



الجامعة الإسلامية العالمية ماليزيا
INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA
يُؤْتِيهِمُ اللَّهُ مِنْ فَضْلِهِ يُشْرِكُ

SHARI'AH AUDIT FOR ISLAMIC FINANCIAL
INSTITUTIONS: PERCEPTIONS OF
ACCOUNTING ACADEMICIANS, AUDIT
PRACTITIONERS, AND SHARI'AH
SCHOLARS

BY

RATNA MULYANY

A dissertation submitted in partial fulfilment of the
requirements for the degree of Master of Science in
Accounting

Kulliyyah of Economics and Management Sciences
International Islamic University Malaysia

FEBRUARY 2008

ABSTRACT

Shariah auditing has currently emerged as an important subject of discussion inline with the advanced development of Islamic Financial Institutions (IFIs) which subsequently demand for the proper governance of the Shari'ah compliance issues. As a new emerging discipline, its scope of study, subject matter and body of knowledge is still in the process of development. This research aims to discern the perceptions of accounting academicians, audit practitioners and Shari'ah scholars on the subject of Shari'ah auditing. By focusing on the fundamental issues of Shari'ah auditing for IFIs, the study has utilized the literature in this area and mail questionnaires to gather the data. The questionnaires aims at obtaining the respondents' perceptions towards the fundamental issues in Shari'ah auditing which become the research questions of this study, i.e. the understanding of the term "Shari'ah audit", the appointment of Shari'ah auditors as well as their qualification requirements, areas to be audited under Shari'ah audit, the content of Shari'ah audit report, regulatory framework for Shari'ah audit practice, and the standards to be applied in performing Shari'ah audit. The mail questionnaires were distributed to the Muslim accounting lecturers teaching in the Accounting Program at public universities in Malaysia, Muslim audit practitioners, and Shari'ah committee members of the Islamic commercial banks (ICB) and Islamic subsidiaries of the commercial banks (ISCB) in Malaysia. This study reports an urgent call for the systematic development of the discipline Shari'ah audit. It involves from the very basic of: 1) defining the subject in an appropriate manner, 2) standardizing the qualification and competence requirements for Shari'ah auditors who are well equipped not only with accounting and auditing techniques but also specifically certified in Shari'ah audit, 3) identifying the scope, the extent, and the timing of Shari'ah audit, 4) regulating and standardizing the content of Shari'ah audit report, 5) establishing an independent body to regulate and enforce the standards and empower this body with other relevant roles such as to evaluate the practice of Shari'ah audit and to promote research and education in Shari'ah audit, and 6) applying the AAOIFI standards into the practice of Shari'ah audit.

