



# Journal of Internet Banking and Commerce

*An open access Internet journal (<http://www.icommercentral.com>)*

*Journal of Internet Banking and Commerce, August 2017, vol. 22, no. 2*

## COMPETENCY OF SHARIAH AUDITORS: ISSUES AND CHALLENGES IN PAKISTAN

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### Abstract

**Purpose:** The Islamic financial system has a crucial necessity to manage the competency requirement including knowledge, skills and some other obligatory abilities to fulfill the increasing industry loads. This paper proposes a novel idea of knowledge, skills and other abilities (KSOA) for the framework of Shariah auditors that can enhance their current performance to improve the Islamic financial system.

**Design/methodology/approach:** The study is based on mix method to present a new model for Shariah auditors in the Islamic Financial Institutions of Pakistan. The

study has utilized the collection of information available in the previous literature. The study presented a model to be followed by IFI's while appointing Shariah Auditor based on their knowledge, skills and other related abilities. Extensive study of the literature has been undertaken to present the model.

**Research limitations:** This paper is a Pakistan based study, so situation may differ from that of Pakistan in other countries.

**Findings:** This article gives an overview of current situation regarding issues and challenges, concerning the competencies required for Shariah auditors in the Islamic Financial Industry of Pakistan. Literature review and study of practitioner's qualification shows that required knowledge about Shariah audit is still not established. It has been found that the internal auditors perform Shariah audit in IFIs in the light of Shariah governance framework given by State Bank of Pakistan (SBP). The study also resulted that most of Shariah auditors working in IFIs have no experience and qualification about Shariah audit and Islamic banking. Moreover the past study in Pakistan has not pointed the specific knowledge, skills and other abilities required for shariah auditors.

**Originality/value:** This paper is a value addition in the literature of Islamic finance which suggests that Shariah audit is one of the major concerns for the Islamic financial institutions of Pakistan. Therefore, the need of skillful and professional manpower which efficiently and effectively apprehends the both i.e. Shariah and Contemporary audit set of regulations has been established in Islamic banking industry of Pakistan.

**Keywords:** **Competency; Shariah audit; IFI's; Knowledge; Skills; Other abilities; KSOA**

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## **INTRODUCTION**

The increasing interest to understand Islamic financial system in the past two decades shows an enormous increase in the establishment of healthy Islamic banking system in Pakistan. According to the state bank of Pakistan (SBP) reported that the assets of the Islamic banks in September 2014 were 1102 billion rupees and their deposits recorded were 934 billion rupees. The market share of Islamic banking assets and deposits in overall banking industry increased 10.7 percent by the end of September 2014. In September 2015 the assets of Islamic banks reached to 1511 billion rupees and its deposits reached to 1271 billion rupees. The market share of Islamic bank's assets and deposits in overall banking industry reached up to 11.2 and 13.1 percent respectively.

The world financial crises also increased the growth of Islamic financial institutions and the assets of Islamic financial industry had grown 19 percent in 2011 and

21percent in 2012 as compared to less than 10 percent increase in conventional banking system across the globe [1]. This shows that consumers adopted Islamic financial industry cumulatively as compared to the conventional banking sector. It ascertains that there lie great possibilities for Islamic financial institutions (IFIs) to grow effectively. After all, the main aim of IFIs is to establish the Islamic values in all phases of financial matters. Any Islamic organization especially IFIs need to have consistent governance model and suitable policies that will boost the application of healthy and real corporate governance according to the principles of Shariah. All the stakeholders of Islamic banks such as account holders, investors, shareholders, employees etc., have a high interest to support the Islamic values and principles. The only way to protect and retain the stakeholder's interest is by confirming Shariah complaint processes and proposing Shariah complaint facilities. Accomplishing this purpose the process of Shariah audit is implemented by IFIs to increase the assurance of the stakeholder's credence regarding the system.

According to our best knowledge it has been observed that there is limited literature available discussing the phenomenon of set rules, process, qualification and competencies required for Shari'ah auditors to be deputed in IFIs. The Islamic financial system has a crucial necessity to manage the competency requirement including knowledge, skills and some other obligatory abilities to fulfil the increasing industry loads. This paper proposes a novel idea of knowledge, skills and other abilities (KSOA) for the framework of Shariah auditors that can enhance their current performance to improve the Islamic financial system.

