

Sharīʿah Audit and Supervision in *Sharīʿah* Governance Framework: Exploratory Study of Islamic Banks in Pakistan¹

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Abstract

Sharīʿah governance in Islamic banking institutions is as essential and significant as corporate governance in modern corporate organizations. It consists of arrangements ensuring the compliance of *Sharīʿah* rules and principles in Islamic banking transactions. The objective of this paper is to investigate the *Sharīʿah* audit mechanism and the challenges faced by Islamic banking institutions after the implementation of *Sharīʿah* governance framework issued by the State Bank of Pakistan (SBP). Our findings suggest that although *Sharīʿah* audit is considered as a distinctive activity from conventional audit, still more training will be required for external audit firms and employees of IFIs. Our study also concludes that the idea of SBP *Sharīʿah* board is a right step towards the future conflict resolution; however, this governance framework may have certain financial implication for IFIs.

Keywords: *Sharīʿah* audit, *Sharīʿah* governance, *Sharīʿah* supervision, Islamic financial institutions (IFIs).

1. Introduction

Islamic financial institutions after four decades of contribution in financial industry have emerged as a strong competitor of conventional financial system. Unique and ethical banking made this industry to grow fast and ensure a broader customer base. Islamic financial institutions (IFIs) provide a viable option to savers and investors who are inclined to deal exclusively with Islamic financial system given

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their religious and ideological stance. With this sort of unique banking framework and emerging industry, activities should be monitored and filtered continuously by *Sharī'ah* guidelines (Haqqi, 2014).

Every organization is supposed to be supervised and regulated according to some standards, the so-called governance standards. Similarly, Islamic financial institutions also need to be regulated and monitored in order to augment and strengthen its workings (Shaharuddin, 2011). Prevailing corporate governance does not fulfill this requirement in the context of Islamic financial institutions, due to their distinctive form of activities and so *Sharī'ah* governance framework comes in play. *Sharī'ah* governance is responsible to ensure the compliance of *Sharī'ah* principles in the products, instruments, operations, practices and management of Islamic financial institutions. *Sharī'ah* governance is entrusted to increase transparency and disclosure, intensify professionalism, and improve oversight of the Islamic financial institutions. It is believed that such governance mechanism would escalate the credibility of Islamic financial institutes.

The objective of audit is to provide an objective independent opinion on the financial statements of an organization. Audited financial statements guarantee absence of material misstatement, its true and fair view, and presence of going concern assumption of the entity (Kasim & Sanusi, 2013). The *Sharī'ah* audit discloses similar functions to the company audit but is more focused on the compliance of Islamic financial institutions to *Sharī'ah* precepts and requirements. The *Sharī'ah* audit is supposed to certify that the Islamic financial institutions have rigorous and effective internal control systems to conform to the *Sharī'ah*.

The State Bank of Pakistan has recently issued a *Sharī'ah* governance framework for Islamic financial institutions. Considering the importance of *Sharī'ah* governance framework in uplifting the Islamic finance industry to next phase, there is a need to look into *Sharī'ah* audit mechanism and, the effects and challenges faced by Islamic banking institutions after implementation of *Sharī'ah* governance framework.

This study intends to investigate an important part of *Sharī'ah* governance framework, i.e. *Sharī'ah* audit. This study focuses on surveying the perception of different stakeholders of Islamic banking institutes in context of post application of *Sharī'ah* governance framework and its effects. Fulfillment of this objective is the novel contribution of this study, which shall be beneficial for all the stakeholders including policy makers to develop and improve better audit mechanism in existing *Sharī'ah* governance framework.

2. Literature Review

The history of governance with reference to corporation can be traced back to Watergate scandal during Nixon presidency in the US. However, the term corporate governance gained attention of policy makers and researchers after various high-profile financial scandals and business failures such as Enron and WorldCom in the US. There was not a single way of describing a firm and explaining the role of governance within it. Shleifer and Vishny (1997) explain corporate governance in the ways through which suppliers of finance to corporations assure themselves of getting a return on their investment. A more comprehensive definition of corporate governance is provided by John and Senbet (1998) which deals with mechanisms by which stakeholders of a corporation exercise control over corporate insiders and management such that their interests are protected. They include stakeholders, debenture holders and even non-financial stakeholders such as employees, suppliers, customers, and other interested parties.

