

Shariah Auditing for IFIs

The Central Bank seeks to promote development of the banking activities to ensure their effectiveness and efficiency. To achieve this, financial institutions that conduct all or part of their activities and businesses in accordance with the provisions of Islamic Shari`ah (“Islamic Financial Institutions” or “IFIs”) must comply with the requirements stated in this Standard when appointing a specialized external firm to conduct External Shari`ah Audit.

Definition:

Shariah auditing is defined as: “A process of examining and analyzing the activities, operations, and transactions of a specific institution by an independent entity to ensure they are conducted in accordance with the principles and regulations of Islamic Shariah, based on relevant fatwas. This is accomplished through the use of specialized professional techniques to determine the accuracy or errors in application and to provide reports to the concerned authorities with the aim of implementing necessary adjustments and enhancing performance.

Importance:

Shariah auditing is of utmost importance for Islamic financial institutions due to its numerous benefits that enhance service quality. Among its primary advantages are providing Shariah-based assurance and advisory services and helping institutions achieve their goals through a systematic and rigorous approach. Abdullah Atiyah (2015) states that Shariah auditing is a fundamental component of Islamic banking, serving as a protective shield against internal and external threats. The strength of this shield within Islamic financial institutions reinforces the stability of the national and global economy, increasing the confidence of investors (shareholders and depositors) and regulatory bodies. This is a key requirement pursued by various regulatory entities to enhance stakeholder trust, especially in the wake of global financial crises.

Moreover, activating Shariah auditing has a positive and effective impact on evaluating and developing the role of the Shariah supervisory board within Islamic financial institutions. The nature of the Shariah auditing process requires organizing the tasks of the Shariah fatwa and supervisory board and ensuring the quality of its performance to safeguard the institution’s activities from Shariah violations.

Tasks of the Shariah Auditor in Islamic Financial Institutions:

The tasks of the Shariah auditor in Islamic financial institutions include the following Examining and assessing the institution's compliance with the rulings and principles of

- Shariah based on the fatwas, guidelines, and directives issued by the Shariah fatwa and supervisory board. Monitoring all directives and decisions issued by the Shariah board.
- Discussing observations and issues identified by the internal audit department with relevant
- bank authorities before issuing the final report. Providing quarterly (or more frequent) reports that contain results from the institution's
- monitoring and examination, submitted to the relevant authorities as stipulated by regulations, with a copy also sent to the Shariah board. Ensuring the institution's departments comply with the Shariah board's directives, fatwas,
- decisions, and other regulatory bodies' guidelines

Internal and External Shariah Auditing:

Internal Shariah auditing is defined as: "A department within the Islamic financial institution, responsible for ensuring that the institution fulfills its obligations towards implementing Shariah principles and rulings as prescribed by the institution's Shariah board).

internal Shariah auditing is a component and tool of the internal Shariah supervisory system, consisting of an administrative unit within the organization's structure that includes internal Shariah auditors. This unit's function is to help corporate management verify the internal Shariah supervisory system's efficiency and effectiveness, ensuring that management complies with Shariah principles.

External Shariah auditing is defined as: "An audit conducted by an external Shariah auditor, aimed at assisting the Shariah board in forming an opinion on the institution's compliance with Islamic Shariah.

The distinction between internal and external Shariah auditing can be based on the organizational structure of the Islamic financial institution. Thus, any Shariah auditing unit that is subject to any administrative level within the institution's organizational structure for appointment, dismissal, compensation,

accountability, and reporting is considered an internal body — i.e., internal Shariah auditing. Any Shariah auditing unit that is appointed, dismissed, compensated, held accountable, and reports to the institution’s general assembly, which is outside the organization’s structure, is considered an external body — i.e., external Shariah auditing.

Differences Between Internal Shariah Auditing and External Shariah Auditing

Aspect	Internal Shariah Auditing	External Shariah Auditing
Objective and Scope	Improving and strengthening the internal control system and activating compliance	Certificate of Compliance and Strength of Internal Shariah Governance
Independence, Subordination, and Relationship with the Shariah Board	Not independent from the bank; administratively follows the bank and technically reports to the Shariah Board	Independent from the Bank, Reports to the Shariah Board, and Circulates to the Shareholder
Profession Organization	Does not exist	
Norms	Fatwas, guidelines from the Shariah Board and Fiqh Councils, and Shariah standards.	Fatwas, Guidelines from the Shariah Board and Fiqh Councils, and Shariah Standards
Supervision and Risks	Identifying Shariah risks and working to activate the internal control system to address them.	Identifying Shariah Risks and Measuring the Internal Control System's Ability to Address Them