
	H <sub>5b</sub>	Independence	0.142	2.969	*	Yes
	H <sub>6b</sub>	Competency	0.177	3.667	*	Yes
	H <sub>7b</sub>	Reporting	0.057	1.318	ns	No
	H <sub>8b</sub>	Scope	0.139	2.309	*	Yes
	H <sub>9b</sub>	Processess	-0.082	2.052	ns	No
	H <sub>4c</sub>	Framework	-0.142	3.873	ns	No

* SAR – Attestation & Assurance (R <sup>2</sup> = 0.671)	H <sub>5c</sub>	Independence	0.183	2.909	*	Yes
	H <sub>6c</sub>	Competency	0.394	10.848	*	Yes
	H <sub>7c</sub>	Reporting	0.087	1.831	ns	No
	H <sub>8c</sub>	Scope	0.222	7.029	*	Yes
	H <sub>9c</sub>	Processess	0.426	7.987	*	Yes
**SAP (R <sup>2</sup> = 0.732)	H <sub>4d</sub>	Framework	0.265	7.029	*	Yes
	H <sub>5d</sub>	Independence	0.215	6.4052	*	Yes
	H <sub>6d</sub>	Competency	0.231	4.3326	*	Yes
	H <sub>7d</sub>	Reporting	0.274	8.3268	*	Yes
	H <sub>8d</sub>	Scope	0.196	3.7134	*	Yes
	H <sub>9d</sub>	Processess	0.238	7.6584	*	Yes

\*SAR - Shariah Audit Responsibility

\*\*SAP – Shariah Auditor’s Performance

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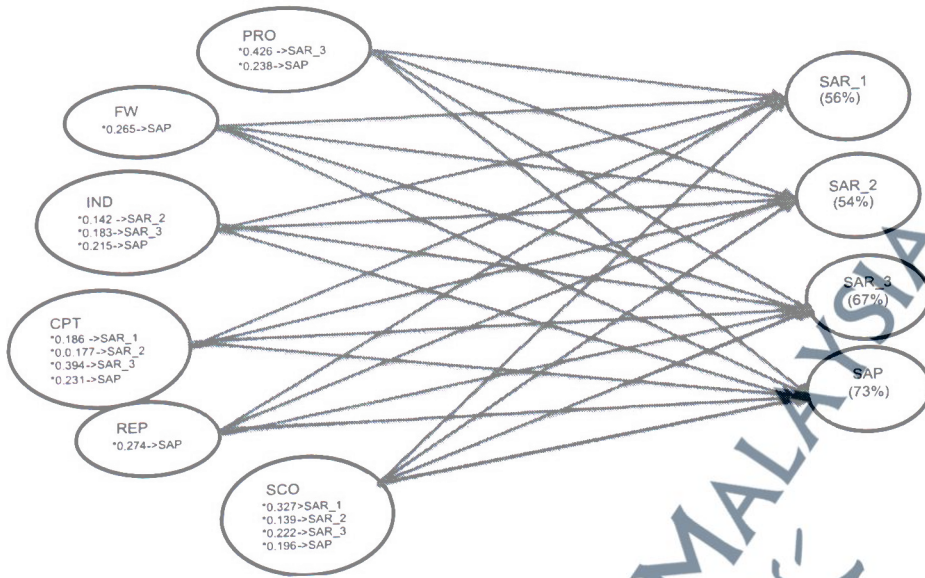


Figure 12: Results of Structural Model

Notes: PRO; Processes, FW; Framework, IND; Independence, CPT; Competency, REP; Reporting, SCO; Scope, SAR\_1; Shariah audit responsibilities-regulatory, SAR\_2; Shariah audit responsibilities-Shariah rulings, SAR\_3; Shariah audit responsibilities-attestation & assurance, SAP; Shariah auditor's performance. \* $p < 0.05$  significant

