

Factors affecting Shari'ah audit quality in Islamic banking institutions of Pakistan: a theoretical framework

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Abstract

Purpose – The objective of this study is to present a theoretical framework, which helps ascertain the meanings of the Shari'ah audit quality and identify the factors that affect it.

Design/methodology/approach – The current literature of conventional and Islamic finance on audit quality is critically reviewed to propose the theoretical framework for the quality of Shari'ah audit.

Findings – The paper suggests that for a better Shari'ah compliance at Islamic banking institutions (IBIs), the role of audit practitioners is very much indispensable. The competency of the practitioner is one of the important factors that affect the quality of the Shari'ah audit. Assessment and identification of Shari'ah risk in different financial arrangements, contracts and transactions require a unique competency on the part of the auditor, that is, gripping Shari'ah law besides traditional assurance skills and techniques.

Practical implications – The Shari'ah compliance is one of the primary objectives of IBIs, which works at the conceptual level, product development and implementation level, various business models and governance level. Shari'ah audit function, internal or external, is an important component of Shari'ah governance framework and provides an independent assessment of IBIs' compliance with the Shari'ah rules and principles and helps in managing the Shari'ah non-compliance risk and ensuring sound internal Shari'ah control system.

Originality/value – The paper proposes a theoretical framework for defining the Shari'ah audit quality and determining the factors that are significant in affecting the Shari'ah audit quality in the IBIs of Pakistan.

Keywords Shari'ah audit quality, Islamic banking, Shari'ah compliance, Shari'ah governance, Shari'ah risk
Paper type Conceptual paper

1. Introduction

The robust and exponential growth of contemporary Islamic banking institutions (IBIs) has unlocked a new horizon of knowledge and skill set in the field of business and finance. The growth stimulated the research in various domains of Islamic finance which laid solid foundation in developing Shari'ah, accounting, auditing, risk, governance, ethics and product development frameworks. Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and International Islamic Fiqh Academy, Jeddah, have put remarkable efforts to standardize or, at least, harmonize the Shari'ah practices to facilitate national and



international integration. Islamic Financial Services Board (IFSB) and local regulatory bodies like the State Bank of Pakistan (SBP) and the Bank Negara Malaysia (BNM) have introduced regulatory, governance and supervisory frameworks, pool and liquidity management guidelines, financial accounting and reporting mechanism, and tax regimes to ensure long-term sustainable growth through better control over the widespread operations of Islamic banking and financial institutions.

However, there are many areas in Islamic finance that are quite neglected by the researchers and require serious attention and efforts. Despite the enormous importance of understanding the quality of Shari'ah audit, its variables and its dimensions, the dilemma is lack of available empirical and theoretical literature on the topic. Understanding Shari'ah audit quality is important because it impacts the primary rationale behind the existence of contemporary IBIs, that is, their adherence with the Shari'ah rules and precepts enshrined in the Holy Qur'an and the Sunnah. This adherence with the Shari'ah rules is termed as "Shari'ah Compliance" in Islamic banking industry.

The Muslim population at large patronizes their funds in Islamic banks since they believe that the financial transactions carried out in these institutions are Shari'ah-compliant (Shome *et al.*, 2018). It is the fiduciary responsibility of those charged with the governance and management to ensure Shari'ah compliance in the pool management, profit distribution, financings and other market-based operations (IFSB, 2009). Moreover, the long-term sustainable growth of these institutions also depends on the strong perception of being Islamic among the general public (Rosman *et al.*, 2017). Upside down, the instances of Shari'ah non-compliance will certainly shake the commitment of the stakeholders toward Islamic banking, which may result in withdrawal of funds, loss of income and most importantly reputational loss and image erosion (Azrak *et al.*, 2016). Hence, Shari'ah compliance is critical to IBIs and can only be ensured through a comprehensive and effective Shari'ah governance framework (Muneeza and Hassan, 2014).

To this end, the central banks in various Islamic countries have issued guidelines, directives and Shari'ah governance frameworks for strict Shari'ah compliance in institutions over time (BNM, 2019; SBP, 2018; SBP, 2008). A comprehensive Shari'ah Governance Framework (the Framework) is issued by the SBP, for example, which has defined the roles and responsibilities of the board of directors, Shari'ah board, executive and senior management, Shari'ah compliance department, internal Shari'ah audit unit, product development and external auditors (the audit firms). According to the framework, the board of directors has the ultimate responsibility of ensuring the Shari'ah compliance in the institution, while the executive management on the other hand is responsible for the implementation of the framework in their respective domains. Further, the framework requires every institution to designate a minimum of three members of Shari'ah board in the institution to supervise and oversee all the Shari'ah-related matters. The provision of Shari'ah board is an additional layer in the governance structure of the IBIs (Hamdi and Zarai, 2014).

