



## The Practices of Conventional and Shariah External Review in Malaysia: The Case Study of Medium Firms

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### Abstract

This study serves as a significant reference for practitioners and researchers to explore further the disparities in the actual practices of external conventional and Shariah reviewers. It is important as the current guidelines do not elaborate in detail on the practices to give more space for the company to manage their own situation on the ground. The research adopted a qualitative research method and conducted interviews with four external review officers, comprising both conventional and Shariah reviewers. The study reveals that both types of reviewers share similar attributes of the reviewer. However, in terms of the review process, only follow-up issues exhibit similarity, while risk assessment and output of the review. It is essential to acknowledge that the findings of this study are solely based on the results obtained from the conducted interviews and may not fully represent the practices of all external review officers in Malaysia. To gain a more comprehensive understanding of the variations in practices among different reviewers, further research in this area is encouraged. Such future research could investigate deeper into the review process, encompassing planning, execution, and reporting, to draw more robust conclusions about the real practices of external conventional and Shariah reviewers.

*Keywords:* - Conventional, shariah, external review officer

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## 1. Introduction

Globally, numerous changes are influencing business operations, especially post of the pandemic of Covid-19 (Stalmachova et al., 2021). Various key areas are impacted, including political, legal, economic, and technological aspects. Whether the impact is direct or indirect, organizations must ensure that they can adapt to these ongoing changes by implementing updated systems and strategies. An effective managerial system will assist organizations in adapting to these changes by revising their planning, controlling, and decision-making processes. One of the managerial systems involved is implementation of monitoring tools, such as establishing internal control functions, strengthen external control functions, and improve systems security functions.

The utilization of these tools is crucial, as evidenced by the downfall of major organizations like Enron and Kmart, which collapsed due to ineffective monitoring systems established within their structure. To show the commitment of the Government of these managerial issues, Government has issued the Malaysian Code of Corporate Governance (MCCG) to improve the practice of the corporate governance in Malaysia in early 2000. MCCG undergoes review process from time to time until now, to ensure its relevance in the current world.

Over the past decade, there has been a significant surge in the demand for Islamic finance. The development of the Islamic finance is increasing rapidly especially in the majority Muslim country (Rohimah et al., 2023). The country with 63% of Muslim like Malaysia surely impacted with this increasing trend This global expansion of Islamic finance has necessitated comprehensive

guidelines of the Shariah governance to be followed by industry players.

To support the expansion of Islamic Finance in Malaysia, Bank Negara Malaysia (BNM) issued the Guidelines on the Governance of Shariah Committee (GGSC) in 2004. The main objective of this guideline is to ensure consistency in practices across all organizations involved in the Islamic finance industry. Subsequently, after a span of six years, BNM introduced the Shariah Governance Framework (SGF) in 2010, slated for full implementation in 2011. In addition, in 2019, the Shariah Governance Policy Documents (SGPD) were issued by BNM, superseding the SGF. These frameworks aimed to emphasize the roles of the Board, Shariah Committee, management, and key Shariah functions to facilitate the operational adherence to Shariah principles within organizations. One of the key Shariah functions is the Shariah Review Function.

In comparison to conventional review function, the implementation of Shariah review still requires substantial improvement, particularly since the initial guidelines, SGF, were issued a decade ago. Compared to the conventional counterparts which were established in early 2000. Hence, this research will particularly focus on the presence of external reviews in Malaysia within both conventional and Islamic financial industries. Even though both parties rely on the different guidelines, this study will discover the similarities and differences between both financial industries. It is important as the current guidelines do not elaborate in detail on the practices to give more space for the company to manage their own situation on the ground. Hence, the practice within the company is only can be explored by interviewing the practitioners.