ملخص البحث

أصبحت المراجعة الشرعية (المراجعة الإسلامية) في الوقت الحالي موضوعاً هاماً للناقش على الخط مع التطورات المتقدمة لمؤسسات التمويل الإسلامية، والتي بالتالي تتطلب توجية ورقابة ملائمة في ضوء الالتزام بإصول ومبادئ الشريعة الإسلامية. وكفرع جديد من علوم المعرفة (المراجعة الشرعية) بمجال دراسته، مواضيع بحثه، وقاعدته المعرفية، فهو مازال في مرحلة التطوير. يهدف هذا البحث إلى تبين تصور أو آراء محاضري المحاسبة، مراجعي الحسابات، و علماء الشريعة حول موضوع المراجعة الشرعية. و بالتركيز على القضايا الأساسية أو الجوهرية للمراجعة الشرعية في مؤسسات التمويل الإسلامية، أستخدم البحث الأدبيات و الدراسات السابقة في هذا المجال وبالإضافة إلى الإستبيانات البريدية لتجميع البيانات. وهدف الإستبيان إلى الحصول على تصور أو رأي المستأين (المستجيبين) تجاه القضايا الأساسية أو الجوهرية للمراجعة الشرعية و التي أصبحت أهدافاً للبحث، والمتمثلة في: فهم أو إدراك مصطلح المراجعة الشرعية، إختيار أو تعيين المراجعين الشرعيين بالإضافة إلى متطلبات مؤهلاتهم، المجالات أو الجوانب التي يجب أن تراجع في إطار المراجعة الشرعية، محتويات تقرير المراجعة الشرعية، الإطار التنظيمي للممارسات العملية للمراجعة الشرعية، و المعايير التي يجب تطبيقها في ممارسة عملية المراجعة الشرعية. هذا ووزعت الإستبيانات البريدية على: محاضري المحاسبة المسلمين الذين يقومون بالتدريس في برنامج المحاسبة في الجامعات الحكومية في ماليزيا، مراجعي الحسابات المسلمين، و أعضاء لجنة الرقابة الشرعية (لجنة الشرعية) في البنوك التجارية الإسلامية و الفروع الإسلامية للبنوك التجارية في ماليزيا. وقد خلص البحث إلى الدعوة العاجلة والملحة للتطوير المنهجي و المنظم لعلم المراجعة الشرعية، والتي تشمل الجوانب الأساسية التالية: 1) تعريف المراجعة الشرعية بطريقة أو أسلوب ملائم، 2) معايرة المؤهلات والكفاءة المطلوبة في المراجعين الشرعيين الذين ليس فقط يجب أن يكونوا مؤهلين جيداً في مجال المحاسبة والمراجعة وإنما مرخصين في مجال المراجعة الشرعية، 3) تحديد المجال، المدى والوقت للمراجعة الشرعية، 4) ضبط ومعايرة محتويات تقرير المراجعة الشرعية، 5) تأسيس مجلس أو هيئة مستقلة بهدف ضبط وضمان الإلتزام بالمعايير، بالإضافة إلى تفويض هذا المجلس أو الهيئة للقيام بانوار أخرى مرتبطة بالمراجعة الشرعية، على سبيل المثال القيام بتقييم الممارسة العملية للمراجعة الشرعية، و تشجيع البحث والدراسة فيها، و 6) تطبيق معايير أوفي (AAOIFI) في الممارسة العملية للمراجعة الشرعية.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science in Accounting.

.....
Shahul Hameed Hj. Mohamed Ibrahim
Supervisor

I certify that I have read this study and that in my opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science in Accounting.

.....
Fatima Abdul Hamid
Examiner

This dissertation was submitted to the Department of Accounting and is accepted as a partial fulfilment of the requirements for the degree of Master of Science in Accounting.

.....
Nazli Anum Mohd. Ghazali
Head, Department of Accounting

This dissertation was submitted to the Kulliyah of Economics and Management Sciences and is accepted as partial fulfilment of the requirements for the degree of Master of Science in Accounting.

.....
Jamil Bin Hj. Osman
Dean, Kulliyah of Economics and
Management Sciences

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.

Ratna Mulyany

Signature

Date

**INTERNATIONAL ISLAMIC UNIVERSITY
MALAYSIA**

**DECLARATION OF COPYRIGHT AND
AFFIRMATION OF FAIR USE OF UNPUBLISHED
RESEARCH**

Copyright © 2008 Ratna Mulyany. All rights reserved.

**SHARI'AH AUDIT FOR ISLAMIC FINANCIAL INSTITUTIONS:
PERCEPTIONS OF ACCOUNTING ACADEMICIANS, AUDIT
PRACTITIONERS AND SHARI'AH SCHOLARS**

No part of this unpublished research may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without prior written permission of the copyright holder except as provided below.

1. Any material contained in or derived from this unpublished research may only be used by others in their writing with due acknowledgement.
2. IIUM or its library will have the right to make and transmit copies (print or electronic) for institutional and academic purposes.
3. The IIUM library will have the right to make, store in a retrieval system and supply copies of this unpublished research if requested by other universities and research libraries.

Affirmed by Ratna Mulyany

.....
Signature

.....
Date

THIS WORK IS DEDICATED FOR:

**Allah SWT, The Almighty.
Prophet Muhammad SAW.**

I humbly hope that this work would contribute to the development of the Ummah.

My Late Brother, Badrul Tamam

Who passed away in the Tsunami 26 December 2004, Banda Aceh.
He was not only the best brother to me but a very good friend with whom I shared my stories. I always pray that he will be in *Jannah* InshaAllah.

My Parents, Muhammad Amin & Juwairiah Daud

Who endlessly sacrifice their life for the sake of my success in this life and hereafter.
May Allah reward them properly in this *dunya* and *akhirah*.

My Husband, Hafas Furqani

Who patiently accompanies and supports me in the hard and happy time.

