



MALAYSIAN INSTITUTE
OF ACCOUNTANTS



White Paper on Shariah Audit

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ABSTRACT

Various organisations that offer Shariah-compliant services and products, contribute significantly to Malaysia's globally competitive Islamic finance industry. Given that Shariah regulations and compliance are a competitive edge in growing and capitalising on Islamic markets, it is imperative to ensure consistent Shariah compliance for the issuance of Islamic finance services and products, particularly through the adequate implementation of Shariah governance structures and Shariah audit practices.

This paper provides an overview of the diverse regulations and current practices, as well as the issues and policy recommendations relating to Shariah audit for the following sectors: Islamic banking and takaful, Islamic capital market, Islamic co-operatives, public trust entities and other Islamic institutions such as State Islamic Religious Councils. This paper is based on a mix of primary and secondary data. Notably, it derives analysis of the current challenges in implementing Shariah governance and audit from roundtable sessions and the deliberations of a Shariah Audit Working Group comprising industry experts and regulators.

Two key challenges are identified : (1) the lack of defined scope for Shariah audit and, (2) the lack of required talent with the requisite skill and knowledge to perform an effective Shariah audit. To tackle these issues, this paper proposes the issuance of a Roadmap and Best Practice Guides that address talent management and professional development for Shariah auditors, as well as audit coverage respectively.

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INTRODUCTION

Malaysia is recognised as a global leader in Islamic finance with bright prospects to generate, drive and capture greater growth owing to strong market demand from the country's Muslim-majority population and high potential to serve the international market.

The Islamic finance industry in Malaysia comprises several sectors that contribute to Malaysia's robust growth in this space. This paper covers the following sectors:

- Islamic banking and takaful;
- Islamic capital market;
- Islamic co-operatives;
- Public Trust Entities (PTEs); and
- other Islamic institutions such as State Islamic Religious Councils (SIRCs).

Shariah audit practices in these sectors are diverse due to the different approaches taken by their respective regulators. This paper provides an overview of the regulations and current practices, as well as the issues and policy recommendations relating to Shariah audit in these sectors.

Section II summarises the Shariah governance and audit practices adopted in each sector. Section III briefly elaborates on the definition, process and scope of Shariah audit.

Lastly, Section IV discusses the current challenges faced by each sector in the areas of Shariah governance and audit. This White Paper derives its analysis of these issues from four roundtable sessions with representatives from Islamic financial institutions (IFIs), the Islamic capital market, public trust entities, co-operatives, and State Islamic Religious Councils. Lastly, Section V proposes a way forward to enhance Shariah audit practices in these sectors.

II. OVERVIEW

2.0 Introduction

According to the *State of the Islamic Economy Report 2020/21*, Malaysia has pioneered the development of Islamic finance ecosystems for eight consecutive years starting from the year 2013. Based on the Global Islamic Economy Indicator, which measures how well-positioned countries are to capitalise on the halal economy, Malaysia is in first place with a total score of 290.2, chiefly due to the rapid development of its Islamic finance sector, while Saudi Arabia is in second place with a score of 155.1 (DinarStandard, 2020). Similarly, the *Islamic Financial Development Report 2021* ranks Malaysia first, followed by Indonesia. According to the Islamic Financial Development Indicators, Malaysia leads in quantitative development, knowledge, awareness and governance (ICD-REFINITIV, 2021). Furthermore, the *Islamic Financial Services Industry Stability Report 2021* produced by the Islamic Financial Services Board (IFSB) recognises Malaysia as the third largest country in terms of Islamic financial assets globally (11.4%). Malaysia also has the largest *sukuk* market, with approximately 47.3% of total *sukuk* globally (IFSB, 2021).

Islamic financial system

Presently, there are 16 Islamic Banks, 15 Takaful Operators and six (6) Development Financial Institutions (DFIs) in Malaysia's Islamic financial industry. These institutions are listed by sector in Table 1 below.

Table 1: Islamic Financial Institutions (IFIs) in Malaysia

No.	Name
Islamic Banks	
1.	Affin Islamic Bank Berhad
2.	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad
3.	Alliance Islamic Bank Berhad
4.	AmBank Islamic Berhad
5.	Bank Islam Malaysia Berhad
6.	Bank Muamalat Malaysia Berhad
7.	CIMB Islamic Bank Berhad
8.	Hong Leong Islamic Bank Berhad
9.	HSBC Amanah Malaysia Berhad
10.	Kuwait Finance House (Malaysia) Berhad
11.	Maybank Islamic Berhad
12.	MBSB Bank Berhad
13.	OCBC Al-Amin Bank Berhad
14.	Public Islamic Bank Berhad
15.	RHB Islamic Bank Berhad
16.	Standard Chartered Saadiq Berhad

II. OVERVIEW (CONT'D.)

2.0 Introduction (cont'd.)

Table 1: Islamic Financial Institutions (IFIs) in Malaysia (cont'd.)