In order to ensure that all the organs of an Islamic bank observe the Shari'ah compliance guidelines issued from time to time by the competent authorities in true letter and spirit, the framework has enforced four different kinds of assurance engagements on the institutions. These engagements include internal and external Shari'ah audit, Shari'ah compliance review and Shari'ah compliance inspection by the regulator itself (SBP, 2018). The reports of all these engagements are then presented to Shari'ah board for their information and review. The quality of these Shari'ah engagements impacts the degree of Shari'ah compliance in IBIs in many ways. For example, the Shari'ah board determines corrective actions on the basis of these reports. The observations and unresolved issues identified by these engagements are presented by the Shari'ah board to the board of directors in biannual briefing on the Shari'ah compliance environment. Similarly, the Shari'ah board forms opinion for the general public published in the annual accounts on the basis of these reports. Moreover, Resident Shari'ah

Board Member (RSBM) periodic report, training need analysis on the Shari'ah trainings and appraisal and bonuses of the bank staff all depend on the reports of these Shari'ah engagements. Therefore, ensuring the Shari'ah audit quality is important because it affects, directly or indirectly, the overall Shari'ah compliance environment of the Islamic bank and subsequently the integrity of Islamic banking industry as a whole (Ghani *et al.*, 2019).

In spite of the testing for compliance with the Shari'ah rules and precepts being carried out by four different segments, the reports of internal and external Shari'ah audits are perceived to be more important due to various reasons. First, the scope of audit engagements is wider than that of review engagements (IAASB, 2016–17a, b, c). Second, the practitioners are more competent in detecting material misstatement, errors and fraud due to versatile experience and knowledge gained over time (Bonner, 1990; Frederick and Libby, 1986). Third, auditors are deemed to be independent (Jenkins and Stanley, 2019; Church *et al.*, 2018). Fourth, they are professionally bound to comply with relevant auditing standards (including the Shari'ah auditing standards in case of Islamic banking in many territories) and standards of quality control for audit firms (IAASB, 2016–17a, b, c), the code of ethics (IESBA, 2018) and the other regulatory requirements. The audit opinion formed by the auditors in their reports has formidable importance in the investment and other financial decisions of the intended users (EY, 2019; Holt and DeZoort, 2009). Therefore, auditors are responsible to exercise professional judgment and apply professional skepticism (KPMG, 2018) to reduce engagement risk and ensure that the quality of the engagement is not compromised at any cost.

It is clear from the above discussion that Shari'ah audit quality impacts the very basic provision of the existence of the IBIs, that is, the Shari'ah compliance. The aim of this study is twofold. First, it presents a theoretical framework for ascertaining the meanings of the Shari'ah audit quality and the factors that affect the quality. Second, it briefly synthesizes the available literature on conventional audit quality and provides some insights for future research on the topic.

The paper is organized as follows. Section 1 presents the introduction. Section 2 deals with the literature review. Section 3 presents the theoretical framework. Section 4 is the conclusion.

2. Literature review

Shari'ah audit has been discussed in the literature from various viewpoints; determining the achievement of the *Maqāsid* al-Shari'ah through Shari'ah auditing process (Rashid *et al.*, 2017), issues and challenges (Shahar *et al.*, 2018) and future Shari'ah audit labor market (Shafii *et al.*, 2014). However, the literature on Shari'ah audit quality is remote as we find only one study (Yazid and Suryanto, 2016) which covers very limited factors. On the other hand, enriched research literature is available on the conventional audit quality. Hence, we used this literature to draw the inferences and understand the conceptual underpinnings of the topic. The available literature on the audit quality can be classified into five subsections: the enigma of audit quality, stakeholders' perspectives for audit quality, frameworks on audit quality, measuring audit quality and factors that affect audit quality.

2.1 Enigma of audit quality

The review of literature on the audit quality shows that consensus upon the definition of audit quality is not yet agreed upon. Numerous efforts have been made in the last few decades to develop a consensus on how to define and measure audit quality. However, no consensus has been achieved yet (Knechel *et al.*, 2013; IOSCO, 2010). The enigma of audit quality leads to two primary issues: (1) the factors that affect audit quality cannot be ascertained clearly, and (2) audit quality cannot be reliably measured. The debate on the topic is still alive among the

regulators, standard-setting bodies, auditors and others to reach at the generally acceptable view on it (IOSCO, 2010; FRC, 2006). For example, International Auditing and Assurance Standards Board states that "Audit Quality is a complex subject and there is no definition or analysis of it that has achieved universal recognition" (IAASB, 2014). Resultantly, the available definitions in the literature are not comprehensive enough to incorporate all the dimensions of the concept (Raak and Thürheimer, 2016).