Table 37: Result of Hypotheses

Hypotheses	Supported	Rank
<p><b>H4:</b> Framework is positively related to the Shariah audit responsibility and Shariah auditor's performance in Islamic banks.</p> <p>a) <b>H4a:</b> Framework is positively related to the Shariah audit responsibility on regulations.</p> <p>b) <b>H4b:</b> Framework is positively related to the Shariah audit responsibility on Shariah rulings</p> <p>c) <b>H4c:</b> Framework is positively related to the Shariah audit responsibility on attestation and assurance</p> <p>d) <b>H4d:</b> Framework is positively related to the Shariah auditor's performance in Islamic banks.</p>	<p>No</p> <p>No</p> <p>No</p> <p>Yes</p>	6th
<p><b>H5:</b> Independence is positively related to the Shariah audit responsibility and Shariah auditor's performance in Islamic banks.</p> <p>a) <b>H5a:</b> Independence is positively related to the Shariah audit responsibility on regulations.</p> <p>b) <b>H5b:</b> Independence is positively related to the Shariah audit responsibility on Shariah rulings</p>	<p>No</p> <p>Yes</p> <p>Yes</p>	3rd

<p>c) <b>H5c:</b> Independence is positively related to the Shariah audit responsibility on attestation and assurance</p> <p>d) <b>H5d:</b> Independence is positively related to the Shariah auditor's performance in Islamic banks.</p>	<p>Yes</p>	
<p><b>H6:</b> Competency is positively related to the Shariah audit responsibility and Shariah auditor's performance in Islamic banks.</p> <p>a) <b>H6a:</b> Competency is positively related to the Shariah audit responsibility on regulations.</p> <p>b) <b>H6b:</b> Competency is positively related to the Shariah audit responsibility on Shariah rulings</p> <p>c) <b>H6c:</b> Competency is positively related to the Shariah audit responsibility on attestation and assurance</p> <p>d) <b>H6d:</b> Competency is positively related to the Shariah auditor's performance in Islamic banks.</p>	<p>Yes</p> <p>Yes</p> <p>Yes</p> <p>Yes</p>	<p>1st</p>
<p><b>H7:</b> Reporting is positively related to the Shariah audit responsibility and Shariah auditor's performance in Islamic banks</p> <p>a) <b>H7a:</b> Reporting is positively related to the Shariah audit responsibility on regulations.</p> <p>b) <b>H7b:</b> Reporting is positively related to the Shariah audit responsibility on Shariah rulings</p> <p>c) <b>H7c:</b> Reporting is positively related to the Shariah audit responsibility on attestation and assurance</p> <p>d) <b>H7d:</b> Reporting is positively related to the Shariah auditor's performance in Islamic banks.</p>	<p>No</p> <p>No</p> <p>No</p> <p>Yes</p>	<p>5th</p>
<p><b>H8:</b> Scope is positively related to the Shariah audit responsibility and Shariah auditor's performance in Islamic banks</p> <p>a) <b>H8a:</b> Scope is positively related to the Shariah audit responsibility on regulations.</p> <p>b) <b>H8b:</b> Scope is positively related to the Shariah audit responsibility on Shariah rulings</p> <p>c) <b>H8c:</b> Scope is positively related to the Shariah audit responsibility on attestation and assurance</p> <p>d) <b>H8d:</b> Scope is positively related to the Shariah auditor's performance in Islamic banks.</p>	<p>Yes</p> <p>Yes</p> <p>Yes</p> <p>Yes</p>	<p>2nd</p>

<b>H<sub>9</sub></b> : Processes is positively related to the Shariah audit responsibility and Shariah auditor's performance in Islamic banks		4th
a) <b>H<sub>9a</sub></b> : Processes is positively related to the Shariah audit responsibility on regulations	No	
b) <b>H<sub>9b</sub></b> : Processes is positively related to the Shariah audit responsibility on Shariah rulings	No	
c) <b>H<sub>9c</sub></b> : Processes is positively related to the Shariah audit responsibility on attestation and assurance	Yes	
d) <b>H<sub>9d</sub></b> : Processes is positively related to the Shariah auditor's performance in Islamic banks.	Yes	

