

PROFESSIONALISATION OF *SHARIAH* AUDIT IN  
MALAYSIA

BY

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## ABSTRACT

This study empirically investigates the professionalisation of Shariah audit (SA) in Malaysia using the theory of the System of Professions. In doing so, it examines the development of jurisdictions within the auditing profession from pre-independence of Malaysia to date and investigates the strategies to secure and maintain SA jurisdiction. The study relied on archival review and interview of participants within the ecology of the auditing profession. The findings on jurisdictional development indicate that professional groups deployed various social structure (association, professional controls and worksites) and culture machinery (methodology and knowledge) strategies to claim jurisdiction over internal and external audits. However, jurisdictional settlement is mainly intellectual since the government controls the issuance of audit licence with mandatory membership to the state-sponsored Malaysian Institute of Accountants (MIA). The Institute of Cooperative and Management Auditors gained full jurisdiction over external audit of cooperative societies. The findings also inform that the Institute of Internal Auditors Malaysia (IIAM) could not maintain the full jurisdiction over SA which Bank Negara Malaysia (BNM) granted it in 2010. Instead, members of IIAM delegated SA work to non-members who eventually assimilated the culture of IIAM. More importantly, this caused the Association of Malay Chartered Accountants Firms to compete for SA jurisdiction by establishing the Institute of Shariah Auditors Malaysia. For SA professionalisation, the majority of interviewees recommend that the IIAM be the independent association for Shariah auditors. Others suggest MIA to certify Shariah auditors. Conversely, the documentary evidence suggests that BNM favours the establishment of a new independent association subject to certain conditionalities, namely, inclusive industry players support, quality standards assurance, role clarification, to name a few. Finally, apart from obtaining the mandate from regulators for an association of Shariah auditors, SA jurisdictional development will significantly depend on the outcome of the ongoing restructuring of the entire auditing profession.

## مُلخَصُ البَحْثِ

حقق هذا البحث تجريبياً في مهنة التدقيق الشرعي باستخدام نظرية نظام المهنة، فقد تناول تطور السلطات القضائية داخل مهنة التدقيق منذ ما قبل استقلال ماليزيا حتى اليوم، وإستراتيجيات التأمين والحفاظ على السلطة القضائية للتدقيق الشرعي، واعتمد البحث على مراجعة الأرشيف ومقابلة المشاركين في بيئة مهنة التدقيق، وأوضحت النتائج المتعلقة بتطوير القضائي أن المجموعات المهنية نشرت مختلف الهياكل الاجتماعية (الجمعيات والضوابط المهنية ومواقع العمل) وإستراتيجيات الآلات الثقافية (المنهجية والمعرفية) للمطالبة بالسلطة القضائية على عملية التدقيق الداخلي والخارجي، على الرغم من أن التسوية القضائية فكرية أساساً؛ إذ إن الحكومة تسيطر على إصدار ترخيص التدقيق مع عضوية إلزامية للمعهد الماليزي للمحاسبين الذي ترعاه الدولة، وقد حصل معهد المدققين والإدارة التعاونية على السلطة القضائية الكاملة على التدقيق الخارجي للجمعيات التعاونية، وبيّنت النتائج أيضاً فشل معهد المدققين الداخليين بماليزيا في الحفاظ على السلطة القضائية الكاملة على التدقيق الشرعي التي منحها المصرف المركزي الماليزي، وفوض أعضاء المعهد عملية التدقيق الشرعي لغير الأعضاء الذين استوعبوا في النهاية ثقافة المعهد، علاوة على ذلك؛ تأسست جمعية شركات المحاسبين القانونيين الملايو للتنافس على السلطة القضائية للتدقيق الشرعي من خلال اقتراح جمعية مدققي الشريعة، ومن أجل مهنة التدقيق الشرعي؛ أوصى معظم الأشخاص الذين جرت مقابلتهم بأن يكون معهد المدققين الداخليين بماليزيا جمعية مستقلة لمدققي الشريعة، واقترح آخرون أن على المعهد الماليزي للمحاسبين التصديق على مدققي الشريعة، وعلى العكس من ذلك؛ تشير الأدلة الوثائقية إلى أن المصرف المركزي الماليزي يفضل إنشاء جمعية مستقلة جديدة تخضع لشروط معينة، وهي دعم الجهات الفاعلة في الصناعة الشاملة وضمان معايير الجودة وتوضيح الأدوار وغيرها، وأخيراً؛ بصرف النظر عن الحصول على تفويض المنظمين لجمعية مدققي الشريعة الإسلامية؛ سيعتمد تطوير القضائي للتدقيق الشرعي كثيراً على نتيجة إعادة الهيكلة المستمرة لمهنة التدقيق بأكملها.