This study serves as a significant reference for practitioners and researchers to explore further the disparities in the actual practices of external conventional and Shariah reviewers. Medium-sized firm has been chosen because the well-established Islamic Financial Institution (IFI) in Malaysia have their own internal Shariah Review Function as required by BNM compared to the medium-size company which need to hire external reviewer. Consequently, for conventional counterparts, medium-sized external review firms have predominantly taken the lead in most external review engagements. Hence, researchers have opted to investigate the similarities and key differences between the two industries by focusing on a medium-sized external review firm. Outlook from each practitioner is crucial to understand the current practices of the external review in Malaysia. This study is expected to guide the regulatory bodies to improve the guidelines and framework of both conventional and Islamic finance industry in line with the best practices by the industry players.

## 2. Literature Review

### 2.1 Monitoring Guidelines in Malaysia

As discussed in the previous chapter, there are 2 main financial sectors which are conventional and Islamic. Both sectors have their own guidelines to monitor the practitioner to ensure his practice is within the acceptable norms and stakeholders' expectations. The non-compliance with the guidelines may lead the engagement team to an under-review issue (Knechel, 2013).

For conventional reviewers, International Standard of Auditing (ISA) will be the main reference to the practitioners. ISA has been issued by the International Federation of Accountants (IFAC) to guide the practitioners for the auditing of the financial information. ISA also guides auditor in the issuance of the audit opinion considering the external and internal factors in the company by assessing the business risk. The use of this standard is likely to increase accountability and professional skepticism, which will improve the audit quality (Li et. al, 2019). ISA has been used since 2006 and there are a lot of amendments that have been made from time to time. Aside to the Shariah reviewer, they will follow the guidelines issued in Governance Standard (GS) of Auditing Organizations for Islamic Financial Institutions (AAOIFI). However, to meet the requirement set-up by regulators in Malaysia, Shariah reviewer will also refer to the guidelines issued by the BNM as it is compulsory in Malaysia. BNM has issued SGF and revised version of SGPD in 2019. Both governance framework aimed to strengthen the Shariah governance structures and processes to ensure Shariah compliance. BNM is closely monitor the organisation to ensure that the Shariah governance has been applied properly in the organisation (Ahmad & Ishaq, 2021).

Bahari & Baharudin (2016) stated that the issuance of the Shariah governance framework will ensure that all activities and business transactions complied with the Shariah principles. However, after almost a decade of its implementation, it is observed that there are still limited guidelines to address the current challenges of Shariah governance in Malaysia.

Then, SGPD was later issued in 2019 to supersede the first version of SGF (Naysary et al., 2020). This is supported by the study done by Laldin & Furqani (2018) that the SGPD is important to enhance the existing regulatory requirements and expectations on Shariah governance. Revision was also made in view of the growing scale and complexity of Islamic financial business, as well as recent policy developments around governance, compliance, and risk management.

## 2.2 External Review Function

The existence of the external conventional reviewer is not a new thing in the corporate world. The existence of the external firm that provided these services was established in the early 1980s. Hence, there are many external firms established in Malaysia which can be properly classified into small, medium, and big firm based on the size of resources and income. The market of the external firm is currently dominated by the Big 4 firms globally.

In Malaysia, Companies Act 2016 has stated the requirement for the company to prepare the financial statements accordance to the applicable accounting framework. To do so, an approved external firm by the Ministry of Finance (MOF) needs to be appointed by the Board to perform the review. This is because the Board must ensure that the appointed firms have adequate experience and knowledge to meet the expectations of the shareholders (Behzadian & Nia, 2017).

Aside to the Shariah reviewer, its existence in Malaysia is considered new as the regulator has only highlighted the existence of the review function in SGF which further enhance to SGPD. As per requirement of SGPD, According to AAOIFI Governance Standard No. (2), Shariah review plays a significant role to ensure all the activities adhere to Shariah rules and regulations as reflected in fatwa, rulings and guidelines issued by Shariah Committee. Supported by para 18.2 SGPD, the Shariah Review Function, at minimum, must:

- i. Identify, assess and monitor the compliance of the business operations and activities with Shariah.
- ii. Report to the Board, Shariah Committee and senior management regularly on Shariah non-compliance issues and findings.
- iii. Ensure adequate training and guidance are provided to the officers on relevant Shariah requirements governing the operations, business, affairs and activities.