My late Mother in-law, Dra Nazri

**My late Brother and Sisters in-law, Hanif Aulia, Hayatul Fitria, and Yusrawati
All relatives and friends**

Who passed away in the Tsunami 26 December 2004, Banda Aceh. May Allah place them in *Jannah*.

My beloved Achenees community

Let us be reminded that our greatest responsibility is to restore the values of Islam in the life of Achenees people.

ACKNOWLEDGEMENTS

In the name of Allah SWT, the Most Compassionate and the Most Merciful. All praise due to Allah SWT and peace and blessings be upon His prophet Muhammad SAW. A long list of individuals have to be acknowledged for their support given in one way or another in completing this work. My special appreciation goes to my parents, Muhammad Amin and Juwairiah Daud, my late brother Badrul Tamam (May Allah blesses him and places him in *Jannah*), and my brothers Denny Safrizal and Muhajir, for their endless support and encouragement, without them certainly I would not go this far. Surely the major credit goes to my supervisor, Assoc. Prof. Dr. Shahul Hameed Hj. Mohamed Ibrahim for his invaluable ideas, guidance, patience, and comments throughout the process of writing this thesis. I am particularly indebted to Dr Fatima Abdul Hamid for her endless help in answering my queries on statistical matters. My deepest appreciation also goes to all my lecturers: the late Dr. Unvar Rahman Abdul Muthalib (May Allah blesses him and places him in *Jannah*), Prof. Maliah Sulaiman, Mdm. Putri Nor Suad Megat Mohd. Noor, Assoc. Prof. Dr. Nik Nazli Nik Ahmad, Assoc. Prof. Dr. Abdul Rahim Abdul Rahman, Dr. Asyraf Wajdi Hj. Dato' Dusuki, Dr. Hafiz Majdi Ab. Rashid, Assoc. Prof. Siti Normala Sheikh Obid, Assoc. Prof. Muhd Akhyar Adnan and all other lecturers who have patiently guided me in the quest of knowledge. I would like to also extend my thanks to the leadership of the KENMS and Department of Accounting especially, and all the staff who have been helping me whenever I need it (especially to Kak Yati and Kak Zura at the DOA who have collected my questionnaires and to Kak Norma and Kak Suria who have assisted me in many administrative matters). This list of acknowledgements would be incomplete if I failed to mention my beloved husband, Hafas Furqani, who certainly deserves a very special place for all his encouragement, support, understanding, and prayers. I would like to also thank our son, Haziq Muharrir, whose smile, laugh and cries have cheered me up and motivated me to finish this research. I always pray to Allah, hopefully he will become a great Muslim scholar and dedicate his life in the struggle for the victory of Islam. Amiin.

TABLE OF CONTENTS

Abstract	ii
Abstract in Arabic	iii
Approval Page	iv
Declaration Page	v
Copyright Page	vi
Dedication	vii
Acknowledgements	viii
List of Tables	xii
List of Figures	xiv
List of Abbreviations	xv
CHAPTER 1: INTRODUCTION	1
1.1 Background of the Study	1
1.2 Objective of the Study	5
1.3 Motivation of the Study	6
1.4 Significance of the study	7
1.5 Organization of the Thesis	8
CHAPTER 2: THE EVOLUTION OF AUDITING	10
2.1 Introduction	10
2.2 The emergence of auditing and financial statement audit	12
2.2.1 Historical background of auditing	12
2.2.2 Financial statement audit	16
2.3 Performance audit	22
2.4 Social and environmental auditing: a new paradigm of auditing?	27
2.4.1 Social audit	28
2.4.2 Environmental audit	37
2.5 Path of the evolution of auditing	43
2.6 Summary of the chapter	49
CHAPTER 3: AUDITING IN THE ISLAMIC FRAMEWORK	50
3.1 Introduction	50
3.2 Islamic Worldview and auditing	50
3.3 Islamic Accountability and Auditing	55
3.4 The Development of Shari'ah Auditing: A Survey of Literature	58
3.4.1 Exploring the meaning of Shari'ah audit	58
3.4.2 The emergence of Shari'ah audit	62
3.4.3 The characteristics of Shari'ah audit	65
3.4.3.1 The scope and the extent of Shari'ah audit .	66
3.4.3.2 The role of Shari'ah auditors	69