## **OBJECTIVE OF THE STUDY**

This paper is a value addition in the literature of Islamic finance which suggests that Shariah audit is one of the major concerns for the Islamic financial institutions of Pakistan. Therefore, the need of skillful and professional manpower which efficiently and effectively apprehends the both i.e. Shariah and Contemporary audit set of regulations has been established in Islamic banking industry of Pakistan.

## **LITERATURE REVIEW**

Competency is the capability which leads the person in an organized way to make the procedure of identification, evaluation and development of behaviors comfortable (The IIA Global internal Audit competency formwork 2014). Competency can be categorized as the measurements of different activities linked to the better individual performance [2]. Furthermore, it is related to the knowledge and some technical skills to do a job with professional attitude. It is noteworthy to know that competency can be general or organization specific. Drejor divided the competency in four different types 1) Competency in the form of technology 2) Human resource 3) Organization 4) Informal organizational culture of the companies. This infers that competency belongs to the abilities of individuals with potential to achieve some goals in the organization and complete different tasks in the given time frame.

According to Mensoori, the auditor needs to put emphases on accounting and

auditing professional program to certify that they are up-to-date and can address the contemporary challenges. It is mandatory for a person performing audit and prepare the report must have the adequate knowledge and corresponding experience [3]. It shows that they should get both formal and informal training during their whole careers. Noor argues that for the success of any profession the following three points are essential, advance information, continuous professional education and minimum level of professional qualification. The auditors are required to triumph these three points through professional education of audit, research and training programs. According to Moutz and Sharaf, a careful auditor is expected to have a deep knowledge, experience and skills of executing work independently.

## **PROFESSIONAL COMPETENCY**

It is expected that auditors have to establish an extensive scope of competencies. From the perspective of accounting profession, the guideline on the international education standard (IES 8) of international federation of accountants (IFAC) is the required competence for auditors which summarizes formal audit education(IES 2), professional skills(IES 3) and ability of applying professional expertise, morals, principles and ethics in diverse conditions and organizations (IES 4). On the basis of these guidelines it could be inferred that competency is the amalgamation of knowledge, skills and abilities, which is the base to measure the general competency of the auditor.

The institute of internal auditor research foundation (IIARF), which is the part of institute of internal auditors (IIA), a regulatory body of internal auditors, conducted a comprehensive research in 2011 to 2013 to find the stakeholder's opinion on the competency of internal auditors. Through this study it was observed that either competency valued higher or lower, exposing a major gap among internal auditors and stakeholders. This research also showed that the high rating competency components were objectivity, confidentiality, professionalism and ethics as opposite to lower rating for negotiation skills, data collection, business analysis and analysis tools and techniques. Beside this the traits in which the stakeholders give internal auditors lower rating then the internal auditors themselves was understanding the business process, nature of business and problem solving skills. It is very interesting that in some areas the stakeholders view the internal audit performance higher than the internal auditors themselves (IIARF).

Previous research showed that a big multinational audit organization provide audit quality [4,5]. Because of greater audit ability the large audit organizations provide a better audit quality. Pickett [6] outlines several internal auditing competencies for the internal auditor of the companies to be able to face the changes in their working environment.

To achieve the continuous development the companies must have to develop in-house development program and they also need to improve their personal audit competencies. Pickett [6] also suggests that competency may be attained through the interaction of three elements, termed as three circles approach i.e. 1) Auditing

Standards 2) Auditing Products 3) Organization risk management strategy. Furthermore, the organizations must have to arrange training programs for their audit staff to make them compatible with the changing working environment.