However, since the medium size companies has no Shariah Review Function internally, its function has been taken by the external Shariah reviewer. For the execution of the Shariah review, the team of the Shariah reviewer should at least lead by a senior officer, who principally accountable and responsible for the overall review of Shariah compliance. Further explained in para 18.4, SGPD, officers who perform the Shariah review should qualified to undertake compliance function responsibilities and have sound understanding of relevant Shariah requirements applicable to Islamic financial businesses. The effectiveness of the Shariah reviewer can be achieved by having a comprehensive plan and working it accurately (Accounting and Auditing Organization for Islamic Financial Institutions, 2010). As per research done by Algabry et al. (2021), this can be done by having proper documentation to summarize all the findings, giving recommendations needed and following up the results. Study done by Salijeni et al. (2021) also highlighted that the documentation is also crucial to ensure that the opinion

or judgment of the reviewer can be justified. Hence, best practices should be applying by the external reviewer in Malaysia to ensure the review can be done effectively.

## 3. Methodology

This study employs a qualitative research method, specifically in-depth interviews, to gather data on the current practices of external reviewers in Malaysia. Interviews are considered the most suitable approach due to the limited existing research on Shariah review in Malaysia. The research participants consist of senior executives from medium-sized firms who are actively involved in conducting review work and presenting the final output to management. Selecting senior executives as participants ensures the collection of first-hand information regarding the actual challenges they face in practice. The interviews utilize semi-structured questions to facilitate open and free-flowing discussions between the researcher and participants, enabling the exploration of a wide range of information related to the real practices of external reviewers. On average, each interview session lasts approximately 40 minutes. To maintain data confidentiality, the details of the participants will not be disclosed. This approach ensures the protection of sensitive information provided during the research process. The list of the participants that will be involved in this study is as in Table 1.

Table 1. Participants of the interview

Sector of reviewer	Code of participant	Total
Conventional	IV1	1
	IV2	1
Shariah	IV3	1
	IV4	1
		4

Prior to conducting the analysis, verbatim transcriptions were completed for all interview sessions using the recorded versions of the interviews. Subsequently, the researcher derived pertinent themes from these transcriptions to be presented in the findings section. The entire interview process, from participant selection to transcription completion, spanned a period of 5 months.

## 4. Findings

Researcher has reviewed the available standards for both conventional and Shariah reviewer which are ISA and AAOIFI to ascertain the similar terms used by both sectors. Researcher discovers the 5 main codes that can be used as an input for the theme which are qualification, training, risk assessment, follow-up issues and output of the review. Based on these codes, researchers have created 2 main themes which are attributes of the reviewer and process of the review.

#### 4.1 Attributes of the reviewer

##### a) Qualification

As per article issued by Chambers & Mc Donald (2013), 7 Attributes of Highly Effective Internal Auditors, it stated that the significance of the reviewer's attributes lies in their ability to enhance the review function. The article also outlines key characteristics of a highly effective reviewer, such as a commitment to continuous learning and essential skills required in practice. Considering the previously classified codes, the reviewer's qualifications and training are identified as crucial attributes. Even though Chiarini et al. (2021) stated that it is unnecessary to have a qualified auditor, but it is important to have an auditor or reviewer that have an adequate knowledge on the review process. Based on the interview done, participants have declared:

*I attended University X, where I earned my Bachelor's Degree in Accounting with honors. Currently, I am working towards obtaining the ACCA professional certificate.*

(IV1, 2023)

*I am graduated from University Y and pursued my professional qualification paper right after my graduation.*

(IV2, 2023)

*I am studied pure Islamic teaching for my degree. I started my career in the Shariah Department before joining Shariah review. I have certificates as Certified Shariah Advisor.*