Haqqi (2014) argues that corporate governance for Islamic financial institutions is unique as it depends on two basic approaches. First approach is faith-based that mandates conduct of the business in accordance with *Sharī'ah* principles. Whereas the second approach relates to profit-motive based on maximization of shareholder's wealth.

Sharī'ah governance is as much important as corporate governance and it is the concept used to evaluate the compliance of financial transactions of Islamic financial industry with *Sharī'ah* rulings and principles in order to ensure the confidence of Islamic finance industry in the eyes of its stakeholders (Haqqi, 2014).

Sharī'ah governance is a complete set of framework which provides not only the guidelines for compliance of Islamic banking practices with *Sharī'ah*, but it also provides a detailed framework of duties and responsibilities of all the concerned stakeholders of this department. In Islamic financial institutions, *Sharī'ah* governance mostly refers to the management, establishment, and affairs of the *Sharī'ah* committee (Shaharuddin, 2011).

Good *Sharī'ah* governance guarantees the dynamicity of Islamic financial growth. The ultimate purpose of *Sharī'ah* governance and all the departments which comes into existence due to *Sharī'ah* governance in Islamic financial institutions is to ensure *Sharī'ah* compliance to its operations and products (Hasan, 2007). *Sharī'ah* audit is a mechanism to ensure the *Sharī'ah* compliance in Islamic Banks (AAOIFI, 2008). *Sharī'ah* audit is as an audit attestation for *Sharī'ah* compliance (Yahya & Mahzan, 2012). State Bank of Pakistan and Bank Negara Malaysia has issued guidelines for *Sharī'ah* compliance and *Sharī'ah* Governance framework. (Yahya and Mahzan, 2012)

have conducted research to explore the practical model defining issues such as scope, extent, audit reporting, qualifications as well as current practices and understanding of *Shari'ah* auditing in Islamic financial institutions through questionnaire.

In Pakistan, the *Shari'ah* governance framework was issued in 2014 which was implemented in 2015. To the best of authors' knowledge, there is no comprehensive study available with respect to *Shari'ah* audit or *Shari'ah* governance in Pakistan. In this situation, this study is supposed to be seminal contribution in investigating the said subject with specific reference to *Shari'ah* governance framework 2014. This study focuses on surveying the perception of different stakeholders of Islamic banking institutes in context of post application of *Shari'ah* governance framework and its effects.

3. Islamic Banking and *Shari'ah* Governance

After the independence of Islamic Republic of Pakistan, many *Shari'ah* scholars, economists started working for the emergence of Islamic finance; however, a formal work for Islamic banking was started during 1979 after the Presidential order to eliminate Riba (interest) from the economic system. The Council of Islamic Ideology (CII) was given the task to provide an alternative Riba free economic system. In light of report submitted in 1980, the State Bank of Pakistan issued a circular to all banks working in Pakistan to switch their interest based products to Islamic Modes of financing recommended by CII till 1981. The CII recommended different modes of financing i.e. participatory modes, trade based, rental based but it was observed that banks adopted only markup financing.

However, the financing procedure based on 'mark-up' practiced by banks was declared un-Islamic by the Federal *Shariat* Court (FSC) in November 1991 but on appeal to the *Shariat* Appellate Bench of Supreme Court the 1991 FSC ruling was suspended till orders of the court. The Supreme Court's *Shariat* Appellate Bench delivered its judgment in December 1999 with the directions that laws involving interest would cease to have effect by June 30, 2001 and later the date was extended to June 30, 2002. However, on a review petition filed by a bank, *Shariat* Bench of the Supreme Court set aside the previous verdicts on Riba in June 2002 and remanded back the case to Federal *Shari'at* Court for hearing afresh.

During the same time, the government decided to promote Islamic banking in a gradual manner as a parallel and compatible system. The initiative to re-introduce Islamic banking in Pakistan was launched in early 2000 to shift to interest free economy through a market driven and flexible approach, in a phased manner without causing any disruptions. A comprehensive regulatory framework including *Shari'ah* Governance framework has been introduced for the development of Islamic banking industry on sound footings.