2.2 Stakeholders' perspectives on audit quality

Reviewing the existing literature, we observed that various perspectives on the audit quality have developed and have been presented by the different stakeholders. The first one is the perspective of the general public or the users, who view audit quality from its end result because their investment and other business decisions are dependent on the audit opinion expressed by the auditors (Ianniello and Galloppo, 2015; Holt and DeZoort, 2009). Therefore, according to this view, the audit quality is achieved if material misstatement, if any, is detected and reported by the auditor (DeANGELO, 1981). The Australian Securities and Investments Commission (ASIC) also agrees with the view that the audit quality is achieved if the financial statements are no materially misstated (ASIC, 2017).

On the other hand, auditors think that audit is an organized task carried out thorough a systematic process. Thus, complying with the effective audit plan satisfactorily is enough for achieving audit quality (Christensen *et al.*, 2015). According to this perspective, if the auditor has complied with the audit plan, risk assessment procedures and audit methodology, the audit quality is achieved even if the material misstatement is not detected during the process. Auditors support their opinion on the fact that audit engagements provide the reasonable assurance on sufficient appropriate audit evidence (IAASB, 2014) rather than absolute assurance.

The third is the perspective of the audit firms. They think that the quality of audit is achieved if the audit work can be defended in court of law in the case of any litigation or claim of malpractice against it. The litigation is a signal of low audit quality (Franz *et al.*, 1998). Therefore, auditors perform more vigilantly in the case of high litigation risk (Sun and Liu, 2011) to avoid adverse outcomes (Peecher and Piercey, 2008).

Lastly, the regulator views high audit quality from its compliance with auditing standards, regulatory requirements and best practices (GAO, 2003). Thus, if the audit is done in strict compliance of auditing standards, regulatory requirements and best practices, it shall be considered high-quality audit. Any deviation from the standards and regulatory requirements shall be deemed as poor audit quality (Krishnan and Schauer, 2001).

2.3 Frameworks for audit quality

In order to overcome the challenge of defining audit quality, many individuals and professional bodies have developed and presented different frameworks as an alternative to gauge the overall audit quality. Financial Reporting Council (FRC) took the lead in this regard and issued a discussion paper "*promoting audit quality*" in year 2006. This effort kicked off the debate on the topic and various frameworks are structured. The FRC itself presented a framework in year 2008 with a title "*The Audit Quality Framework*" (FRC, 2008). Similarly, Australian Treasury published "*Audit Quality: A Strategic Review*" (Australian Treasury, 2010), International Auditing and Assurance Standard Board issued "*A Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality*" (IAASB, 2016-17a, b, c) and some other individuals also presented frameworks on the audit quality (Francis, 2011; Knechel *et al.*, 2013; DeFond and Zhang, 2014). The frameworks generally categorized the factors affecting audit quality in inputs, process, output and context. Inputs are those attributes that belong to auditors such as experience, professional judgment and industry

knowledge. Audit process includes audit planning, risk assessment, sampling, evaluation of audit evidence and so forth. Output means audit reports and information presented to the users. Lastly, context means the environment such as laws and regulations, audit fee, audit tenure and non-audit fee in which the audit is performed.

2.4 Measuring audit quality

The next dimension discussed in the literature is how to measure the audit quality. Many studies have tried to solve this challenge. However, no study provides conclusive answer to the issue (Ramamoorti, *et al.*, 2017; Raak and Thürheimer, 2016; Rajgopal *et al.*, 2020; Duff, 2009). The reason for this failure is obvious, that is, the lack of universally acceptable definition. Therefore, without a generally acceptable yardstick, gauging and measuring the accuracy and effectiveness of an audit is not possible.

2.5 Factors affecting audit quality

As we discussed earlier, determining audit quality is a multifaceted and complex challenge not only from theoretical but also from practical perspective. The professional bodies and individuals built up their frameworks by categorizing the attributes of audit quality in inputs, process, output and context. A rich literature on the factors is available that affect audit quality, either individually or collectively, directly or indirectly. Below, we discuss some of the major factors identified in the literature.

Various studies investigate the impact of industry-specific knowledge and experience of the auditor and found that they are positively related to the audit quality (Carcello *et al.*, 1992). One of the reasons is that auditors develop industry-specific skills due to repeating the same assignment (Bonner and Lewis, 1990; Frederick and Libby, 1986), which positively affects their performance (Beck and Wu, 2006). Moreover, this experience enhances their competency to detect internal control weaknesses (Rose-Green, Huang and Lee, 2011; Hammersley, 2006) and fraud and errors (Sarwoko and Agoes, 2014). We can easily infer that the same is true for Shari'ah auditors. Without understanding the dynamics of Shari'ah non-compliance risk, a Shari'ah auditor cannot evaluate and examine the adequacy, efficiency and effectiveness of the Shari'ah controls at branches and operation units. However, scarcity of such Shari'ah auditors and compliance review officers is one of the main challenges for the industry (Ali and Kasim, 2019).

