Professionalizing the role of Shari’ah auditors: How Malaysia can generate economic benefits☆

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1. Introduction

Islamic finance is no longer an alien concept in major countries of the world. With average annual growth rates ranging from 15% to 20% per annum over the past decade, calls for recognizing Islamic finance as an alternative (and socially just) financial system to the dominant conventional system are widespread (IIFM, 2010). The interest in incorporating Islamic finance has emerged not only from Muslim markets and jurisdictions, but also from non-Muslim markets and investors. Countries such as Australia, China, France, Germany, Italy, Japan, Korea, Luxembourg, Singapore and United Kingdom have all undertaken measures to

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introduce Islamic finance in their financial systems. A growing number of conventional banks have introduced parallel Islamic banking in their conventional operations (IFSB, 2010). As per ambitious estimates, Islamic finance industry experts anticipate the Islamic capital markets of having a potential to reach capitalization levels of several trillion USD or nearly 25% of the world’s capital market capitalization from the current 3.3% level in the next decade or two (IIFM, 2010).

The peculiar feature of the Islamic financial system is that it is structured on the divine fundamentals of Islamic Law known as ‘Shari’ah’. From the economic point of view, Shari’ah requires gains from investments to be earned in an ethical and socially responsible manner that comply with teachings of Islam (DeLorenzo, 2000). In order for a product to be classified as Shari’ah compliant and hence an ‘Islamic finance’ product, the product needs to undergo a screening process to ensure that it is free from prohibitive elements as dictated by Shari’ah. The common elements screened for are riba (interest), gharar (uncertainty), maysir (gambling), prohibited commodities (liquor, pork, etc.) and fulfillment of contractual requirements as required in Fiqh Mu’amalat (Offer and acceptance, buyer and seller, subject matter and price) (Rosly, 2005).

In current practice, Shari’ah advisors and Shari’ah Supervisory Boards (SSBs) hired by various Islamic finance institutions constitute the only party responsible in determining Shari’ah compliant status of financial instruments. Their front-end role is namely issuing opinions on the legality of financial products offered by the Islamic banking, takaful, mutual funds, and wealth management business (Rosly, 2010). As the validity of Islamic contracts is established on the basis of Shari’ah compliance, Shari’ah scholars at the supervisory level have issued a set of Shari’ah rules and principles that must be fully observed by the contracting parties in their respective business engagement and contracts.

However, this technical process of determining Shari’ah legitimacy of financial instruments tends to overlook the financial reporting aspects of the transactions (Ibrahim, 2008). There is a growing branch of literature which calls for a review of the auditing practices of Islamic financial institutions as the existing conventional auditors fail to perform a Shari’ah audit of an institution while the Shari’ah advisors do not conduct an ex-post review of the product once they have issued their opinions ex-ante. Thus, the key motivation of this paper is to study the need for inventing the profession of Shari’ah auditing and how this role can be professionalized in the form of an international chartered body to reap economic benefits. The paper further argues how accounting and auditing services are being monopolized and exported all over the world by a few dominant players and why Malaysia is a good country to take lead in establishing a chartered Shari’ah audit body that can attain dominance in the export of Islamic accounting and auditing services.

Following this introduction, the paper presents an extensive discussion on what exactly is Shari’ah audit and why there is a need for inventing such a profession to provide accounting and auditing services to Islamic financial and non-financial institutions. Next, the paper critically analyzes the role of international accounting bodies in monopolizing the profession of auditing and how they are instrumental in reaping economic benefits by exporting their qualifications all over the world.

Moving on, the paper critically reviews the current Shari’ah accounting and auditing qualifications being offered by various institutions around the world and why they are insufficient to achieve the objectives of a holistic Shari’ah audit. The paper then moves on to argue the case for an international chartered Shari’ah accounting and auditing body and why Malaysia can be a good country to take lead and reap economic benefits from such a move. Finally, the paper lists down the various issues and challenges which are expected in this initiative and what are the limitations of this study. Conclusion and references make up the end of this paper.

2. What is Shari’ah audit?

In the sphere of financial auditing, Ibrahim and Mulyani (2007) argue that the establishment of Islamic financial institutions resulted in the creation of a new dimension of auditing known as Shari’ah audit. However surprisingly, one does not come across a standard definition of Shari’ah audit in literature and this could be mainly due to lack of sufficient attention dedicated towards this topic area (Sultan, 2007). There have been differences in what has been offered currently in literature with some proposing Shari’ah audit to imply analysis of organizational products, processes, and people to identify Shari’ah non-compliance risks (for e.g. see Sultan, 2007), while others have contended that Shari’ah auditors assume the full role of conventional auditors along with the added Shari’ah knowledge (for e.g. see Ibrahim, 2008). In this paper,
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