3.4.3.3	Qualifications and competence requirements for Shari'ah auditors	72
3.4.4	Shari'ah auditing: The challenges ahead	74
3.4.4.1	The conceptual framework of Shari'ah audit.....	75
3.4.4.2	Lack of internationally accepted comprehensive Shari'ah auditing standards or guidelines	76
3.4.4.3	Who should carry the function of Shari'ah Audit	79
3.5	Gap of the existing literatures on Shari'ah audit	85
3.6	Summary of the chapter	94
 CHAPTER 4: RESEARCH DESIGN & METHODOLOGY		96
4.1	Introduction	96
4.2	Research Objective and Research Questions	96
4.3	Data Collection Method	97
4.3.1	Questionnaire Design	98
4.3.2	Administering Postal Questionnaire	101
4.4	Population and Sample	102
4.4.1	Respondents' background and Sample selection	102
4.5	Pilot Testing	105
4.6	Data analysis	106
4.7	Summary of the chapter	107
 CHAPTER 5: FINDINGS AND ANALYSIS		108
5.1	Introduction	108
5.2	Response Rate	108
5.3	Non-Response Bias Test	109
5.4	Validity and reliability test	113
5.4.1	Reliability test for part A of the questionnaire	114
5.4.2	Reliability test for part B of the questionnaire	115
5.4.3	Reliability test for part C of the questionnaire	116
5.4.4	Reliability test for part D of the questionnaire	117
5.5	Demographic analysis	118
5.6	Statistical analysis for each research questions	121
5.6.1	Research Question No.1	121
5.6.2	Research Question No.2	124
5.6.3	Research Question No.3	129
5.6.4	Research Question No.4	136
5.7	Summary of the chapter	139
 CHAPTER 6: CONCLUSION		142
6.1	Introduction	142
6.2	Conclusion for each research question	142
6.2.1	Research question No.1	143
6.2.2	Research question No.2	145

6.2.3 Research question No.3	147
6.2.4 Research question No.4	149
6.3 Limitations of the study	151
6.4 Contribution of the study	151
6.5 Suggestions for future research	152
BIBLIOGRAPHY	154
APPENDIX 1 : Cover letter	167
APPENDIX II : Questionnaire	168

LIST OF TABLES

<u>Table No.</u>		<u>Page No.</u>
2.1	The characteristics of different auditing models	47
3.1	The existing literature on (or related to) Shari'ah audit	89
4.1	Derivation of the sample size for accounting academicians	103
4.2	Composition of audit practitioners participating in this study	104
4.3	Details of samples of Shari'ah committee members	105
5.1	Response rate	109
5.2	Non-response bias test for part A and part B of the questionnaire	111
5.3	Non-response bias test for part C of the questionnaire	112
5.4	Non-response bias test for part D of the questionnaire	112
5.5	Respondents' gender and age	118
5.6	Respondents' educational background & working experience	119
5.7	Job position of auditors	120
5.8	Awareness of the term "Shari'ah Audit"	122
5.9	The importance of developing the discipline "Shari'ah Audit"	123
5.10	Who should perform Shari'ah audit for IFIs	125
5.11	Who should appoint Shari'ah auditors for IFIs	126
5.12	Competence and qualification requirements of Shari'ah auditors	128
5.13	Areas to be audited under Shari'ah audit	129
5.14	To what extent Shari'ah Audit should be performed?	131
5.15	When should Shari'ah audit be performed?	131
5.16	The importance of Shari'ah audit report	133

5.17	The content of Shari'ah audit report	134
5.18	The extension of Shari'ah audit to other Islamic institutions	136
5.19	The regulatory body for Shari'ah audit	137
5.20	The standards to be applied in performing Shari'ah audit	138

LIST OF FIGURES

<u>Figure No.</u>		<u>Page No.</u>
2.1	The broadening scope of auditing	45
3.1	Effective framework to monitor and assess Shari'ah compliance	85
5.1	Reliability analysis for part A of the questionnaire	115
5.2	Reliability analysis for part B of the questionnaire	116
5.3	Reliability analysis for part C of the questionnaire	117
5.4	Reliability analysis for part D of the questionnaire	117

CHAPTER 1

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

The emergence of Islamic financial institutions (IFIs) has created a new reality within the global finance arena, and supported the development of Islamic economy in particular. At its core, the research conducted on Islamic economy has increased tremendously in the past few decades. Though the effort to formulate the ideal Islamic economic system is still ongoing but its development triggers significant changes in many aspects of business activities, such as in the areas of accounting and auditing.