Some studies investigated the effect of professional skepticism on the audit quality and documented that lack of professional skepticism leads to audit deficiencies (Favere-Marchesi and Emby, 2018), and audit failures (IFIAR, 2016). Therefore, there is a positive relationship between professional skepticism and the quality of audit (Chen *et al.*, 2009). Similarly, researchers found a positive relationship between auditor's professional judgment and audit quality. However, some studies suggest that the judgment is sometimes affected by many biases such as the recency effects (Asare, 1992), the framing effect or the framing bias (Emby and Finley, 1997) and the dilution effect (Hoffman and Patton, 1997). On the other hand, trait skepticism (Koch *et al.*, 2016) and experience (1993) both mitigate the auditor's judgment bias.

Auditor independence is one of the important factors that affect the quality of audit. Different studies accounted for various dimensions, which may affect the auditor independence such as client importance, auditor tenure, non-audit fee (Tepalagul and Lin, 2015), abnormal audit fees (Hribar *et al.*, 2014) and audit market concentration (Huang *et al.*, 2016). Both higher audit fee (Blay and Geiger, 2013) and lower audit fee relative to the normal fee (Ettredge *et al.*, 2014; Asthana and Boone, 2012) are perceived as threat to auditor independence, which may lead to poor audit quality. Similarly, it is generally perceived that non-audit fee also affects auditor independence (Kinney *et al.*, Auditor Independence, Non-Audit Services, and Restatements: Was the US Government Right?, 2002).

Some studies investigated the factors that are related to the audit process such as risk assessment procedures (Zaiceanu *et al.*, 2015), analytical procedures (Glover *et al.*, 2015), audit sampling (Hoogduin *et al.*, 2015) and audit documentation (Payne and Ramsay, 2008). Many studies are carried out to check the relationship of various factors pertaining to an audit firm and audit quality. For example, the audit firm rotation improves audit quality (PCAOB, 2011) because auditors may develop personal ties with the customer, which may negatively affect the audit quality (Carey and Simnett, 2006). Similarly, fee premiums charged by Big N firms have a positive relationship with the audit quality (Carson *et al.*, 2012; Alzoubi, 2016; Rusmin, 2010).

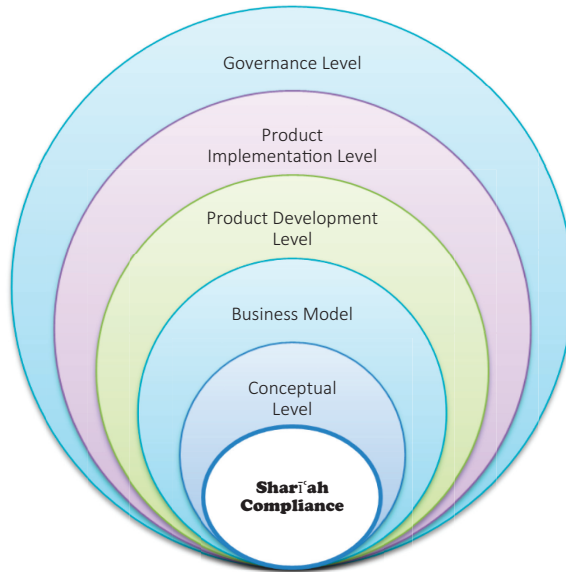
The above discussion on the quality of audit reveals that the literature can be divided into five main areas. First is the enigma of audit quality, which suggests that the audit quality is multifaceted concept and there is no universally agreed definition of audit quality. The second area discusses the various perspectives developed in the absence of consensus on the definition of audit quality. In this regard, it was learned, so far, that there are four perspectives on the audit quality: the perspective linked with successfully detection of material misstatement (that may be termed as “the consequential perspective”), the perspective related to the process of audit (the procedural perspective), the perspectives related to successfully defending the audit work in court of law (the advocacy perspective) and the perspective related to complying with the regulation and best practices (the compliance perspective). Each of these perspectives provides a specific viewpoint regarding the audit quality, which it deemed fit. The third area of the literature on the audit quality is a framework for audit quality that is presented by various individuals and professional bodies to grip the dimensions of audit quality. The fourth area in the literature is the studies that propose different methodologies to measure audit quality and classify the factors affecting audit quality as inputs, process, output and context.