## **APPROVAL PAGE**

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## DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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*In recognition of his unconditional support, this research is dedicated to Salihin  
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Islamic Financial Services Act 2013  
Malaysian Code on Corporate Governance 2017  
Securities Industry Act 1973  
Securities Industry Act 1983  
Shariah Governance Framework 2010

## LIST OF ABBREVIATIONS

AA1967	Accountants Act 1967
AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
ACCA	Association of Chartered Certified Accountants
AcG	Accountant General
ACRA	Accounting and Corporate Regulatory Authority
AMCAF	Association of Malay Chartered Accountants Firms Malaysia
AOB	Audit Oversight Board
APB	Accountancy Professional Body
AQIF	Associate Qualification in Islamic Finance
AuG	Auditor General
AUP	Agreed Upon Procedures
BNM	Bank Negara Malaysia
CA	Chartered Accountant
CA2016	Companies Act 2016
CAEs	Chief Audit Executives
CIAs	Chief Internal Auditors
COE	Code of Ethics
CPA	Certified Public Accountant
CPD	Continuous Professional Development
CPSA	Certified Professional Shariah Auditor
CSA1993	Co-operative Societies Act 1993
CSAA	Certified Shariah Advisor and Auditor
CSAP	Committee to Strengthen the Accountancy Profession
EC	Education Committee
FRAC	Financial Reporting and Accountants Council
FRF	Financial Reporting Foundation
FRIBIs	Financial Reporting for Islamic Banking Institutions
GIA	Group Internal Audit
IAASB	International Auditing and Assurance Standards Board
IBA1983	Islamic Banking Act 1983
IBFIM	Islamic Banking & Finance Institute Malaysia
ICAEW	Institute of Chartered Accountants in England and Wales
ICMA	Institute of Cooperative Management and Auditors
ICPAS	Certified Public Accountants of Singapore
IEASB	International Accounting Education Standards Board
IFAC	International Federation of Accountants
IFI	Islamic Financial Institution
IFSA2013	Islamic Financial Services Act 2013
IIA	Institute of Internal Auditors
IIAM	Institute of Internal Auditors Malaysia
IUM	International Islamic University Malaysia
INCEIF	International Centre for Education in Islamic Finance
ISAM	Institute of Internal Auditors Malaysia
ISAs	International Standards on Auditing



ISQC	International Standard on Quality Control
ISRA	International Shari'ah Research Academy for Islamic Finance
JAKIM	Department of Islamic Development Malaysia
LHDN	Inland Revenue Board of Malaysia
MAAA	Malaysian Association of Accounting Administrators
MAFA	Malaysian Accounting Firms Association
MASA	Master of Accounting and Shariah Audit
MASB	Malaysian Accounting Standards Board
MCCG	Malaysian Code on Corporate Governance
MIA	Malaysian Institute of Accountants
MICA	Malaysian Institute of Chartered Accountants
MICPA	Malaysian Institute of Certified Public Accountants
MOE	Ministry of Education
MOF	Ministry of Finance
MOHE	Ministry of Higher Education
MQE	MIA Qualifying Examination
NRB	New Regulatory Framework
PAIB	Professional Accountants in Business
PDICA	Professional Diploma in Cooperative Auditing
PLCs	Public Listed Companies
RBSA	Risk-Based Shariah Audit
ROSCAA	Report on the Observance of Standards and Codes in Accounting and Auditing
SA	Shariah Audit
SAC	Shariah Advisory Council
SC	Shariah Committee
SGF	Shariah Governance Framework
SKM	Malaysia Co-operative Societies Commission
SMPs	Small- and Medium-sized Practitioners
SoP	System of Professions
SSM	Companies Commission of Malaysia
UCE	Unified Common Examination
UITM	Universiti Teknologi MARA
UKIFC	Islamic Finance Council UK
USIM	Universiti Sains Islam Malaysia
WB	World Bank

# CHAPTER ONE

## INTRODUCTION

### 1.1 BACKGROUND AND PROBLEM STATEMENT

The rise of Islamic finance and its capital markets across the globe hinges on a sound Shariah governance (SG) (Grais & Pellegrini, 2006). On this account, Shariah Auditing (SA) has long been acknowledged as an important component of the SG (Khan, 1985; Muneeza & Hassan, 2014). Accordingly, it is now mandatory in certain countries including Malaysia where its SG framework (SGF) specifically requires Islamic Financial Institutions (IFIs) to establish SA function (Bank Negara Malaysia [BNM], 2010). This did not only create a new audit service market space but also triggered the emergence of SA as an occupation. However, SA has since been described as an occupation to be fully developed into a ‘profession’ (Najeeb & Ibrahim, 2014).