(IV3, 2023)

*I completed a Diploma in Finance before pursuing a Degree in Islamic Finance. Then, I am further study for Master's degree in Islamic Finance at Institute Y.*

(IV4, 2023)

As mentioned earlier, all reviewers possess at least a bachelor's degree. However, the specific field of their degree varies, depending on the requirements set by regulators or the market. In the case of the Shariah reviewer, the SGPD expects them to have a profound understanding of the relevant Shariah requirements that apply to Islamic financial business. SGPD however did not state the classification of bachelor's degree that should be held by the officer. That has led to the different background of degree for both Shariah review officer.

In addition to the conventional reviewer, all the Big 4 audit firms have indicated that the least requirement is to possess at least a bachelor's degree in accounting or a relevant professional qualification either it is ACCA, MICPA, CPA Australia or ICAEW.

##### b) Training

Another attribute is continuous learning or training. As per speech given by the former Auditor's General of Malaysia (AG), Tan Sri Ambrin bin Buang, he mentions that the training is crucial to assure the effectiveness of the reviewer (Tan Sri Ambrin, 2011). Organizations may provide relevant guidelines, conduct seminars, and participate in the related training program to enhance the knowledge and skills of the reviewer. Participants has stated:

*We will attend the training once a month during peak period season. Nevertheless, during the off-peak season, we typically conduct face-to-face training approximately once a week or once every two weeks. This training primarily focuses on accounting standards, performing audit procedures, and comprehending the audit workflow.*

(IV1, 2023)

*We have a lot of training throughout the year. But the busiest month for training is around October every year. It focused to the updates related to the audit and review.*

(IV2, 2023)

*We receive training on an engagement or project basis. Whenever there is a new project, our superiors provide guidance on how to conduct the Shariah review.*

(IV4, 2023)

According to the analysis mentioned above, both reviewers participate in internal training conducted by the firms. These training sessions are led by superiors, such as partners, directors, or managers, and primarily emphasize the completion of assigned tasks. However, IV3 has a different view. She mentioned that the training cannot be only specified into the scheduled physical or online training by the firm. There are 4 types of trainings which will involve all officers throughout the year as below statement:

*The technical training is not the only training important for the Shariah review officer. Pursuing a professional certificate is also actually one of the trainings for the officer. During review execution, the officer will also learn from their senior on a case-by-case basis which can be one of the trainings for them. Lastly, the officer should read any new article, resolution or guidelines issued by the authority. This is important to ensure that the review done by the officer is meet the expectations of the authority.*

(IV3, 2023)

From the above statements, researchers are aware that there are many types of training involved the review officer. We cannot specify the term training to only technical training, other things that may assist the officer to more understand of the job scope and governance framework should be considered as training for the officer. From the interview, researcher concluded that officer from both conventional and Shariah will involve in a training related to their job scope. However, the frequency of trainings for the conventional reviewer is higher with a proper arrangement compared to the Shariah reviewer. This is due to the more frequent update from the regulator related to the conventional governance framework compared to the Shariah governance.

#### 4.2 Process of The Review

##### a) Risk Assessment

For the risk's assessments, participant has explained: *Before commencing the review, we have already determined the areas of risk that we need to address in advance.*

(IV1, 2023)

*The assessment of the risks is important. We will go through the current accounts and prior audited accounts*



*to classify the risks of the current year's audit. Everything will be documented in our system.*

*(IV2, 2023)*

*We utilize an Excel template that incorporates both BNM and AAOIFI guidelines. During the review, we assess the conditions based on the template and assign an audit rating accordingly. If we identify a potential non-compliance, it will be rated as high, and we will undergo further review. Features that require improvement will receive fair and low ratings*

*(IV3, 2023)*

The Shariah reviewer's risk assessment process is more straightforward in comparison to that of the conventional reviewer. The Shariah reviewer concentrates directly on a checklist provided in guidelines to evaluate the compliance of review matters. Responses are simply categorized as either "yes" or "no," without considering additional factors. Following this, matters receive ratings ranging from low to high, and only those with high ratings proceed to undergo Shariah non-compliance review process. For matters deemed medium or lower risk, the reviewer offers improvement suggestions. This stands in contrast to the conventional reviewer's approach, which involves a comprehensive investigation of all areas. The conventional risk assessment is mainly utilized to gauge the impact of different areas on the entire review process, prioritizing higher-risk areas for more immediate attention compared to those with lower risk levels.