The detailed analysis of the literature shows that the concept of the Shari'ah audit quality is almost untouched besides its enormous importance due to its effects on the provision of strict Shari'ah compliance in the IBIs. Neither the definition nor the factors are defined for the Shari'ah audit quality. This study therefore aims to provide a framework to ascertain the meanings of Shari'ah audit quality and to identify the factors that affect the quality of Shari'ah audit in the context of audit risk model.

3. Theoretical framework

The quality of Shari'ah compliance carries peculiar importance in Islamic banking because the primary rationale behind the existence of Islamic financial institutions is their adherence with the Shari'ah rules and precepts. The concept of Shari'ah compliance works at various levels in IBIs. Some of the important areas are discussed and shown in Figure 1.

It is pertinent to note that the Shari'ah compliance works at the conceptual level, product development and implementation level and governance level. The Shari'ah audit is an important component of Shari'ah governance framework and provides an independent assessment of IBIs' compliance with the Shari'ah rules and principles. It helps in managing the Shari'ah non-compliance risk and ensuring sound internal Shari'ah control system. As the ears and eyes of the Shari'ah boards, the quality of Shari'ah audit also affects the quality of Shari'ah boards decisions, which subsequently affects the overall Shari'ah compliance environment of the institution. Therefore, due to the vital significance of Shari'ah audit quality in ensuring a sustainable and sound Shari'ah compliance mechanism in the institution, this paper provides a framework to ascertain the meanings of Shari'ah audit quality at the first place and to determine the factors that affect Shari'ah audit quality in the IBIs of Pakistan at the second place.



Source(s): Authors' construction

Figure 1.
Ensuring Shari'ah
compliance at various
levels

3.1 *Ascertaining the meaning of Shari'ah audit quality*

The meaning of Shari'ah audit quality can be ascertained by developing an index of the four stakeholders' perspectives of audit quality discussed in the literature review. The descriptions of each of these perspectives are given in Table 1.

As we have already discussed, the consequential perspective is taken by the end users that the Shari'ah audit quality is achieved when there is no material misstatement due to error and fraud. The end user wants to make decision on its basis; hence, from his perspective, audit quality is achieved in the absence of any material misstatement. The second perspective is generally taken by the auditors by which they think that if any audit is done according to firms' audit methodology, then the audit quality is achieved. The advocacy perspective generally taken by audit firms is that the quality of audit is achieved if we can advocate our work in court of law in the case of any litigation. The regulator generally holds the compliance perspective. This is because regulators are more concerned with the compliance of the best practices and professional standards.

Table 1.
Perspectives
determining Shari'ah
audit quality

| | |
|-------------------------------|---|
| The consequential perspective | The high Shari'ah audit quality is achieved when the material misstatement, if any, is detected and reported by the Shari'ah auditor |
| The procedural perspective | The high Shari'ah audit quality is achieved when all the audit tasks are carried out according to Shari'ah audit plan and methodology |
| The advocacy perspective | The high Shari'ah audit quality is achieved when the Shari'ah audit work done during the Shari'ah audit can be defended against any litigation or a claim of malpractice in court of law |
| The compliance perspective | The high Shari'ah audit quality is achieved when the Shari'ah audit is conducted in line with strict compliance of the best-practices, regulatory requirements and professional standards |

Source(s): Authors' construction

A survey questionnaire can be developed on the basis of the above perspectives and the opinion of the Shari'ah board members, members of the audit committee, internal and external Shari'ah auditors, Shari'ah compliance, review and inspection officers, Shari'ah coordinators and other relevant professionals. This may help in understanding the meanings of Shari'ah audit quality.

The same approach is adopted by the International Auditing and Assurance Standards Board by conducting a survey to investigate the stakeholders' perspectives on the audit quality in nine countries whereby the opinion from board audit committee members, senior managers, public users and institutional investors was gathered. About 169 responses on perceptions of audit quality were collected, and results show the mixed opinion. The perspectives of the respondents on what constitutes audit quality largely varied (IAASB, 2014).

3.2 Determining the factors affecting Shari'ah audit quality

As far as the factors affecting Shari'ah audit are concerned, we have classified the factors on the basis of Audit Risk Model which has three components: (1) inherent risk, (2) control risk and (3) detection risk.