Although the professional responsibility for SA is conferred to internal auditors (BNM, 2010), it is shared by other professional groups (e.g. external auditors and lawyers) within and outside the ecology of the auditing profession. This is without clear boundaries in areas of responsibility to the extent that a question is raised as to who holds the jurisdiction to provide religious assurance for the Islamic finance industry (Hassan, Haridan, Zamil, & Muhammad, 2016). Given the uniqueness of SA relative to the conventional audit, Najeeb and Ibrahim (2014) claimed that none of the existing professional groups has ‘holistic’ knowledge and qualification that gives it the professional basis and legitimacy. Hence, none has jurisdiction in SA. More recently, Bosi and Joy (2017) highlight persistent issues and challenges of SA relating to standards/framework, independence, qualification, competency and accountability.

Thus, their study supports Najeeb and Ibrahim (2014) and further reveals the currency of earlier call (Ibrahim, 2008) for SA professionalisation, prior to the issuance of the SGF in 2010.

Although Najeeb and Ibrahim (2014) have theoretically proposed a model for the professionalisation of SA, they challenged SA scholars to empirically investigate the professionalisation of SA. However, how to professionalise SA remains a serious concern as subsequent studies have failed to respond to this call. Najeeb and Ibrahim's (2014) model follows the taxonomic conception (traits and functions) of a profession. Besides its theoretical weaknesses, the major problem with this conception is that there is no agreement as to what conditions have to be met before a particular occupation can be termed a "profession" (Carnegie & Napier, 2010).

As such, a number of contending theories (traits, functional, interaction, and critical) have been employed in an attempt to define a 'profession' (Abbott, 1991; Savage, 1994; Willmott, 1986). However, these theories have generally been discredited for either mainly focusing on the structure, traits, functions, or on aspirations of professions and for the neglect of religion and the work of professions (Abbott, 1986, 1988, 2005; Chua & Poullaos, 1998; Hollander & Campbell, 1990; Macdonald, 1995; Uche, 2002; Willmott, 1986). They have traditionally assumed a static notion of the occupational system and mainly concentrated on identifying the features that differentiate professions from other occupational groups and how the features relate to economic and social power of professional groups (Isaksson & Larsson, 2017).

Consequently, there is the need to, firstly, use an alternative theoretical approach for SA professionalisation and, secondly, to respond to the challenge. In the absence of any study empirically addressing the SA professionalisation as highlighted, this study intends to fill the gap.

## **1.2 MOTIVATION OF THE STUDY**

The primary motivation of this study is inherent in the pervasiveness of Shariah guiding our actions. This research is seen as a divine ‘calling’ in the field of SA, internalised as a religious obligation. Despite its significance, the field has not been given its due consideration. One of the neglected areas in both theory and practice is the professionalisation of SA. Thus, SA professionalisation is chosen because little systematic attention has been given to its professionalisation process. Generally, information on SA professional status has been rare, because most studies have focused on issues and challenges of SA, and so far, no empirical attempt has been made to assess the professionalisation of the occupation.

For the above reason, Najeeb and Ibrahim (2014) have challenged SA researchers to empirically investigate the professionalisation of SA practice. Therefore, this study is triggered by the need to rise up to the challenge for a comprehensive empirical work on the professionalisation of SA. It is also driven by the call for examination of the expansion of boundaries by conventional auditors into new services spectrum (O’Dwyer, Owen, & Unerman, 2011; Power, 2003) such as SA. As the scope of the accounting and auditing practices in the present century has become more diverse and far-reaching than ever, the extension of the profession’s jurisdiction beyond its traditional frontier raises crucial questions about the extent to which conventional audit concepts are applicable to new fields like SA which is essentially religiously inclined.

Furthermore, a cursory look at the market shows different actors claiming to be experts and taking various initiatives to justify their jurisdictional claim. For instance, individuals, large accounting firms, local and international accounting professional bodies and a standard setter (Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)) are all claimants of SA expertise. On the other hand,

international standard setting bodies [e.g. International Accounting Standards Board (IASB)] and even some Islamic finance practitioners may deem the professionalisation of SA as irrelevant on the contentious claims that prevailing conventional standards are sufficient enough for IFIs (Najeeb & Ibrahim, 2014). It is not surprising that “since its inception, AAOIFI has failed to make inroads within the major Islamic finance practicing countries” (Ibid: 11). It is therefore interesting to examine the basis of competition and the likely future direction of SA.

Finally, in the wake of growing markets for Islamic finance and the increasing popularity of Islamic retail banking products worldwide, the financial sector in particular has developed practices that seek to assure customers on its conformance to religious expectations (Khalifa, 2012) through, among others, SA. This further enhances their legitimacy and brand reputation. Presently, IFIs are the consumers of SA service and the crucial sites for Shariah auditors’ professionalisation. Despite the lack of standardisation across the institutions, each is a claimant of professionalism in SA. This presents unchallenged ‘calling’ to understanding the role of IFIs in SA professionalisation.