Sharī'ah governance is as essential and significant as corporate governance in any entity. It is the procedure which determines the compliance of Islamic business and practice of any Islamic financial institutions. IFSB⁵ (2009) has provided a comprehensive definition of Sharī'ah governance system:

“a set of institutional and organizational arrangements through which the Islamic financial institutions ensure that there is effective independent oversight of Sharī'ah compliance over the issuance of relevant Sharī'ah pronouncements, dissemination of information, and an internal Sharī'ah compliance review”

Sharī'ah governance helps Islamic financial institutions to show a credible and sound image in front of the stakeholders whereas Sharī'ah rules and principles are the justification of existence of Islamic financial institutions, as history has shown that improvement in Sharī'ah governance can assist in swift development of Islamic financial institutions (IFSB, 2009).

The Sharī'ah governance framework includes guidelines for the stakeholder of Sharī'ah supervisory board, Sharī'ah auditors, and internal Sharī'ah audit unit. Appointment of an effective and independent Sharī'ah advisory board as per fit and proper criteria, accountability of executive management in implementation of governance frameworks, Sharī'ah compliance review mechanism, Sharī'ah compliance unit serving as conduit between Sharī'ah board and management of the Islamic bank, establishment of independent Sharī'ah audit unit and undertaking external Sharī'ah audit are the fundamental requirements mentioned in Sharī'ah governance framework to be fulfilled by Islamic financial institutions. Every segment lays a block in building a stronger and more credible Islamic banking industry under the guidelines of Sharī'ah governance.

Malaysia can be considered as the leading country in the development of Islamic banking industry. In any context whether it is research, product development, regulatory frameworks or practical steps, Malaysian Islamic finance industry is always a step ahead from the rest of the world. In view of this, it would be appropriate to mention the Sharī'ah governance framework designed by Malaysian authorities.

Sharī'ah advisory council is the sole Sharī'ah authority in Islamic finance of Malaysian Islamic Finance Industry and operates as an independent entity. Key objectives of Sharī'ah governance framework includes; establishment of the rules, regulations and procedures for Sharī'ah committee, role, scope of duties and responsibilities of Sharī'ah committee, working arrangements, relationship between Sharī'ah committee and Sharī'ah advisory council of Bank Negara Malaysia. These guidelines are applicable to all Islamic financial institutions regulated and supervised by Bank Negara Malaysia.

5 The Islamic Financial Services Board (IFSB), which is based in Kuala Lumpur, established in November 2002, It serves as an international standard-setting body of regulatory and supervisory agencies.

4. Scope and Definition of Sharī'ah Audit

Sharī'ah Governance and audit are very important elements of Islamic banking system for accountability and transparency of *Sharī'ah* rules and principles in Islamic banking transactions. The *Sharī'ah* audit in Islamic financial institutions assures the stakeholders regarding compliance of *Sharī'ah* rules and principles in products and services of the IFI. The AAOIFI⁶ (2008) narrates *Sharī'ah* audit in following words;

“Expression of opinion on financial statement that need to be prepared in all material respects, in accordance with the fatwas, rulings and guidelines issued by the SSB, accounting standards of the AAOIFI⁶, national accounting standard and practices, and relevant legislation and regulations applied in the country”.

Sharī'ah compliance audit enables the *Sharī'ah* auditor to express an opinion that, the operations of Islamic financial institutions (IFI) are in accordance with *Sharī'ah* rules, fatwas, guidelines issued by the *Sharī'ah* Supervisory Board (SSB) of the IFI. On the other hand, *Sharī'ah* review is an examination of the level of an IFI's compliance in all its activities with the *Sharī'ah*. The examination in *Sharī'ah* review includes contracts, agreements, transactions, products and policies. The *Sharī'ah* review enables the *Sharī'ah* auditor or *Sharī'ah* committee to ensure that the activities carried out by an IFI do not violate the *Sharī'ah* principles through its operations. The *Sharī'ah* Advisor prepares a report in the bank's annual financial statement in respect of its *Sharī'ah* compliance.

Shafii, Abidin, and Salleh (2015) argue that the main difference between *Sharī'ah* audit and financial/statutory audit is that the financial audit which enables the auditor to express his opinion on the financial report reflects true and fair view, whereas *Sharī'ah* audit focuses on assurance of the overall activities and operations of the IFIs to be in line with the *Sharī'ah* rules and principles.