The path coefficient between two latent variables is assessed to validate the proposed hypotheses and the structural model. The path coefficients indicate the strengths of the relationships between the independent variables and dependent variables. Based on previous studies, the path coefficient value needs to be at least 0.1 to account for a certain impact within the model (Hair et al., 2011; Wetzels et al., 2009). Assessment of the path coefficient (refer to Table 36) shows that out of 24 hypotheses proposed, 15 are supported. From the analysis, supported hypotheses are significant at least at the level of 0.05, have expected sign directions (i.e., positive) and consist of a path coefficient value ( $\beta$ ) ranging from 0.142 to 0.426. The analysis of the structural model also involves the  $R^2$ .  $R^2$  is a measure of the predictive power of a model for the dependent variables. Thus, a larger  $R^2$  value increases the predictive ability of the structural model. The  $R^2$  in this study range from 56% to 73%. The  $R^2$  for dependent variable for Shariah auditor's performance show at 73%. This indicates that the explained variance for Shariah auditor's performance is 73%, whereby 56% explained variance for Shariah audit responsibility on regulations, 54% for Shariah audit responsibility on Shariah rulings and 67% for Shariah audit responsibility on attestation and assurance.

As in the table 37 above, it is observed that framework in Shariah audit has a

significant relationship with Shariah auditor's performance in Islamic banks ( $b=0.265$ ;  $t=7.029$   $p<0.001$ ). Therefore, this supports the hypothesis that framework in Shariah audit is positively related to the Shariah auditor's performance in Islamic banks.

Regarding independence in Shariah audit, the hypothesis posits that independence in Shariah audit is positively related to the Shariah audit responsibility on Shariah rulings and assurance & attestation. The path coefficient for Shariah rulings is ( $b=0.142$ ;  $t=2.969$   $p<0.01$ ) and for assurance & attestation is ( $b=0.183$ ;  $t=2.909$   $p<0.01$ ). As a result, hypotheses H<sub>5b</sub> and H<sub>5c</sub> are supported. In addition, independence in Shariah audit is positively related to Shariah auditor's performance based on ( $b=0.215$ ;  $t=6.405$   $p<0.001$ ). This indicates that the higher the independence in Shariah audit the higher the Shariah auditor's performance in the Islamic banks. Thus, H<sub>5</sub> is supported.

This research also posits that competency of Shariah auditor is positively related to the Shariah audit responsibility and Shariah auditor's performance in Islamic banks. The results on competency related to Shariah audit responsibility on regulations is ( $b=0.186$ ;  $t=2.436$ ,  $p<0.05$ ). Whereas on Shariah rulings is ( $b=0.177$ ;  $t=3.667$ ,  $p<0.001$ ) and on attestation and assurance is ( $b=0.394$ ;  $t=10.848$   $p<0.001$ ). Competency in Shariah auditor's performance also shows a significant effect based on the result ( $b=0.231$ ;  $t=4.332$   $p<0.001$ ). Thus, hypothesis H<sub>6a</sub>, H<sub>6b</sub>, H<sub>6c</sub> and H<sub>6d</sub> is supported.

According to Najeeb and Ibrahim (2014), conventional audit fails to understand the Shariah aspects of the Islamic financial system nor does it appreciate the social objectives (that go beyond economic measures) which IFIs intend to achieve. Accountancy bodies have always sought to portray accounting as an independent, objective and neutral constructor of the state of corporate affairs (Mitchell and Sikka,

2002). This portrayal does not hold ground with the Islamic system, which does not divide between religion, and business and Shari'ah takes precedence above all (Karim, 1990). It is also pointed out on how rare it is to find an SSB member that is a qualified accountant/auditor and hence trained to conduct an audit of IFI statements as per international principles. Thus, in the current set up, the conventional auditors are auditing the financial statements and the SSB members are conducting a narrow technical Shari'ah compliance audit of the practices of the IFI.