4. Inherent risk

Inherent risk is multifaceted in the case of Shari'ah audit. The quality of subject matter, the education and experience of product manager, the size and age of the bank and so forth may affect Shari'ah audit quality. However, all the risks classified in inherent risk are eventually reflected in the quality of the subject matter of the Shari'ah audit. For the purpose of clarity, the subject matter of Shari'ah audit means financial arrangements, contracts, transactions, policies and procedures, accounting and IT systems, transaction process flows and so forth (SBP, 2018). To comprehensively understand the concept, we can evaluate the quality of subject matter from the following dimensions:

4.1 Quality of subject matter with regard to structure of the products and services

With regard to the structure of the products and services, inherent risk may arise due to complex Shari'ah structures where the rights and obligations of the parties are not properly defined, for example, inter-dependence of combined contracts; or products structured on the contracts that have narrow permissibility and can be used only in a dire need, for example, *bay' mu'ajjal of sukuk*; or even if the products are structured on strong theoretical and conceptual foundations but practical application may lead to Shari'ah issues, for example, identifying actual proceeds in *istiṣnā'* transactions; or application of same financial structure in different industries, for example, *murābahah* in sugarcane has different risks as compared to cotton and cement.

4.2 Quality of subject matter with regard to structure of the institutions

At the institutional level, assessing inherent risk in newly established Islamic bank is difficult as compared to well-established Islamic bank where processes are well-documented and tested over time. Likewise, maintaining Shari'ah audit quality is difficult in Islamic banking divisions of conventional banks as compared to full-fledged Islamic banks because of inter-connection of various transactions, for example, accepting deposits on both counters. Similarly, assessing inherent risk is difficult in subsidiary of conventional bank as compared to full-fledged IBIs.

4.3 Quality of subject matter with regard to nature of transactions

At the transactional level, maintaining Shari'ah audit quality is difficult in transaction involving estimates/judgments or calculation, for example, treasury/pool management as compared to simple and routine transactions, for example, Murabaha and Istisna'. Hence, inherent risk affects Shari'ah audit quality in IBIs from various perspectives.

5. Internal Shari'ah control system

One of the important components of audit risk model is controlling for risk. To ensure strict Shari'ah compliance environment in the bank, the management in coordination with Shari'ah board and other organs of Shari'ah governance framework is expected to design and establish adequate systems and controls in the form of Internal Shari'ah Control System (ISCS). ISCS means the processes and procedures designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance to the stakeholders regarding the achievement of an entity's Shari'ah-related objectives. It is sometimes considered mis-selling Islamic financial products when appropriate internal controls to ensure Shari'ah compliance are not in place (IMF, 2014). The ISCS provides assurance that operations are carried out in accordance with the Shari'ah principles.

ISA-315 provides a detailed guidance to "the auditor to gain an understanding of numerous aspects of the entity and its environment in assessing risk of material misstatement" (IAASB, 2019). This understanding provides the auditor the opportunity to understand the business of the entity and related risks due to inadequate controls. On the basis of this understanding, auditors can determine appropriate audit strategies and substantive procedures.

The International Standards for the Professional Practice of Internal Auditing (IPPF) Glossary defines the control environment as "the attitude and actions of the board and management regarding the significance of control within the organization. The control environment provides discipline and structure for the achievement of the primary objectives of the system of internal control" (IIA, 2011). Similarly, the COSO published the Internal Control-Integrated Framework in 1992 and defined the control environment as "the control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include integrity, ethical values and competence of the entity's people; management's philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its people; and the attention and direction provided by the board of directors" (Crowe, 2019).

To comprehensively understand the controls perspective, we have presented the broad components of ISCS on the basis of globally accepted Internal Control Framework presented by COSO. The descriptions of the components of the ISCS are as follows.

5.1 Shari'ah control environment

Shari'ah control environment means the attitudes, awareness and actions created and maintained in the bank that provide basis for carrying out internal Shari'ah control. The bank should demonstrate a culture of integrity, honesty and ethical behavior, commitment toward Shari'ah compliance and zero tolerance on Shari'ah non-compliance risk. The environment provides a foundation to other internal control components.

5.2 Shari'ah risk assessment

Shari'ah risk assessment means an effective and proactive mechanism for identification and appraisal of the significance of Shari'ah compliance risks and actions required to address

those risks. Shari'ah compliance risk is defined as "the possibility that a financial service or product is not or will not be in compliance with established Shari'ah principles and standards" (DeLorenzo, 2007). Hence, Shari'ah compliance risks may hinder the achievement of a bank's Shari'ah-related objectives. Therefore, IBIs need to have in place a comprehensive and dynamic Shari'ah risk assessment process to identify and assess Shari'ah compliance.

5.3 Shari'ah control activities

It means those policies and procedures that help ensure that all the operations of the institution remain in line with Shari'ah rules and principles are in place. It must be ensured that Shari'ah controls are introduced for all levels of operations. For example, Shari'ah controls that legitimate contracts are used in the product development process such as contracts combining and their combined outcome are Shari'ah-compliant, prohibitions like *Ribā*, *Maisir* and *Gharar* are avoided and the transactions are executed as per the Shari'ah-approved process flows and so forth.