## **SHARIAH BASED HUMAN COMPETENCY**

A suitable human capital is an essential part to support the validity of Islamic financial product and services. In addition, the accessibility of the trained human resource to produce sufficient groups of suitable Shariah professionals and experts is important to lead Islamic financial services and products [7]. Natt, et al. [8] argues that in the light of Shariah perspective a person must have a deep understanding and robust commitment to the basics of Islamic philosophies and ideologies. Different Islamic countries adopt different accounting standards so it is a crucial task for the coming accounting graduates to learn different accounting standards whilst IFIs chart different accounting standards. For instance, the study of El Razik [9] shows that different Muslim countries used different accounting standards because of their different culture and business environment, and also we have to produce proficient graduates from Pakistan if we expect them to understand the international accounting standards and also the standards used by different Muslim countries however, they want to work out of Pakistan. The production of the experts and graduates having well knowledge of accounting and Shariah at same time before they enter the corporate industry is also a big challenge for academicians and scholars. This suggestion is also recommended by Abdul Rahman [10] and Price Water House Cooper (PWC) survey conducted in 2011. They propose an increase in the human capital capable Shariah audit. The past empirical findings also suggest that it is necessary for accounting apprentices to read Shariah audit as a part of their syllabus. To fulfil this high demand the IFIs and the academia are advised to design new courses and training programs.

## **GENERAL COMPETENCY DIMENSIONS**

The issues of competency have been discussed by different researcher in different disciplines. The technological revolution has set new goals for the employees to update their skills, knowledge and abilities accordingly [11]. Emotional and social competencies with cognitive intelligence can foresee the efficiency of leadership, professional and management responsibilities in many area of society [12]. Majority of financial professionals are unable to practice sharia concepts because of the conventional background, which might lead to clash of interests [13]. To produce competent Shariah auditors and to make additional parameters to address the Shariah audit problems, it is suggested to spend on educational facilities. According to a study by Kaseem and Muhammad Sanusi [14] entitled "Issue of auditor qualification in Malaysia" it was observed that only 5.9% respondent were there who qualified in both Shariah and auditing or accounting qualification as compared to 69% who claimed to work in IFIs as Shariah auditors.

Another research accompanied by Yahya and Mahzan [15] also supported the

results, according to which 76% of internal auditors who practice Shariah audit have no knowledge of Islamic financial system. It was found that almost 39% of Shariah auditors have 10 to 12 years' experience of conventional banking and only 6% of them have 10 to 12 years' experience of Islamic banking. This points out the problem of unsatisfactory skilled human resource of Shariah auditing, which needs to be resolved that might affect the image of IFIs to all financial users. In order to perform a comprehensive Shariah audit of IFIs, it is of utmost importance for Shariah auditors to have deep Shariah knowledge of Islamic financial system.

## METHOD

The study is based on mix method to present a new model for Shariah auditors in the Islamic Financial Institutions of Pakistan. To achieve the objective of the study we used Questionnaire and Interviews of the different people involve directly or indirectly in the process of Shariah audit. This study has also utilized the collection of information available in the previous literature. The study presented a model to be followed by IFI's while appointing Shariah Auditor based on their knowledge, skills and other related abilities. Extensive study of the literature has been undertaken to present the model.

## DISCUSSIONS FINDINGS AND MODEL

There are three main elements related to the competency of Shariah auditors. These are knowledge, skills and other abilities. On the basis of this study (Questionnaire + Interviews) in IFIs working in Pakistan, more than 80 percent practitioners are qualified only in accounting and auditing or in Shariah and only 20 percent have Shariah, accounting and auditing qualification at same time. In addition to that 90 percent Shariah auditors having only 3 to 5 years' experience of Islamic banking.

**Table 1:** Descriptive statistics.

Aggregate mean values		Variance	
Desired Qualification	The "Actuals"	(Gap)At 5 Rating	(Gap)At 4 Rating
(5-4) A shariah auditor must be expert of accounting and shariah knowledge	(1.05) Ratio of the working Auditors	3.95	2.95

This shows the situation of competent Shariah auditor is not good in Pakistan. Below Table 1 shows the analysis of the data collected from a total of 70 out of a total of 100 questionnaires which were distributed among the Shariah auditor involved directly or indirectly in the audit of Islamic Financial Institutions, and Table 2 shows the result of interviews of the Shariah Auditors. The analysis was made on the basis of mean values and the variance on the standard of Strongly Agree (5.00) and Agree

(4.00) which is tabulated as under.

