

# *Shariah Audit Issues and Considerations*

Nik Shahrizal Sulaiman

*IFN 2011  
Issuers and Investors  
Asia Forum*

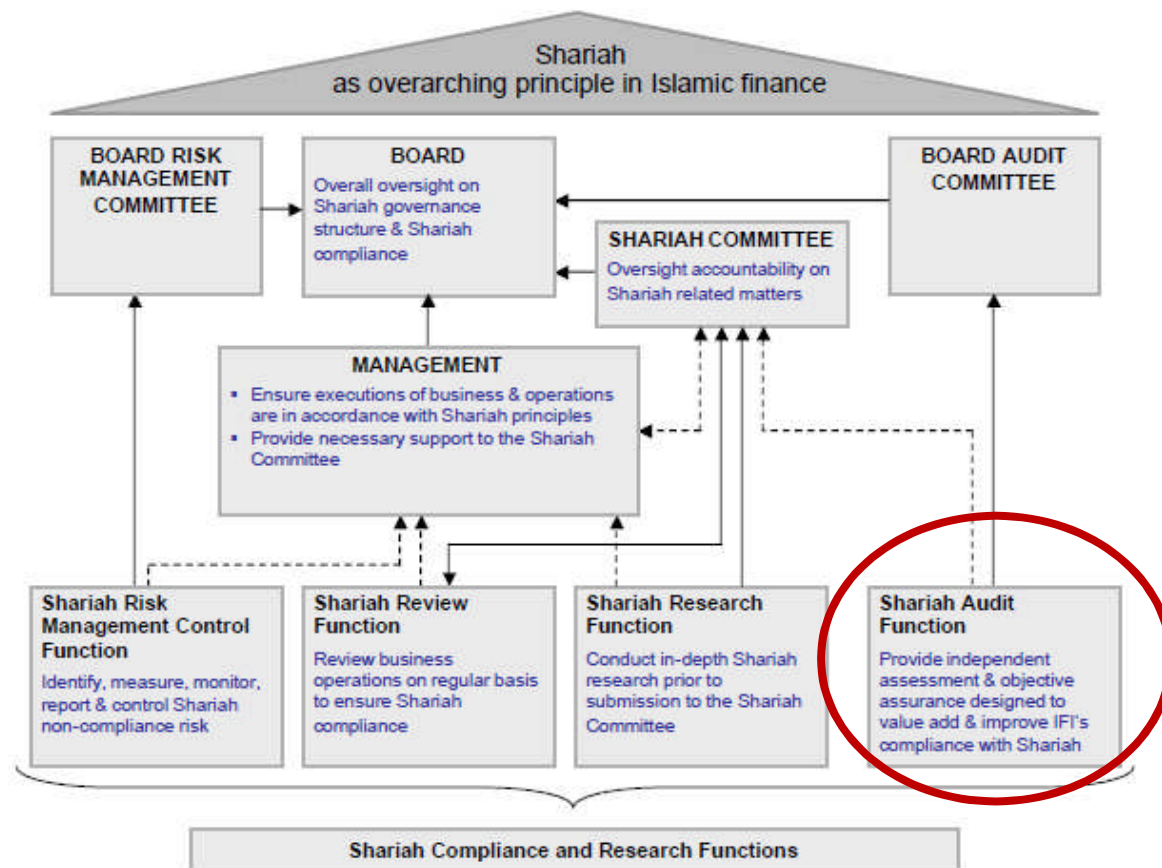
*October 2011*



**pwc**

# Shariah audit as part of Shariah Governance Framework

Figure 1: Shariah Governance Framework Model for Islamic Financial Institutions



---

# ***Shariah non-compliance risk is a key risk***

---

## ***Definition of Shariah audit (BNM)***

- 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.