5. *Sharī'ah* Governance Framework Issued by the State Bank of Pakistan

Due to the importance of *Sharī'ah* compliance in Islamic banking industry, the State Bank of Pakistan (SBP) has issued guidelines to strengthen the overall *Sharī'ah* compliance environment in Islamic banking institutions. The establishment of a separate Islamic banking division (IBD) at State Bank of Pakistan was an important step in this direction. The IBD-SBP issued a detailed set of regulations and guidelines on *Sharī'ah* compliance in 2008 vide circular No. 2 of 2008. In 2014, SBP revised the

⁶ The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is a Bahrain based Islamic international autonomous non-for-profit corporate body that prepares accounting, auditing, governance, ethics and *Sharī'ah* standards for Islamic financial institutions established in 1991.

guidelines of *Sharī'ah* compliance keeping in view the fact that Islamic banking has grown enormously in these years. The framework is applicable to all Islamic banking institutions i.e. full-fledged Islamic banks, Islamic banking subsidiaries, and Islamic banking division of conventional banks.

Prior to implementation of this *Sharī'ah* Governance Standards by SBP in Pakistan, the *Sharī'ah* audit was only in practice under the supervision of *Sharī'ah* advisor. According to State Bank's Circular issued on 25th March 2008, the duties of the *Sharī'ah* advisor includes review of operations of the Islamic banking institutions on periodic basis in coordination with official staff responsible for *Sharī'ah* compliance to ensure that all the products and services being offered by the Islamic bank conform to the injunctions of *Sharī'ah* rules and principles. On the basis of this *Sharī'ah* audit, the *Sharī'ah* advisor prepares a report which was published in the annual report of the Islamic financial institution. According to latest *Sharī'ah* Governance Framework, all Islamic banking institutions are required to conduct *Sharī'ah* Compliance review, internal *Sharī'ah* audit and external *Sharī'ah* audit.

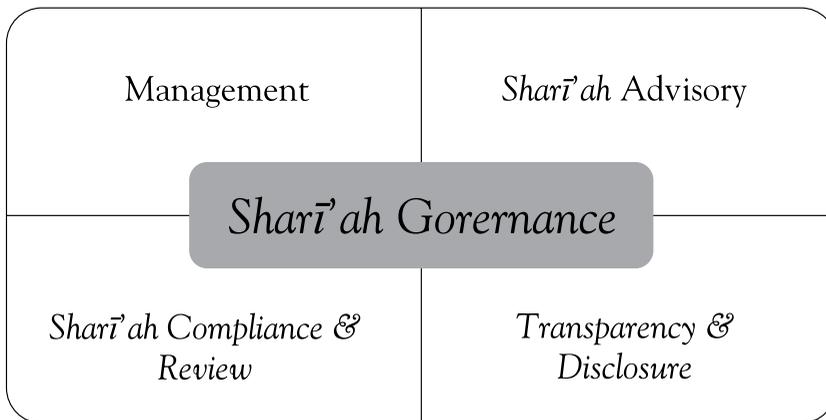


Figure 1. Source: (Minhas: 2012)

5.1. Sharī'ah Compliance Review

According to the *Sharī'ah* Governance Framework, hereafter SGF, implemented by SBP, every Islamic banking Institution is required to establish a *Sharī'ah* Compliance Department (SCD) headed by a full-time two Resident *Sharī'ah* Board Members (RSBM) or a suitably qualified, trained, and experienced officer recommended by the *Sharī'ah* Board. The *Sharī'ah* compliance department (SCD) shall work under the supervision of the *Sharī'ah* Board and departmental head shall report to the *Sharī'ah* Board. The SCD shall ensure the *Sharī'ah* compliance environment in IBI's including Board of Director, internal *Sharī'ah* audit, and enforcement of SB instructions by the

management.

In order to ensure and monitor IBI's operations comply with *Shari'ah* principles and other guidelines/fatawas issued by *Shari'ah* Board and SBP, the SCD is required to conduct *Shari'ah* internal control review under the supervision of RSBM/*Shari'ah* Advisor. On the basis of which the RSBM/*Shari'ah* Advisor shall submit a report to the *Shari'ah* Board that includes the status of overall *Shari'ah* compliance environment in the IBI.