5.4 Information and communication

The fourth important component of ISCS is Information and Communication. Effective communication of relevant internal Shari'ah controls and their objectives to concerned personnel lead to good ISCS and subsequently to better Shari'ah compliance environment in the bank. Moreover, effective communication is the continuous process of sharing and obtaining information from the all the concerned for the achievement of the higher objectives of ISCS.

5.5 Shari'ah monitoring activities

Last but not the least, the Shari'ah Monitoring Activities of the Shari'ah controls in the IBI is another important factor. Ongoing monitoring, periodic inspections of the effectiveness of Shari'ah controls through internal Shari'ah review and internal Shari'ah audit lead to an effective and efficient ISCS which, in turn, ensures Shari'ah compliance in IBIs. Moreover, the part of it is the timely communication of internal Shari'ah control deficiencies to every concerned for taking corrective actions.

From the above ISCS structure, control risk in an Islamic bank can be identified in a timely manner so that the material misstatement can be prevented or detected and corrected on a timely basis by the Islamic bank's internal controls system. The outcome of this control system may also result in sensitization of board of directors and executive management with Shari'ah compliance risk, development of well-defined management oversight, structures and reporting lines, along-with appropriate authorities and responsibilities of the segments, departments and individuals. Moreover, internal Shari'ah controls embedded in policies, products and procedures will definitely result in the stringent Shari'ah compliance environment in the institution.

6. Detection risk

The third component in the audit risk model is detection risk. This is also a multifaceted concept. Inability to detect material misstatement may relate to auditor, audit firm and assurance engagement. The factors that impact the audit quality related to auditor, audit firm and audit engagement are discussed In the following subsections.

6.1 Factors pertaining to auditor

Factors pertaining to the auditor are the education, experience, professional skepticism and ability to interpret the audit results. From the perspective of Shari'ah audit quality,

the education and experience of Shari'ah auditor mean both type of education and experience, that is, Islamic banking and auditing.

The competency of the auditor is one of the important factors that affect the quality of the Shari'ah audit. Assessment and identification of Shari'ah risk in different financial arrangements, contracts and transactions required a unique combination of competencies, that is, gripping Shari'ah law besides traditional assurance skills and techniques (Ali et al., 2020). Hence, without core education and proper training in Islamic banking and auditing, as well as the deep understanding of the features, risks, practical limitations and implications of Islamic financial products, the Shari'ah auditors cannot comprehend the Shari'ah non-compliance risk: a multifaceted phenomenon. For example, the understanding that where the transaction is valid (*sahih*), when any mistake nullifies the very requisite of a contract, when the transaction is irreconcilable (*batal*), when it is voidable/irregular (*Fasid*) and how can it be corrected and when it is merely disliked (*makrooh*) needs adequate knowledge and skill set on the part of Shari'ah auditor. Similarly, the financial arrangements and contracts in different Islamic banks for the same product differ. For example, some Islamic banks are offering vehicle financing on the basis of *shirkat al milk-cum-ijarah*, some banks are offering on the basis of *ijarah* and still other banks are offering on diminishing *musharakah*. Understanding the underlying contracts of the transaction and Shari'ah implications at every step of these transactions needs a complete and deep understanding of Shari'ah law.

Therefore, any incompetency in understanding the inherent risk or control risk at the planning stage will lead to designing weak analytical procedures. Similarly, any inability to detect any material misstatement will expose to higher engagement risk which, in turn, shall affect the quality of the Shari'ah audit engagements.