*Source: Shariah Governance Framework, BNM*

---

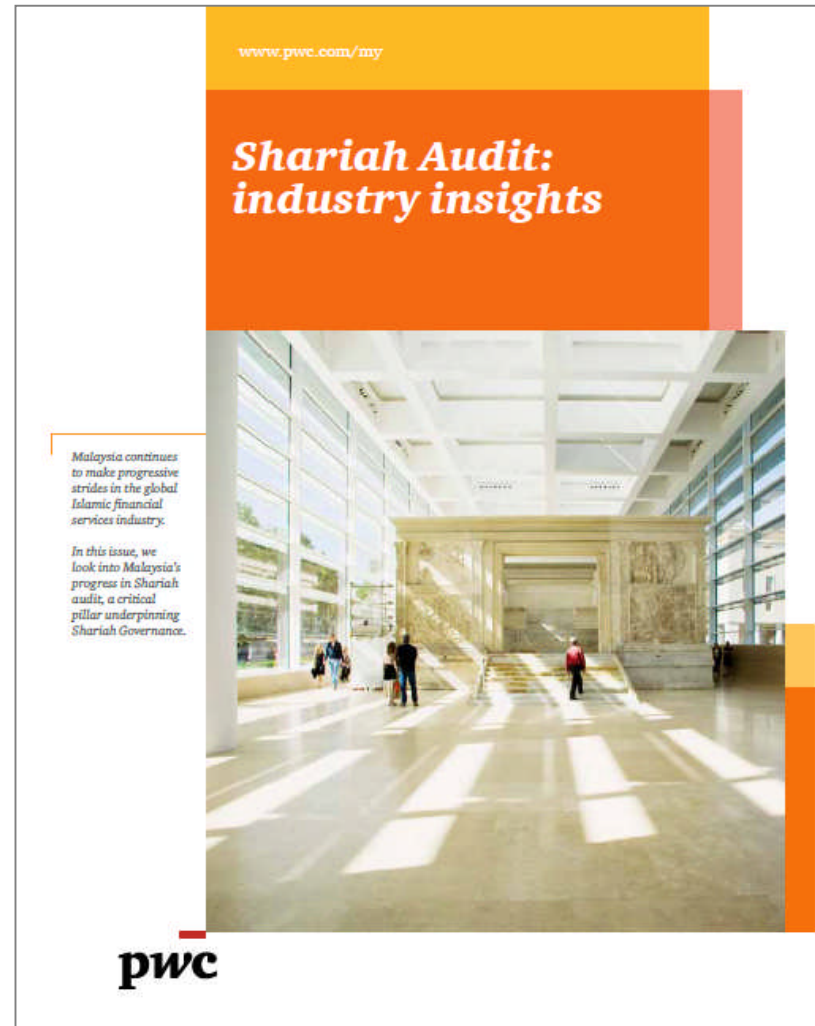
## ***Definition of Shariah audit (AAOIFI)***

- The primary objective of the internal Shariah review (carried out by independent division or part of internal audit department) is to ensure that the management of an IFI discharge their responsibilities in relation to the implementation of the Shariah rules and principles as determined by the IFI's Shariah Supervisory Board (SSB).