5.2. Internal *Shari'ah* Audit

The basic objective of the *Shari'ah* audit is to ensure that the transactions carried out by the Islamic financial institutions are in compliance with *Shari'ah* rules and regulations and there is no prohibited element involved, i.e. Riba (interest), Qimar (gambling), and Gharar (uncertainty). A strong *Shari'ah* Governance and audit framework will increase the confidence of stakeholders of the IFIs and minimize the risk of *Shari'ah* non-compliance (Shafii, Salleh, & Shahwan, 2010). In the light of SGF all Islamic banking institutions are required to establish an Internal *Shari'ah* audit Unit (ISAU). The department may be part of internal audit department (IAD) or an independent unit depending on the size of the bank. The *Shari'ah* audit staff should be qualified and dedicated only for *Shari'ah* audit. The *Shari'ah* audit manual, its scope, program, methodology and checklists/work must be approved by the *Shari'ah* Board and audit committee. On the basis of *Shari'ah* audit, a report of internal *Shari'ah* audit shall be submitted to *Shari'ah* Board for recommendations and proper enforcement actions.

The AAOIFI has also issued detailed governance standards on internal *Shari'ah* review. The objectives of these standards are similar to the SGF issued by the State Bank of Pakistan. AAOIFI (2008) narrates internal *Shari'ah* review as follows;

“The internal Shari'ah review shall be carried out by an independent division/department or part of the internal audit department, depending on the size of an Islamic financial institution (IFI). It shall be established within an IFI to examine and evaluate the extent of compliance with Islamic Shari'ah rules and principles, fatawas, guidelines, and instructions issued by the IFI's Shari'ah supervisory board (SSB), hereafter referred to as Shari'ah rules and principles. The main objective of the internal Shari'ah review is to ensure that the management of an IFI discharges their responsibilities in relation to the implementation of the Shari'ah rules and principles as determined by the IFI's SSB.”

5.3. External *Shari'ah* Audit

After internal *Shari'ah* audit, need arises to have an independent assessment to

ensure *Sharī'ah* compliance environment in IBI. In this regard, it is mandatory for IBI's to have an external *Sharī'ah* audit after implementation of SGF. The scope of this audit is to ensure the IBI's operations with *Sharī'ah* rules and principles, which will be limited to assessing *Sharī'ah* compliance in contracts, transactions, and financial arrangements, according to following sequence:

- a. All the instructions, regulations, guidelines of the State Bank of Pakistan regarding *Sharī'ah* Compliance and the AAOIFI *Sharī'ah* standards adopted by SBP.
- b. The Fatawas and ruling issued by the *Sharī'ah* supervisory board of the State Bank of Pakistan.
- c. The Islamic Financial Accounting Standards (IFAS) notified by the Securities and Exchange Commission of Pakistan (SECP);
- d. The Fatawas and ruling issued by the *Sharī'ah* supervisory board of IBI

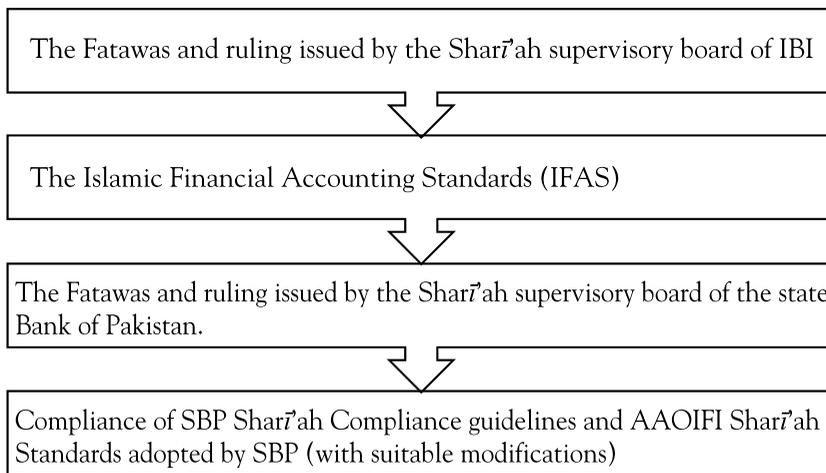


Figure 2. (External *Sharī'ah* audit Structure)

On the basis of the assessment of the IBI's transactions, contracts etc. the external auditors shall prepare a report for the BOD regarding *Sharī'ah* compliance environment which will be published in the annual financial statements. Besides, according to AAOIFI (2008), there is no need for separate external *Sharī'ah* audit but they believe that the annual financial audit will also ensure *Sharī'ah* compliance in IBI.