In the field of auditing, the establishment of IFIs results in a new dimension of auditing, i.e. Shari'ah audit, which is in addition to conventional audit. Its philosophies and basic principles are however, not new, having been practiced in the time of Prophet Muhammad (p.b.u.h) and His companions. Subsequently, those principles also were carried over during the time of Ummayyads and Abbasids (Khan, 2001). However, it is not the purpose of this study to provide in depth discussion on auditing practices in the early Islamic era.

Shari'ah audit might be simply defined as an audit to attest for Shari'ah compliance. However, how to comprehensively define the discipline of Shari'ah audit? Who are qualified to perform the task? What is the scope of Shari'ah audit? How to actually audit various aspects of Shari'ah? Does Shari'ah audit necessitate a dedicated regulatory and supervisory framework on its own? These are among the questions that are yet to be resolved with regards to the Shari'ah audit. As a result, the theory of Shari'ah audit as well its practice is little known and heterogeneous across

the countries. To date, there has been no an established framework for Shari'ah auditing that can serve as a guide as compared to the conventional audit.

Ideally, there should not be any separation between “conventional audit”, which refers to financial audit, and Shari'ah audit. In line with this, Karim (1990) contends that religious auditors and external (i.e. financial) auditors are supposed to come from the same organizational body since Islam does not separate between *religion* and *business*. Islam perceives all human activities are integrated and they should not be seen as exclusive from one to another. If those activities, e.g. business, rituals, etc., are performed with the right intention, they will be accounted as *ibadah* in the eye of Allah and rewarded accordingly. Therefore, if Shari'ah is explored and understood in the right way, it would be very comprehensive and covers all elements of human life. Hence, financial matters, social and environmental issues are all the concerns of the Shari'ah. This is supported by Khan (2001) where he asserts that in public life, the objectives of Shari'ah may be summarized as evolving a society in which the values of freedom, mutual trust, consultation, accountability, public welfare, transparency in public policy, the rule of law, and elimination of injustice, corruption and fraud are supreme.

In the previous studies such as Hood & Bucheery (1999), Karim (1990) and Khan (1985), the term “Shari'ah audit” has been interchangeably used with “religious audit” or “auditing in the Islamic framework”. The term “Shari'ah audit” has not been popularly used until recently by the contemporary scholars. Khan (1985) which probably provides one of the initial discussions on auditing in Islamic framework refers auditing in the Islamic economy as a normative art inspired from the moral code of the Shari'ah.

In a practical way, perhaps the definition of Shari'ah review given by AAOIFI in Governance Standard for Islamic Financial Institutions (GSIFI) is also parallel to our discussion on Shari'ah audit. GSIFI No.2, para. 3 defines that Shari'ah review is “an examination of the extent of an Islamic financial institution’s compliance, in all its activities with the Shari’ah” (AAOIFI, 2002). This paragraph further states that the examination should cover contracts, agreements, policies, products, transactions, memorandum and articles of association, financial statements, reports (especially internal audit and central bank inspection), circulars, etc. In performing this assessment, Shari'ah Supervisory Board (SSB) shall have completed and unhindered access to all documents, transactions, and information from all sources including professional advisers and the IFI employees.

Currently, auditing practice of IFIs in various countries depicts that besides external auditors who are responsible for financial audit; almost all Islamic banks have in-house SSB whose main duty is to certify the adherence of the banks to the Shari'ah principles. Observing the Shari'ah audit practices in different countries, it is interesting to note that in Sudan, different types of SSB with different level of jurisdictions have taken place (Abdallah, 1994). He further explained that some of Sudanese Islamic banks have opted to appoint Shari'ah consultant whose duty is to ensure that the banks activities are in compliant with Shari'ah rules. On the other hand, other Islamic banks have established SSB who pursue similar role as Shari'ah consultant and carry out their duties on part time basis.

Abdallah (1994) also stated that another innovation in Sudan is through the establishment of Department of Fatwa and Research (DFR) in the Islamic banks. This model of SSB is considered to have wider scope of responsibility where they work on full time basis and collaborates with all divisions of the banks. On the top of all these

models of SSBs, the experience of Shari'ah supervision and control in Sudan has further developed into another higher tier of control which is Higher Shari'ah Supervisory Board who serves as main governing body of SSBs at individual bank level.