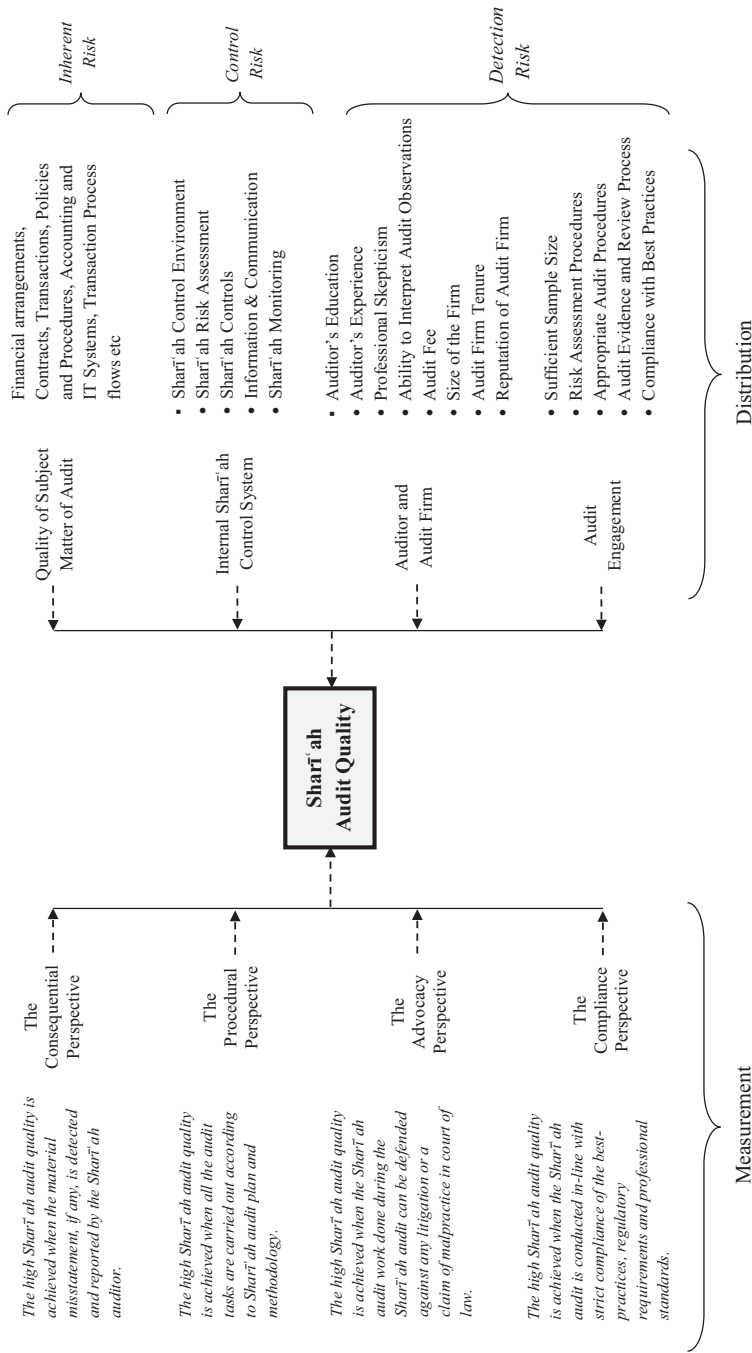
The factors related to audit firms are audit fee, reputation of the audit firm, audit firm tenure and the size of the firm. All the factors included in this list are the most relevant and much debated factors in the audit quality literature. Lastly, the factors that are incidental to audit engagement are sufficient sample size, risk assessment procedures, appropriate audit procedures, audit evidence and review process, complying with the necessary statutory and regulatory requirements and industry-wide best practices.

On the basis of the above discussion on defining Shari'ah audit quality in the light of consequential perspective, procedural perspective, advocacy perspective and compliance perspective, and on the factors affecting Shari'ah audit quality in the light of audit risk model, on the factors classified as inherent risk, control risk and detention risk, in this paper, a theoretical model is developed and presented in Figure 2.

7. Conclusion and future research

Besides the overwhelming importance of the quality of the Shari'ah audit in ensuring the strict Shari'ah compliance environment in IBIs, researchers have neglected this research area. The literature is silent on what is the Shari'ah audit quality. What are the factors that affect the quality of Shari'ah audit? And how we can reliably measure it? Hence, there is a dire need to discuss the variables, dimensions and impact of Shari'ah audit quality to better understand the concept and to provide a concrete foundation for effective and efficient decision-making regarding internal Shari'ah control system in the IBIs.

This paper is an effort to initiate the debate on the topic of Shari'ah audit quality by providing a framework. The framework comprehensively identified the areas which may affect Shari'ah audit quality ranging from the factors related to subject matter of Shari'ah audit, internal Shari'ah controls, auditors, audit firm and audit engagement. Each variable presented in the framework may be explored from various dimensions by drawing inferences from the tremendous amount of research literature available on the conventional audit



Source(s): Authors' construction

Figure 2. Theoretical framework of factors affecting Shari'ah audit quality

quality. Some of the research topics may include the following: How do the training, promotions, incentives and religious teachings impact the decisions and Shari'ah audit opinions of Shari'ah auditors? What are the factors that enhance the professional skepticism and judgment of the Shari'ah auditors in IBIs? How does the technical expertise in Shari'ah audit and professional skepticism interact? What are appropriate benchmarks for evaluating the quality of Shari'ah audit output? Does the second partner review of the Shari'ah audit engagement enhance Shari'ah audit quality? How can the Shari'ah audit reports be expanded? Do the AAOIFI Shari'ah auditing standards result in overstandardization of Shari'ah audit and review process? Does the external Shari'ah audit scope defined by the State Bank of Pakistan appropriate and sufficient? How well the existing Shari'ah audit proxies can predict the Shari'ah audit quality?

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