“When testing for Sharī'ah compliance, the auditor shall obtain sufficient appropriate audit evidence that provides the auditor with reasonable assurance that the Islamic financial institution (IFI) has complied with Islamic Sharī'ah rules and principles... There are no material

misstatements in the financial statements taken as a whole. Reasonable assurance relates to the whole audit process”

6. Research Design

This study intends to investigate the perception about the impact of *Sharī'ah* Governance Framework (SGF) on auditing activities in Islamic banking institutions. To gain insight on this issue, research was designed on the basis of survey.

The survey consisted of two parts. First part was comprised of demographic and other related information of respondents, for example gender, experiences, status/job designation (students, employed etc.), qualification etc. Other important related questions include whether respondents are employed in full-fledged Islamic Bank or otherwise. Two questions were related to respondents' basic theoretical understanding about accounting and auditing, and also whether they have any *Sharī'ah* qualification.

Second part of survey consisted of eighteen questions, out of which six questions dealt with the perception of respondents about *Sharī'ah* audit and its gulf with conventional financial audit. Two questions were focused on the importance of *Sharī'ah* audit in SGF. Remaining questions were related to important clauses of SGF related to *Sharī'ah* audit e.g. *Sharī'ah* audit manual, internal control review by *Sharī'ah* Compliance Department and assessing the cost of *Sharī'ah* non-compliance risk among others.

Data collection through questionnaire is generally subject to various limitations and may cause results to be biased. For example, sometimes, the respondents may provide response blindly without much thinking because of other competing urgent tasks. We have taken two important steps while collecting responses from respondents. First, the questions were not asked according to their construct, but shuffled to avoid bias. Secondly, three questions in eighteen questions were inverse questions, just to identify whether respondents are blindly answering the question or thoughtful responses are being delivered.

Approach of convenience sampling was used for identification of respondents. Questionnaires were provided to prospective respondents through email and in person/paper as well. One pre-condition, set by researchers for appropriate respondents, was that the respondents must have knowledge about *Sharī'ah* Governance Framework issued by State Bank of Pakistan. The authors incentivized all respondents by promising them to provide and share the results and final copy of this study. Authors believed that our respondents being related to Islamic banking industry would be interested in the results. The process of data collection started in mid-December 2015 and continued till end of January 2016.

7. Analysis and Discussion

Authors contacted a total of 120 respondents through email, telephone and in person whereas a total of 106 responses were received. Out of 106 responses, 19 were received online through Google docs whereas 87 were collected in person out of which

Table 1: Descriptive Statistics of Respondents

Total Questionnaire Received		106	Online, 19; Paper, 87
Usable questionnaire		69	Male, 51 (74%)
Sharī'ah Advisor	02 (Male, 02)		
Internal Auditors	15 (Male, 09)		
External Auditors	12 (Male, 08)		
Sharī'ah Compliance Dept.	17 (Male, 17)		
Academia	23 (Male, 15)		
None of above	0		
Respondents studied Accounting/auditing related course		65 (94% of respondents)	
Respondents having Sharī'ah qualification		63 (91% of respondents)	

only 69 (65%) were found usable. Out of 37 rejected responses, 18 were rejected because respondents mentioned their lack of knowledge about *Sharī'ah* Governance Framework and remaining questionnaires were blindly responded. Table 1 presents other important facts about respondents of the survey.

Out of usable responses, 51 (74% of respondents) were filled by male which represents males proportion in Pakistan work force and also the same in Islamic banking sectors. Significant numbers of survey participants (i.e. 57 out of 69) were related to auditing and banking profession. After many attempts, only two questionnaires could be filled from any *Sharī'ah* advisor or person in *Sharī'ah* Supervisory Board or equivalent. Responses from academia include 23, taken from students and teachers at Islamic banking department of International Islamic University Islamabad. One prominent success of this survey is that significant number of respondents is accounting/auditing and *Sharī'ah* literate people, i.e., 94% and 91% respectively.