#### *b) Follow-Up Issues*

Other than that, is the follow-up issues. The former Auditor General (AG), Tan Sri Dr. Madinah in her speech in 2016 has focus on the importance of following up issues found during the review works (Tan Sri Dr Madinah, 2016). The former AG has stressed the significance of effective communication with individuals tasked with governance responsibilities. This emphasis is crucial to ensure that appropriate actions can be taken in accordance with their respective jurisdictions. Participant has shared:

*If a deficiency in the Standard of Procedures (SOP) is identified, such as the staff not adhering to the job description outlined in the SOP, and it has a significant impact on the financial statements, we will duly highlight this issue. We initiate discussions with the client to address the matter. If, however, the issue cannot be resolved through discussions, we will include it in the management letter. This step serves to notify the Board about the concern and elicit their response to the highlighted deficiency.*

*(IV1, 2023)*

*If the client does not meet the required standards, the certificate will not be issued. Instead, we will inform the management about the specific non-compliance issues and give them a reasonable period to address and rectify the problems. Once the necessary improvements are made and compliance is ensured, we will proceed with the issuance of the certificate. This process ensures that the client meets all the necessary criteria before obtaining the certificate.*

*(IV4, 2023)*

According to the interviews, both reviewers have implemented this practice by flagging necessary issues to the management. While the communication methods might vary between the reviewers, the ultimate objective of the follow-up remains consistent to ensure that management can address and rectify the identified issues as soon as possible. The common goal is to facilitate timely and effective resolution of any concerns to maintain compliance and improve overall performance.

#### *c) Output of The Review*

Thirdly is the output of the review. Both participants have response:

*Our report needs to be submitted to the Suruhanjaya Syarikat Malaysia (SSM), which is also referred to as the Companies Commission of Malaysia or the Securities Commission.*

*(IV1, 2023)*

*We will issue a certificate containing detailed information on Shariah compliance. Additionally, a prepared report will outline our findings and discussions regarding Shariah compliance throughout the entire review process. Both the certificate and report aim to communicate the compliance status effectively, offering a clear overview of the review outcomes for the benefit of relevant stakeholders.*

*(IV3, 2023)*

The researcher noted a distinct contrast in the output provided by the two reviewers. Although both reviewers generate a compliance report, the Shariah reviewer goes a step further by furnishing an additional output in the form of a Shariah compliance certificate. This certificate holds significance as it summarizes the audited Shariah matters, offering stakeholders a concise and accessible summary of the information for their understanding and use. The certificate serves as a clear declaration of the organization's adherence to Shariah principles and provides stakeholders with a concise overview of the review's outcomes in terms of Shariah compliance.

## **5. Conclusion**

The aim of this study is to explore the similarities and key difference of external review between conventional and Shariah reviewers. The research findings focus on two main themes: reviewer attributes and the review process. Based on the conducted interviews, several similarities and differences were observed between the two practices. It was noted that both reviewers share the same attributes required to conduct the review. However, there are distinctions in the review process, with only follow-up issues showing similarity while risk assessment and compliance output differing. It's important to highlight that the study's findings are solely based on the results from the conducted interviews, and they may not fully represent the practices of all firms in Malaysia. Further research in this area could be initiated, focusing on a comprehensive examination of the review process from planning to reporting in greater detail. This would provide a more

comprehensive understanding of the similarities and differences between conventional and Shariah reviewers across various firms.

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