Reporting in Shariah audit is significantly impact the Shariah auditor's performance in the Islamic banks. This is based on the result that ( $b=0.274$ ;  $t=8.327$ ,  $p<0.001$ ). This show that the greater the reporting, the better the performance of Shariah auditors in the Islamic banks.

The next hypothesis is on the scope in Shariah audit. This research supports  $H_{8a}$  since the result ( $b=0.327$ ;  $t=4.340$ ,  $p<0.001$ ) shows that scope in Shariah audit is positively related to Shariah audit responsibility on regulations. For Shariah rulings the result is ( $b=0.139$ ;  $t=2.309$   $p<0.05$ ), for attestation & assurance ( $b=0.222$ ;  $t=7.029$ ,  $p<0.001$ ) and Shariah auditor's performance ( $b=0.196$ ;  $t=3.7134$ ,  $p<0.001$ ). The overall results support hypothesis  $H_8$  that scope in Shariah audit is positively related to Shariah audit responsibility and Shariah auditor's performance in Islamic banks.

In addition, processes in Shariah audit is positively related to Shariah audit responsibility on attestation & assurance and Shariah auditor's performance. This is based on the result ( $b=0.426$ ;  $t=7.987$ ,  $p<0.001$ ) and ( $b=0.238$ ;  $t=7.658$ ,  $p<0.001$ ).

After arriving at the findings, this research ranks the factors that affect the Shariah audit responsibility and Shariah auditors' performance according to the significant effect in the group. For example, for hypothesis  $H_4$  on framework, there are four sub-hypothesis. Only one sub-hypothesis has a significant effect on Shariah

auditor's performance. Framework ranks number six in the factors since only one sub-hypothesis is significant. Competency ranks number one based on all sub-hypotheses that have a significant effect on the regulator, Shariah rulings, Shariah assurance and Shariah auditor's performance. For Shariah audit practices to be at par with the statutory audit, the competency level needs to be addressed, and greater emphasis on Shariah auditors' qualification is needed to narrow the gap. This is to ensure the high impact on the Shariah auditor's performance.

The factor ranked number two is scope in Shariah audit. Even though all four sub-hypotheses have a significant effect, the t-value scored for each item is lower than t-value for competency. Therefore, scope falls second after competency. The third important factor is independence in Shariah audit. Independence is deemed significant in Shariah audit since it is vital in ensuring that the stakeholders view the audit work performed and the results as credible, factual and unbiased. In addition, the integrity of the Shariah auditors is expected by those who have an interest in the Islamic banks to be independent enough to give opinions on the positions of the Islamic banks to be in Shariah-compliant in all aspects. According to Flint (1998), in situations where the responsibility and social significance of the audit are at their greatest, the criteria of independence must be applied with the utmost rigour. Thus, there is no doubt that for the benefit of the ummah in assuring the Shariah compliance are in place there is a need for independence among the Shariah auditors in the Islamic banks.

The fourth factor is on processes in Shariah audit. Two out of four sub-hypotheses is significant which is on Shariah audit assurance and Shariah auditor's performance. Better processes in Shariah audit impact the practices of Shariah audit responsibility and their auditor's performance. The factor ranked number five is on reporting in Shariah audit. Reporting in Shariah audit is important to ensure the

reporting findings in the Shariah audit whether to report the findings in the Shariah committee report or to have another separate Shariah audit reporting. Based on the qualitative and quantitative findings, the Shariah audit findings should be reported in the Shariah committee report instead of having a separate Shariah audit report.

## 6.5 CHAPTER SUMMARY

It can be concluded that different expectations exist among the respondents on the practice of Shariah audit in the Islamic banks. The analysis of the nature and compositions of the expectation gap based on Porter's (1993) framework shows that there exists a reasonableness gap, deficient performance and deficient standard in the Shariah audit practices. The findings of this survey are summarised as follows:

Reasonableness gap	Deficient standard	Deficient performance
a) Shariah audit framework should differ from Shariah review framework	a) Shariah audit function shall be performed by internal auditors who have acquired adequate Shariah-related knowledge and training	a) Shariah auditor is responsible towards the outside financiers (i.e. capital contributor; i)
b) Shariah auditor should audit the findings of Shariah review done by Shariah officers	b) The audit committee upon consultation with the Shariah Committee shall determine the deliverables of the Shariah audit functions.	b) Shariah auditor should have a clear understanding of the business activities of the IFI to allow for better scoping of an audit exercise, i.e. auditability and relevance of activities;
c) Professional training and Continuous Professional Development (CPD) in Shariah audit is necessary	c) Shariah audit should cover on Shariah rulings	c) Shariah auditor should develop a comprehensive internal audit programme or plan.
d) The internal auditors should attest the financial statements of the Islamic banks for Shariah compliance	d) Shariah auditor should obtain and make references to relevant sources, including the SACs published rulings, the Shariah committee decisions, fatwas, guidelines, the Shariah audit results and the internal Shariah checklist.	d) Shariah auditor should provide recommendations on rectification measures taken as well as following-up on the implementation by the IFI.

e) The scope of Shariah audit is limited as per SGF only	e) Shariah auditor should attest and provide assurance that the Shariah audit conducted have met Shariah objectives and comply with Shariah requirements	e) Shariah auditor should attest and provide assurance that the Internal Shariah Control System (ISCS) established by the IFIs have met Shariah objectives and comply with Shariah requirements.
f) Human resource management		f) Shariah auditor should assess the adequacy of Shariah review as a basis to determine the authenticity of Shariah rulings, adoption of Shariah requirements and validity of Shariah-complaint transactions.
g) A qualified accountant		g) Shariah auditor should detect fraud related to Shariah
h) appointed among Muslims only		h) Providing a useful service to the stakeholders.
i) qualified in Shariah and accounting		i) Reporting truthfully.
j) qualified in Shariah only		j) Providing a useful service to the IFIs.
k) Fully subscribe to the principles and Shariah rulings upon engagement and execution of the audit task		k) Detecting errors and irregularities pertaining to Shariah.
l) the internal auditors of the IFIs		l) Acting independently without regard to self-interest
m) Audit committee should not determine the Shariah audit planning		m) Communicating effectively
n) Shariah audit programme is necessary for evidence purpose		n) Prescribing remedies in the event of Shariah noncompliance issues.
o) Shariah auditor should ensure that all new fatwas, rulings and guidance and modifications to existing fatwas are identified and reviewed for each period under examination		o) Preventing errors and irregularities pertaining to Shariah.
p) Shariah committees are aware of the income purification issues and disclosed in the Shariah committee report		p) Coping with risk and uncertainty in the transactions related to Shariah.
q) The bank may appoint or employ external party or person to conduct Shariah audit		q) Diagnosing problem.

r) Shariah audit engagement should be endorsed by the Shariah committee		r) Predicting the future in the event of Shariah litigation.
s) Shariah audit engagement should be recommended by the Audit committee		s) Acquiring information related to Shariah noncompliance.
t) Shariah audit engagement should be approved by the Board		t) Enforcing Shariah legal requirements.
u) A Shariah auditor should be independent in the execution of the audit		u) Forming correct judgements.
v) A Shariah auditor is a person who always thinks of the concept justice in discharging responsibilities		v) Coping with professional rules and Shariah rulings.
w) A Shariah auditor should act independently without regard to self-interest		
x) Shariah audit function should not be attached to the internal audit department of an Islamic bank.		
z) Shariah audit report should communicate ongoing basis with monthly report to Shariah committee and quarterly reporting to audit committee		
b) Shariah audit report is a formulation of audit opinion on the degree of assurance of timely and comprehensive adoption or implementation of Shariah principles and rulings		
c) Report should include reporting on <i>ihsan, ihtar, ta'awun, sabr', syukur</i> and <i>silaturahmi</i>		
d) The findings of Shariah audit should be reported in the annual report of the IFI.		
e) Shariah audit findings should be disclosed separately from Shariah Committee report i.e., Shariah audit report		

f) The findings of Shariah audit should be included in the Shariah Committee report.		
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