**Table 2:** Interviews.

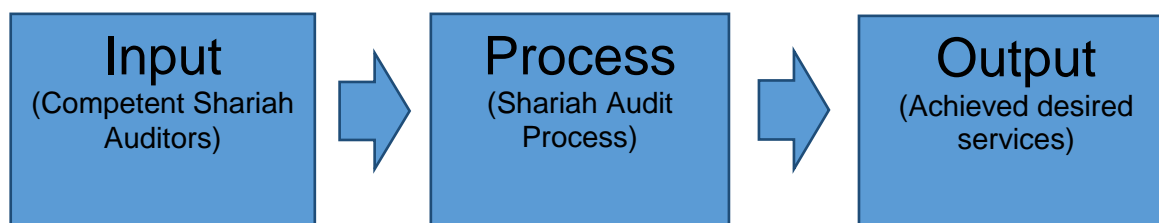
Opinion on Desired		Actual Practice	
Internal Auditors	External Auditors		
Only Shariah Qualified people should done Shariah audit.	It is an Internal matter.	1) Internal Auditors with both Qualification	1) Only 2
	External Auditors should not involve in it.	2) Management of Shariah Unit	2) Only Shariah Qualified
		3) Team work of Sharaih Unit and Internal auditors	3) Only Few
		4) Internal Audit Department doing Shariah Audit alone	4) None
		5) External Auditors doing Shariah Audit	5) None

The above descriptive statistical results were found for the Qualifications of the Shariah auditors. This point toward the total difference between what is and what is desired Qualification of Shariah auditors in IFIs of Pakistan.

### SHARIAH AUDIT PROCESS

Figure 1 gives a planned synopsis of the process of shariah audit. The ultimate target of this audit is to ensure shariah based products and services for the customers and conforming to Maqasid al sharia, which is for the elimination of Haram and hardships for the protection of public interests [16]. In order to complete a successful audit process some features such as regulation and human capital must have to inject in the first step which is input.

**Figure 1:** Shariah Audit Process.



This paper focuses on the first step especially on the competent human capital to implement proper and strong Shariah audit process. In the 2<sup>nd</sup> step the competency will be explained briefly as to cover knowledge, skills and other abilities, abbreviated as KSOA in the paper. The 3<sup>rd</sup> and last step is output which is the result of the

Shariah audit process. This process comprises audit planning, documentation, review and result submitting. If such audit model is designed to get Maqasid al Shariah and to fulfill the needs of stakeholder regarding Islamic banks, the only preferred Output in the form of achieved desired services can be delivered successfully.

### Competency Requirements for Shariah Auditor

**Figure 2:** Suggested factors of KSOA Model.

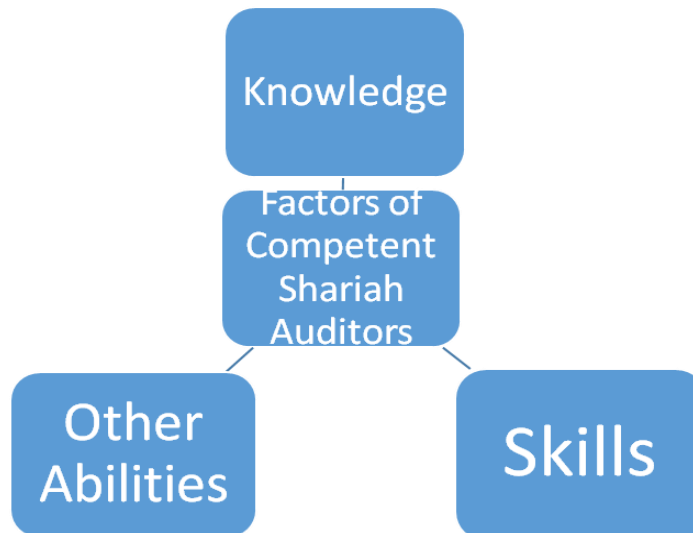


Figure 2 gives a planned overview on suggested factors of the KSOA model about competent Shariah auditors. The following discussion will bring the detail information about these factors.