*Source: Governance Standard for IFI No.3, AAOIFI*

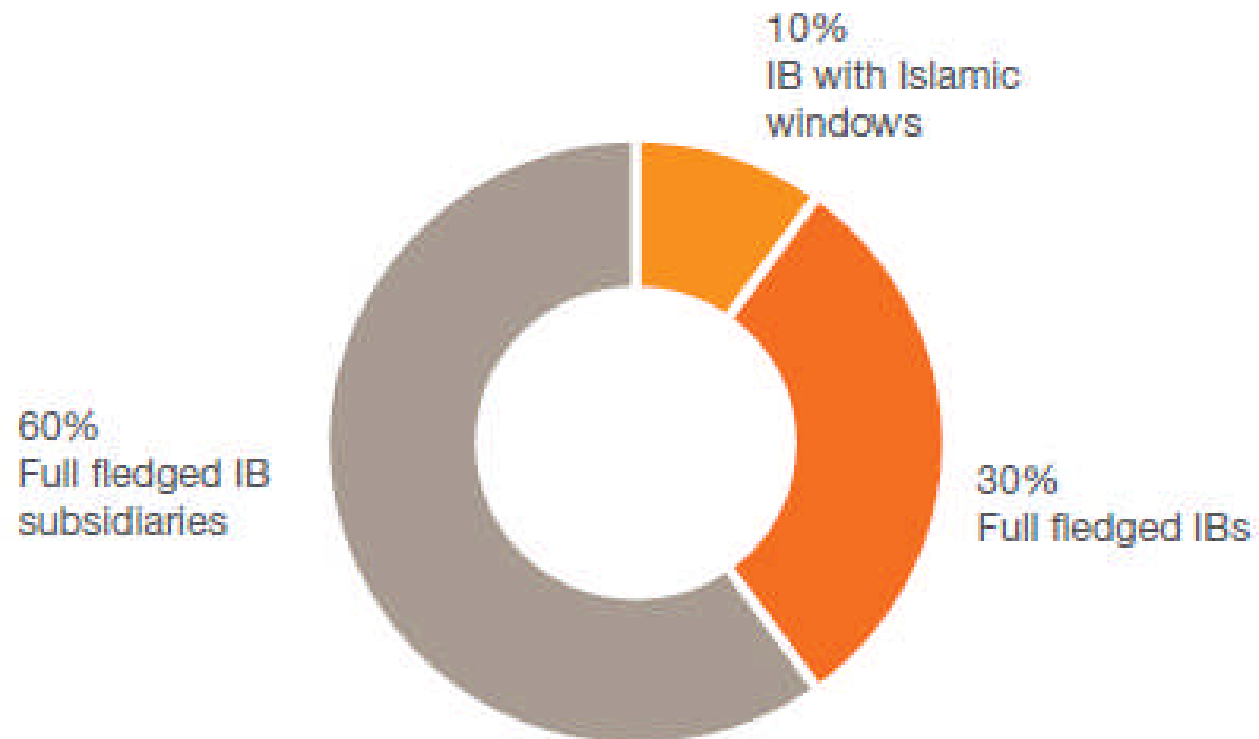
---

# Shariah audit: A survey



---

## *Profile of survey respondents*



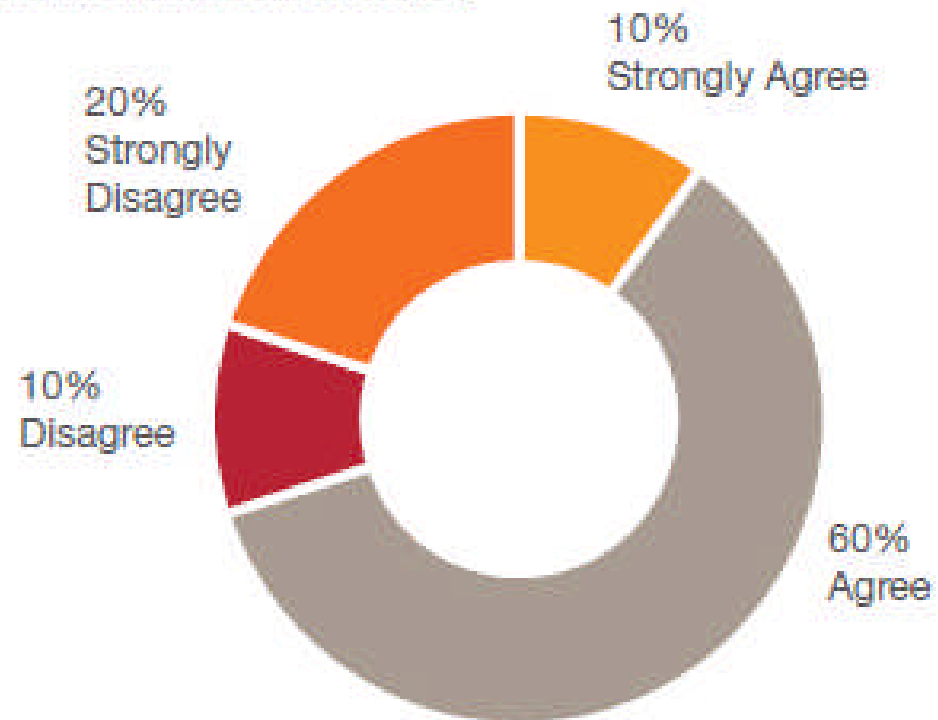
Source: PwC Shariah Audit Survey, December 2010