### **1.3 OBJECTIVES AND QUESTIONS OF THE STUDY**

The call for SA professionalisation to be empirically examined (Najeeb & Ibrahim, 2014) and the need for employing an alternative theory warrant this study to empirically investigate how SA be professionalised using Abbott’s (1988) System of Professions (SoP). The SoP has gained wider acceptance in the sociology of professions over the other contending theories (Adams, 2007; Bureau & Suquet, 2009; Clarke, 1989; Isaksson & Larsson, 2017; Krause, 1989; McKenna, 2006; Roberts, 1989; Stinchcombe, 1990; Tolbert, 1990). It theorises that professions evolve and operate in an

interdependent system characterised by jurisdictional claims, competition and disturbances shaping the system.

According to the SoP, to study professionalisation is to examine how jurisdiction is created in work, how it is secured by social structure, and how the competition for jurisdiction between professions defines the life of the individual professional group. Jurisdiction is the society's recognition of a profession's claim to decide how work content should be interpreted and how the work should be performed (Isaksson & Larsson, 2017) based on the efficacy of its structure and culture machinery (Abbott, 1988).

The SoP theorised that jurisdictional claim leads to either intra or interprofessional competition which results in temporary jurisdictional settlement (Abbott, 1988). Abbott (1988) notes that the settlement is temporary as it is vulnerable to internal and external disturbances. Therefore, he advises that an effective study of professions must begin with case studies of jurisdictions to ascertain the endogenous and exogenous factors shaping the profession. Consequently, there is the need to begin with the examination of the jurisdictional history of the Malaysian auditing profession to ascertain the factors shaping its ecology for effective study of SA professionalisation in Malaysia. This leads to the first primary objective of this study:

1. To examine development of jurisdictions in the auditing profession in Malaysia.

With the SoP as the theoretical framework, examining the development requires tracing initial jurisdiction, jurisdictional disturbances, jurisdictional competition and settlement in a larger context. Thus, to achieve the primary objectives, the following secondary objectives are pursued:

- a) To determine the initial jurisdiction of the auditing profession;

- b) To examine the jurisdictional disturbances shaping the development of the auditing profession; and
- c) To evaluate the ensuing jurisdictional competition and settlement.

The initial jurisdiction is the original state or the status of the auditing profession prior to any disturbance to the system. The disturbances are the internal or external forces destabilising or shaping jurisdictions. When a disturbance occurs, professional groups compete to defend or claim new jurisdiction before key actors. The outcome is a jurisdictional settlement, which is temporary due to the occurrence of disturbances. The key actors are those who have the authority to influence or grant jurisdictional rights (settlements) to the competing groups.

Pursuing the above objectives requires answering the following primary and the corresponding secondary questions:

1. How jurisdictions were developed in the auditing profession?
  - a) What was the initial jurisdiction of the auditing profession?
  - b) How jurisdictional disturbances shaped the development of the auditing profession?
  - c) How jurisdictional competition ensued and how was it settled?

According to the SoP, a profession has a social structure (association, professional controls and worksites) and culture machinery (methodology and knowledge base). Thus, answering the first secondary question (1a) requires ascertaining the initial state of the profession's social structure and cultural machinery. Thereafter, identify the forces of disturbance to the initial state and how they impacted it. As the SoP theorises, in the wake of disturbance, competing groups employ social structure and cultural machinery strategies for jurisdictional claims. The outcome is of one the possible temporary jurisdictional settlements, either full, divided, subordinate, advisory,

intellectual or client differentiation jurisdictions. Hence, the answer to the third secondary question mandates identification of competing groups, the strategies employed and the resultant settlement.

After satisfying the precondition for the effective study of SA professionalisation, the second primary objective is:

2. To investigate SA professionalisation.

The above objective partly draws lessons from the examination of the development of jurisdictions to investigate SA professionalisation. Firstly, it entails establishing the status of SA jurisdiction. It is then followed by ascertaining the jurisdictional strategies used for competition and the temporary settlement reached. Thereafter, there is the need to the strategies required to professionalise SA. Therefore, to achieve the second primary objective, the following secondary objectives are pursued:

- a) To analyse the status of SA jurisdiction;
- b) To examine SA jurisdictional competition and settlement; and
- c) To investigate the strategies to secure and maintain SA jurisdiction.

The corresponding primary and secondary questions are:

2. What are the strategies to professionalise SA?
  - a) What is the status of SA jurisdiction?
  - b) How SA jurisdictional competition ensued and how it was/is settled?
  - c) What are the strategies to secure and maintain SA jurisdiction?

The second primary question is based on the SoP's premise that professionalisation involves employing strategies to attain SA jurisdiction. The first secondary question (2a) aims to determine SA jurisdictional status. The second identifies the competing groups for SA, the strategies employed, and the jurisdictional settlement granted by key actors. The third then empirically ascertains the necessary social structure and cultural