These numbers increased the credibility of our survey because all the participants are fully qualified to grasp the true essence of this survey and outcomes. The categorization of respondents as per their affiliation with organization is shown in Table 2.

Table 2: Respondents Affiliations with Organizations

Total Respondents	69
Full-fledged local Islamic financial institution	24
Full-fledged foreign Islamic financial institution	6
Islamic branch of local financial institution	21
Islamic window foreign financial institution	0
Islamic window local financial institution	6
University/college/Academia	12*

* (Include only full time teacher & students, whereas part time students are included as per their employments)

A significant number of respondents, i.e. 57 out of 69, were attached to audit assignments, at least once in their career, in Islamic banks. Another important question asked was, in first part of survey, related to the current status of *Shari'ah* auditing in various types of Islamic banks in Pakistan. Very interesting responses were received, as almost 59% were of the view that current *Shari'ah* auditing mechanism heavily relies on conventional auditing framework. The responses are presented in Table 3.

Table 3: Response about Current Auditing Practices

Same as the conventional auditing framework	0	0.00%
Relies heavily on conventional auditing framework with few adjustments	41	59.42%
Have their own brand-new framework of auditing in the Islamic perspective	24	34.78%
Not aware of what framework they use	4	5.80%

Second part of our survey consisted of specific questions from *Shari'ah* audit perspective with specific reference with SGF. The average value of responses has been presented in Table 4.

As mentioned earlier, question 1-6 specifically related to investigate the perception of participants about *Shari'ah* audit. It is pertinent to mention that in table 4, questions have been gathered as per their construct, however the same were not asked in their chronological order. Questions 2-5 related to examine the participants perceived importance about *Shari'ah* audit distinction from conventional audit. The average response for these four questions range from 3.54 to 4.45 which depicts that participants do recognize the distinction between these two types of audit and importance of the process.

Question 6 was included as a negative question whose response is in line with above question depicting that participants are sure that *Shari'ah* audit being a distinct

Table 4: Response for Research Questions

Sr.#	Questions	Average Response
1	Banks need to appoint more people in Sharī'ah audit department	1.64
2	Sharī'ah auditing framework is different from conventional auditing framework.	3.54
3	The scope of Sharī'ah audit should ensure Sharī'ah audit activities are distinct from ordinary audit activities.	4.01
4	A broader scope of Sharī'ah audit is necessary to safeguard the IFI's social acceptance by society.	4.45
5	Sharī'ah auditing is needed to strengthen internal controls of IFIs.	3.75
6	Sharī'ah audit function should be incorporated into mandatory financial audit as both are approximately similar.	1.36
7	The preparation of Sharī'ah audit manual, as proposed by SGF, is an easy task and will be easily achieved.	3.43
8	Internal Control review, by SCD, is similar to internal audit and therefore, pose redundancy.	3.65
9	Extension in scope of statutory audit by incorporating Sharī'ah audit is not a prudent step due to lack of Sharī'ah expertise in audit firms.	2.12
10	Sharī'ah audit is just one small part of Sharī'ah governance framework.	2.96
11	External auditors will be in position to rightly assess the risk associated with Sharī'ah non-compliance.	3.45
12	Various audit mechanisms, as proposed by SGF, seems to have lot of financial implication for banks.	3.26
13	SBP Sharī'ah board is right step for conflict resolution and effective Sharī'ah compliance and thus for internal audit function.	4.23
14	Proposed audit mechanism is expensive and burden will be shared by customer of Islamic Banks.	3.36
15	The scope of Sharī'ah audit should be extended to examining the performance of the management in relation to 3Es in handling resources under their control.	2.12
16	The audit of Sharī'ah compliance is more important than the financial statement audits in IFIs.	1.93
17	If Sharī'ah audit is implemented properly; objectives of Sharī'ah governance framework will be achieved.	3.78
18	The scope of Sharī'ah audit is limited to compliance with rules and procedures only.	3.46

KEY: Strongly disagree, 1; Disagree, 2; Neutral, 3; Agree, 4; Strongly agree, 5.

activity cannot be clubbed with conventional audit. When participants were asked whether ‘more appointments are needed in *Shari’ah* audit department’, the average response was somewhere in middle of ‘Strongly disagree’ and ‘Disagree’. When this response was further investigated then authors came to know participants are of the view that *Shari’ah* audit departments are established with reasonable human resource, however their work is not as it is supposed to be. This was a quite different perspective got received from the participants.