Note: \*IB = Islamic bank

---

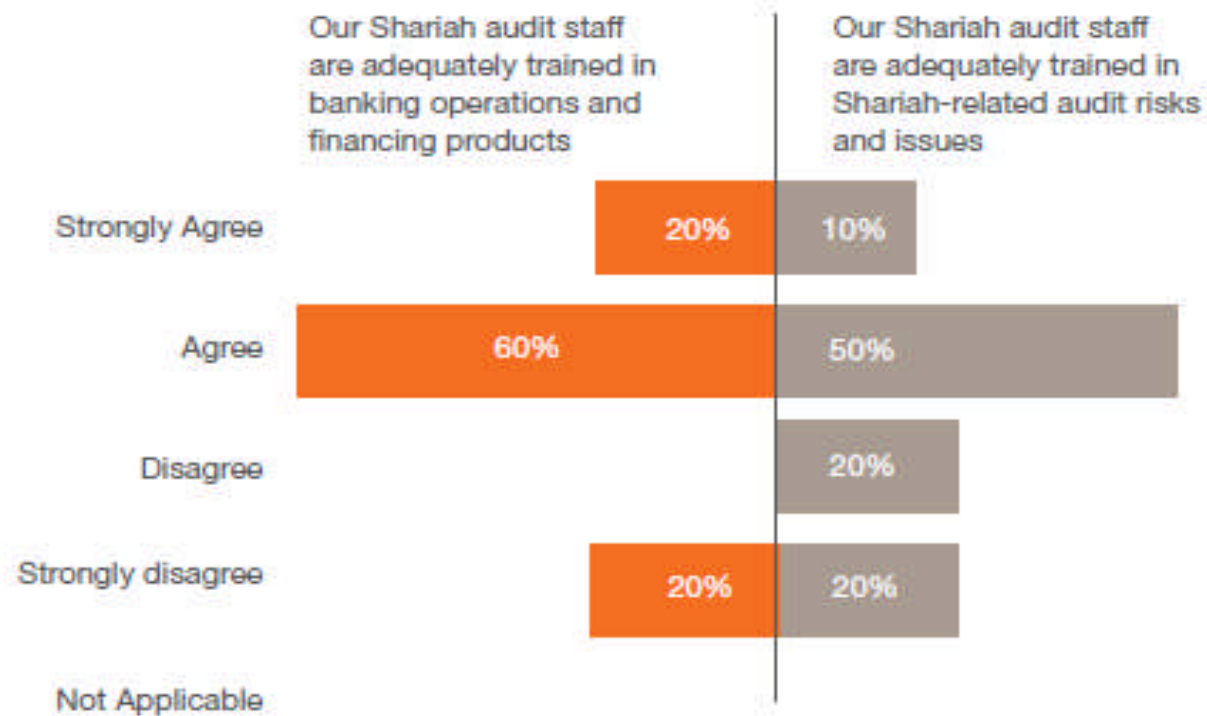
## ***Survey result: Shariah audit talent pool***

We have sufficient number of staff to perform Shariah audit effectively



Source: PwC Shariah Audit Survey, December 2010

## ***Survey result: Shariah audit competencies***



Source: PwC Shariah Audit Survey, December 2010

## ***Survey result: Shariah audit coverage***

Which areas are covered in the scope of the Shariah audit?	Percentage of Respondents		
	YES	NO	N/A
Financing	90%	0%	10%
Credit admin			
Treasury			
Treasury operation			
Settlements/disbursements			
Finance	60%	30%	10%
Shariah fatwa process			
Human Resources	50%	40%	10%
Recovery	80%	10%	10%
Legal	70%	20%	10%
Risk management	50%	40%	10%

Source: PwC Shariah Audit Survey, December 2010

## Survey result: Risk assessments in Shariah audit

Chart 11: Specific type of Shariah risk events which the audit is designed to address