In Bahrain for instance where the country is a primary financial market in the Gulf, religious audit is a must in addition to regular financial audit for any Islamic financial institution that declares that its activities adhere to Islamic principles (Hood & Buchery, 1999).

In term of its legislative ruling, Shari'ah audit of IFIs in Malaysia is expected to be very much similar to the above countries. However, the current practice might not reveal the best to be practiced. For instance, a study on the responsibility and independence of Shari'ah advisors of Islamic banks in Malaysia by Abdul Rahman et al. (2004) provide preliminary evidence on the immediate need for proper regulation on the role and function of Shari'ah advisors in order to enhance the credibility of Malaysian Islamic banking. Their finding indicates that some improvement initiatives have to be embarked in term of the regulatory and supervisory framework of Shari'ah audit.

Emphasizing the above argument that even though general picture on Shari'ah audit practice is probably known, yet, the theoretical framework of Shari'ah audit has not been well established and put into practice. If a particular body is to certify whether or not an entity is in compliance with Shari'ah, then the comprehensive understanding of Shari'ah should be put as fundamental guidelines to carry out such assessment. It is believed that Shari'ah audit should not only be confined in assessing whether business entities are engaged with *riba* and non-halal activities but it should

be beyond these issues. Hence, given the complex issues of Shari'ah audit, examination on the framework of Shari'ah audit is perceived to be vital.

1.2 OBJECTIVES OF THE STUDY

This research aims to explore the perceptions of Muslim accounting academicians, Muslim audit practitioners and Shari'ah committee (SSB) members or named as Shari'ah scholars in Malaysia with regards to the fundamental issues of Shari'ah auditing. It is the vision of the researcher that through the opinions derived from the study, the subject of Shari'ah audit will be further enriched and nurtured as a distinct discipline.

To accomplish the above objective hence four research questions are formulated as follow:

1. *What should be the definition of Shari'ah audit?* This question examines the awareness of respondents of the term Shari'ah audit, the importance of establishing the discipline of Shari'ah audit and its definition.
2. *What are the qualification requirements for Shari'ah auditors?* This question seeks to identify who are supposed to perform Shari'ah audit, what are the qualification and competence requirements for Shari'ah auditors, and the appointment of Shari'ah auditors.
3. *What is the scope of Shari'ah audit?* This question encompasses the investigation on the business areas to be audited under Shari'ah audit, the extent of Shari'ah audit, timing of Shari'ah audit, the importance and content of Shari'ah audit report.
4. *What is the regulatory framework for Shari'ah audit?* This question seeks to identify the framework of regulation and supervision of Shari'ah audit

in terms of regulatory body and its role, and also on the standards to be applied in the Shari'ah audit practice.

To answer the above research questions, sample groups from Muslim accounting academicians teaching in the Accounting program in the public universities in peninsular Malaysia, Muslim audit practitioners, and Shari'ah committee (i.e. SSB) members of the Islamic commercial banks (ICB) and Islamic subsidiaries of the commercial banks (ISCB) in Malaysia are selected as respondents for this study. These individuals are selected due to the belief that they have expertise, understanding and involvement in the area of the subject of this study. Hence it is expected that the respondents would provide relevant particulars sought by the study.

1.3 MOTIVATION OF THE STUDY

This study is mainly motivated by lack of research in the field of Shari'ah audit. Several studies on Shari'ah audit are merely general in nature and none attempts to explore the comprehensive conception of Shari'ah audit. Indeed the discussion of Shari'ah audit in majority of these studies is only part of their discussion for their main topic. Apart from that, though several scholars have initiated to discuss on auditing in the Islamic perspective, yet there has been no extensive continuation of these initiatives.