The preparation of *Shari’ah* audit manual was not considered as an easy task and the average response is at somewhere middle of ‘Neutral and Agree’ position (i.e. 3.43). However, a significant part of participants thought Internal Control Review by SCD is a redundant process in the presence of internal audit procedure. The response for question 9 regarding ‘extension in scope of statutory audit by incorporating *Shari’ah* audit in it, the average response was 2.12, depicting that majority participants do agree with the SGF and considered this step as prudent step. However, similar question when asked in different way that whether “*External auditors will be in position to rightly assess the risk associated with Shari’ah non-compliance*”, the response is nearly lying in the regime of ‘Agree’, depicting that participants think external auditor will be able to do it. However, when investigated the same, participants stressed the need of *Shari’ah* training in external audit firms. Question 13 asked participants about their perception regarding constituting SBP *Shari’ah* Board for conflict resolution; the average response was 4.23 which are among the highest ‘Strongly Agree’ responses in this survey.

This response showed that Islamic banking industry realized the need of such mechanism for conflict resolution related to *Shari’ah* compliance matter. The survey results provided us with two other most important insights. First was the financial burden of SGF which might result in increased cost of Islamic financial product, as asked in Question 14. Second, the importance of implementing *Shari’ah* audit related clauses in the whole SGF, as asked in Questions 10 and 17. Participants seemed to believe that if *Shari’ah* audit is implemented properly, a major part of SGF will be covered.

The participants were also asked to comment on SGF and its clauses. Two very important comments, provided by our respectable respondent about *Shari’ah* audit and its role in *Shari’ah* compliance, are worth mentioning. Authors are not revealing participants’ names however their related organizations have been mentioned.

Shari’ah Governance has many legs to ensure the prudent *Shari’ah* compliance functions of an IBI. *Shari’ah* audit is one of the important legs destined to aid the *Shari’ah* Board in its decision about the comfort level in *Shari’ah* compliance. Lack of competent HR, both for IBI and audit firms is one of the major issues. Furthermore, for audit firms, there must be decision making authority for identifying and deciding the severity of *Shari’ah* non-compliance. (From Bank Islami Pakistan Limited)

IBIs should put more concentration to achieve the objectives of *Sharī'ah* Compliance and audit in its letter & Spirit rather than mere compliance of regulatory requirement. Further, a proper training mechanism shall be introduced for capacity building. (From Burj Bank Limited)

8. Conclusion

The importance of *Sharī'ah* governance cannot be underemphasized while discussing the Islamic banking industry because a major part of customer base here is concerned about halal profits and services as per *Sharī'ah* principles. One source of this confidence comes through *Sharī'ah* audit process. Realizing the need for such mechanism, State Bank of Pakistan has issued *Sharī'ah* governance framework for Islamic banking institutions in 2014.

This study intends to investigate the impact and role of *Sharī'ah* governance framework on *Sharī'ah* audit and its supervision through a survey with detailed questionnaire. The results of our survey provide the following insights:

- a. *Sharī'ah* audit and its activities are distinct from conventional external audit activities.
- b. Proper implementation of *Sharī'ah* audit will help in achieving the objectives of *Sharī'ah* governance.
- c. The idea of SBP *Sharī'ah* board is right step for conflict resolution in Islamic Banking industry.
- d. With proper training, External auditors will be in position to rightly assess the risk associated with *Sharī'ah* non-compliance.
- e. The SGF is expected to have certain financial implication for Islamic banking sector.

Research in social sciences is generally conducted either for intellectual curiosity or for policy implication. This study has the capacity to satisfy both types of readers, as it not only providing answers for intellectual curiosity but providing policy implications as well. Significant policy implications provided by this study are the following:

- a. *Sharī'ah* governance framework need to provide some guideline regarding lack of *Sharī'ah* literate human resource both in Islamic banks and in audit firms.
- b. *The study* identifies the need of decision making authority for identifying and deciding the severity of *Sharī'ah* non-compliance.
- c. *Sharī'ah* non-compliance is a growing key risk area requires to be understood and need to be managed carefully.

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