#### Knowledge

“Merrriam web star Lerner dictionary” defines the knowledge as, Information, understanding or skills that you get through experience or education: awareness of something: the state of being aware of something. So generally knowledge is the understanding of something but in the perspective of Shariah auditor it can be general and specific. The general knowledge means the formal education based on the syllabus which Student get through their college and university. Natt et al., [8] suggest two type of knowledge for a Muslim worker, i.e. revealed and acquired knowledge. The acquired knowledge means the knowledge that a person gets through his learning years in different institutions while revealed knowledge means the main source of knowledge revealed by Allah. To produce knowledgeable and well balanced worker to perform in Islamic financial institutions is possible only in one case when both acquired and revealed knowledge are implanted in human capital development and training programs. The required education for Shariah auditors in Pakistan can be classified in two categories i.e. University education and Madrassa education. General education obtained from universities is helpful in various disciplines in Islamic banking. But unfortunately there is no university in



Pakistan offering Shariah audit in their accounting degree. Recently the only specific education by which competent Shariah auditors can be produced is the combination of madrassa and university education or some other agencies providing training about Shariah audit like Darululoom Karachi, Alhuda center of Islamic banking and economics (ACIBE), and center for Islamic economics Karachi.

The research institute of internal auditors IIARF (International internal auditor's research foundation) conducted a survey from the whole world to regulate their own common body of knowledge (CBOK) in 2006 and 2010 on the internal auditors. They want to document how internal auditors are practicing and they also want to find out the internal auditor's focuses area of knowledge.

## **Skills**

Business dictionary defines the skill as "An ability and capacity acquired through deliberate, systematic, and sustained effort to smoothly and adaptively carryout complex activities or job functions involving ideas (cognitive skills), things (technical skills), and/or people (interpersonal skills)." Hoffman, Hampe and Muller [17] also support this idea they discovered the skills in two forms 1): Cognitive; involving creative and logical thinking 2): Practical; involving in the using of resources and methods. Wodruff suggested that for a competent worker, technical and communication skills are very impartment. As an internal auditor it is very necessary for Shariah auditors of Islamic financial institutions to gain the knowledge by which they become able to understand all types of transaction being occurred in their institutions, and then they will be able to protect their organization from all non Shariah compliance product and services. To achieve this phase their knowledge must have to exceed the knowledge of conventional internal auditors about banking process. CBOK [18] (Common Body of Knowledge) divide the skills into two core classes, the first one is technical skills and the 2nd one is behavioral skills. Then they also recognized the five core technical skills i.e. understanding of business, governance, recognizing kinds of control, risk analysis and control valuation technique, risk and control tools and technique business process analysis. CBOK [18] also categorized behavior skills into five core skills i.e. ethics sensitivity, objectivity, communication, confidentiality and judgment besides governance (IIARF).

## **Other Abilities**

It means the behavioral aspects of an individual which should be definitely differ from other individuals [17]. The institutions who want to hire best candidates for their professional vacancy they must have to build such recruitment process which should be able to identify such traits in junior candidates with the help of psychological test [18-21].

Generally for both internal and external auditor's combination of these three components are necessary to produce competent Shariah auditors. A competent Shariah auditor must have to gain basic Shariha knowledge about Fiqh ul Muamlat

and Shariah audit for understanding and scrutiny of banking documentation. Current education system in universities is not able to produce competent Shariah auditors because no university in Pakistan have Shariah audit subject in their graduate's curriculum. In a right sense Shariah audit cannot be adopted by the Shariah auditors during their job without these three elements discussed earlier [22-25].

## CONCLUSION

This article gives an overview of current situation regarding issues and challenges, concerning the competencies required for Shariah auditors in the Islamic Financial Industry of Pakistan. Literature review and study of practitioner's qualification shows that required knowledge about shariah audit is still not established. It has been found that the internal auditors perform shariah audit in IFIs in the light of Shariah governance framework given by State Bank of Pakistan (SBP). The study also resulted that most of Shariah auditors working in IFIs have no experience and qualification about Shariah audit and Islamic banking. Moreover the past study in Pakistan has not pointed the specific knowledge, skills and other abilities required for Shariah auditors.

After developing the CBOK, the academia will be clear about how to produce competent Shariah auditors so that the profession of Shariah audit gets its importance in the market.

This study recommended is for Shariah auditors to get more and more knowledge and exposure about Shariah audit through different training programs conducted by different organizations. This study also advised the academia to offer Shariah audit courses with other courses of Islamic finance to produce competent Shariah auditors and fulfill the needs of future.

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