In addition, despite its importance in current development of IFIs, however, it is interesting to note that so far no specific standard on Shari'ah audit has been promulgated and made compulsory for Islamic financial institutions to follow as compared to conventional auditing. This intriguing fact necessitates further investigation on the regulatory and supervisory framework for Shari'ah audit itself. Currently, Governance Standard on Shari'ah review by Accounting and Auditing

Organization for Islamic Financial Institutions (AAOIFI) is probably the most relevant guideline available for Shari'ah audit practice. However, whether the standard is able to cater the practice of Shari'ah audit in comprehensive manner is still another question to ponder. According to the Study on the Adoption and Acceptance of AAOIFI standard by AAOIFI (2006), it was found that only three countries adopted AAOIFI standard (Bahrain, Sudan and Jordan) while in other countries the standard are either voluntarily used or used as guidelines in establishing national standards or not used at all. Their findings further revealed that among the major obstacles in adopting AAOIFI standard are the prohibitive statutory and/or legal framework, the additional cost of disclosure and risk of standard overload, and the question on the quality of AAOIFI standard.

1.4 SIGNIFICANCE OF THE STUDY

This study is significant in various ways. Through exploring the framework of Shari'ah audit it will contribute to the development of Shari'ah audit as one distinct discipline of knowledge and provides accounting educators with information pertaining to the curriculum development. In a broader perspective, the establishment of Shari'ah audit as a discipline of knowledge will also support the initiative of Islamization of knowledge.

In particular, the study will benefit the IFIs in achieving its objectives mainly in the aspect of Shari'ah compliance. Having an overview of what should constitute the practice of Shari'ah audit, it will indicate necessary improvements to be done on this significant area and thus it will enhance the confidence of IFIs stakeholders.

The study also hopes to assist standards setters and regulatory bodies, not only confined to Malaysian environment, in setting up the relevant policies or governance

standards with regards to Shari'ah audit. In addition, it is also important for Muslim scholars to identify the key issues of Shari'ah audit in order to institute the comprehensive theory of Shari'ah audit. Finally, hopefully this research will inspire further research to be conducted in this area and enrich the existing knowledge and literature.

1.5 ORGANIZATION OF THE THESIS

This thesis will be organized into six chapters, which includes this chapter as the introduction of the thesis. Chapter two will review the literature in the evolution of auditing. Specifically, chapter two will explore the evolution of auditing by discussing different types of auditing that have emerged from time to time and relate it to the current necessity of formulating the discipline Shari'ah audit.

Chapter three aims to provide a review of literature in the area of auditing from the Islamic perspective. In particular, the chapter attempts to explore how far literatures have progressed in the area of Shari'ah auditing. The chapter is organized into three sections. First section examines the understanding of Islamic worldview and how it moulds the different concept of auditing. Secondly, the chapter analyses the concept of auditing and accountability in the Islamic institutions. Finally the chapter reviews the literature development in Shari'ah auditing.

Chapter four aims to discuss the research method of the study. The chapter begins with the presentation of research questions, followed with the discussion on the research design which covers the sample selection, respondents' background as well as method used and questionnaire design. Apart from that, the chapter also highlights the pilot testing, data collection procedure, and method of data analysis.

Subsequently, the findings and analysis of the study will be thoroughly explored in chapter five. Finally, chapter six provides the conclusion of the study.

CHAPTER 2

THE EVOLUTION OF AUDITING

2.1 INTRODUCTION

This chapter aims to explore the evolution of auditing so that the researcher could relate it to the current emergence of Shari'ah audit. Principally, the literature relevant to the range of issues in auditing is extensive. However, literature which specifically addresses the development of auditing is quite limited. As compared to many writings and debates on accounting history (see for e.g. Edwards, 1989; Parker & Yamey, 1994; Bryer, 1998; Merino, 1998; Napier, 1998; Poullaos, 1998; Bryer, 2000; Edwards, 2000; Arnold & McCartney, 2003; Walker, 2004; Walker, 2005; Beattie & Davie, 2006; Napier, 2006; etc.), there seems to be a rather limited interest in the auditing history. The reasons could be either the history of auditing has been included in the sub discussion of accounting history or auditing has been commonly regarded as part of the domain of accounting.

Auditing has evolved considerably ever since its emergence until today. Its theoretical dimension as well as its practical issues have been evolving in response to the growing public expectations of accountability, the rapidly advancement of technology, and other socio-economic developments which take place in the society.

Since the subject (i.e. auditing) itself is very broad and encompasses various issues, this chapter will specifically look into the emergence and the development of different auditing areas (e.g. financial statement audit, social and environmental audit, etc.) and briefly discuss the framework and related issues of each of the major auditing areas identified. Even by specializing to those areas it is still impossible to