Please describe the specific type of Shariah risk events which the audit is designed to address	Percentage of Respondents		
	YES	NO	N/A
Shariah approval of financing products	90%	0%	10%
Trade sequencing			
Legal agreements and product documentation			
Valid commodity vendors			
Staff awareness on Islamic Finance			
Communication between Shariah committee and management	80%	10%	10%
Marketing materials	70%	20%	10%
Role of Shariah risk in the risk management framework			

## ***Survey result: Shariah scholars involvement***

Chart 13: To identify the level of involvement of the Shariah scholars in the Shariah audit as being practiced in the bank, a closed-ended question was put forward

<b>What is the level of involvement of the Shariah scholars in the Shariah audit?</b>	<b>Percentage of Respondents</b>		
	<b>YES</b>	<b>NO</b>	<b>N/A</b>
Provide general guidance and strategy during the audit planning stage	20%	70%	10%
Facilitate the audit fieldwork process (e.g. perform inquiry, observations on behalf of Shariah auditors)	10%	70%	20%
Assist in the preparation of audit report and help recommend action plans			
Review audit report and perform follow up queries with management	30%	50%	20%
Shariah scholars have no involvement in the Shariah audit process	70%	20%	10%

Source: PwC Shariah Audit Survey, December 2010

---

## ***Shariah audit opinion: Assertions***

We have assessed the work carried out by Shariah review and Shariah audit which included examining, on a test basis, each type of transaction, the relevant documentation and procedures adopted by the ABC Islamic Financial Institution.

We planned and performed our review so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the ABC Islamic Financial Institution has not violated the Shariah principles.

In our opinion:

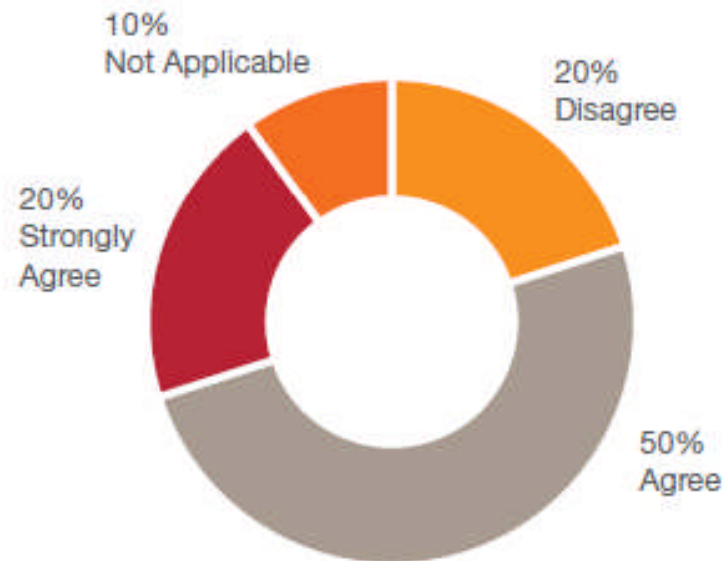
1. the contracts, transactions and dealings entered into by the ABC Islamic Financial Institution during the year ended XX/XX/XXXX that we have reviewed are in compliance with the Shariah principles;
2. the allocation of profit and charging of losses relating to investment accounts conform to the basis that had been approved by us in accordance with Shariah principles;

---

## ***Survey result: Shariah audit and IT system***

Chart 15: Shariah audit – adequacy of IT systems

The bank's IT systems are sufficient to provide Shariah auditors with the necessary data and information to complete the audit



Source: PwC Shariah Audit Survey, December 2010

---

## ***Take away points***

- Shariah non-compliance risk is a key, emerging risk
- Organised methodology for Shariah audit needed
  - Scoping of Shariah audit universe
  - Shariah risk assessments
  - Shariah audit planning procedures
  - Audit testing methodology
  - Reporting and rating methodology
- Coordination with the work performed by Shariah review function
- Link between the Shariah audit opinion and the work performed
- Investments in Shariah audit expertise and knowledge are key

---

***pwc.com/my***

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PricewaterhouseCoopers, its members, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

© 2011 PricewaterhouseCoopers. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.