No.	Name
Takaful Operators	
1.	AIA PUBLIC Takaful Berhad
2.	AmMetLife Takaful Berhad
3.	Etiqa Family Takaful Berhad
4.	Etiqa General Takaful Berhad
5.	FWD Takaful Berhad
6.	Great Eastern Takaful Berhad
7.	Hong Leong MSIG Takaful Berhad
8.	Prudential BSN Takaful Berhad
9.	Sun Life Malaysia Takaful Berhad
10.	Syarikat Takaful Malaysia Am Berhad
11.	Syarikat Takaful Malaysia Keluarga Berhad
12.	Takaful Ikhlas Family Berhad
13.	Takaful Ikhlas General Berhad
14.	Zurich General Takaful Malaysia Berhad
15.	Zurich Takaful Malaysia Berhad
Development Financial Institutions (DFIs)	
1.	Bank Pembangunan Malaysia Berhad
2.	Small Medium Enterprise Development Bank Malaysia Berhad (SME Bank)
3.	Export-Import Bank of Malaysia Berhad (EXIM Bank)
4.	Bank Kerjasama Rakyat Malaysia Berhad (Bank Rakyat)
5.	Bank Simpanan Nasional
6.	Bank Pertanian Malaysia Berhad (Agrobank)

Source: BNM (2021)

The Islamic Capital Market sector is significant as it supports economic growth by facilitating equity and non-equity funding. Malaysia's Islamic capital market sector features 787 public listed companies (81% of 969 companies) that are classified as Shariah-compliant securities as at 25 November 2022. In addition, there are forty (40) Shariah-compliant securities in the Leading Entrepreneur Accelerator Platform (LEAP) market, five (5) Islamic Real Estate Investment Trusts (i-REITs) and six (6) Islamic Exchange-Traded Funds (i-ETFs) (Securities Commission, 2022). These Shariah-compliant securities are listed in Tables 2 to 5 below.

Table 2: Shariah-Compliant Securities in the Main Market/Ace Market as at 25 November 2022

Main Market/ACE Market	Number of Shariah-Compliant Securities	Total Securities	Percentage of Shariah-Compliant Securities (%)
Industrial Products & Services	238	280	85
Consumer Products & Services	156	205	76
Property	90	99	91
Technology	85	108	79
Construction	61	63	97
Plantation	36	43	84

II. OVERVIEW (CONT'D.)

2.0 Introduction (cont'd.)

Table 2: Shariah-Compliant Securities in the Main Market/Ace Market as at 25 November 2022 (cont'd.)

Main Market/ACE Market	Number of Shariah-Compliant Securities	Total Securities	Percentage of Shariah-Compliant Securities (%)
Transportation & Logistics	31	34	91
Energy	27	32	84
Healthcare	27	27	100
Telecommunications & Media	20	30	67
Utilities	11	13	85
Financial Services	5	33	15
Closed-End Fund	Nil	1	Nil
SPAC	Nil	1	Nil
Total	787	969	81

Source: Securities Commission (2022)

Table 3: Shariah-Compliant Securities in the LEAP Market as at 25 November 2022

Sectors	Number of Shariah-Compliant Securities
Technology	6
Consumer Products & Services	13
Industrial Products & Services	12
Healthcare	4
Construction	3
Energy	1
Plantation	1

Source: Securities Commission (2022)

Table 4: List of Islamic Real Estate Investment Trust (i-REITs)

No.	Fund	Fund Management Company
1.	Al-'Aqar Healthcare REIT	Damansara REIT Managers Sdn Bhd
2.	Al-Salam REIT	Damansara REIT Managers Sdn Bhd
3.	Axis-REIT	Axis REIT Managers Bhd
4.	KLCC Property & REIT – Stapled Securities	KLCC REIT Management Sdn Bhd
5.	AME Real Estate Investment Trust	I REIT Managers Sdn Bhd

Source: Securities Commission (2022)

Table 5: List of Islamic Exchange-Traded Fund (i-ETFs)

No.	Fund	Fund Management Company
1.	MyETF Dow Jones Islamic Market Malaysia Titans 25	i-VCAP Management Sdn Bhd
2.	MyETF MSCI Malaysia Islamic Dividend	i-VCAP Management Sdn Bhd
3.	MyETF MSCI SEA Islamic Dividend	i-VCAP Management Sdn Bhd
4.	VP-DJ Shariah China A-Shares 100 ETF - MYR	Value Partners Asset Management Malaysia Sdn Bhd

II. OVERVIEW (CONT'D.)

2.0 Introduction (cont'd.)

Table 5: List of Islamic Exchange-Traded Fund (i-ETFs) (cont'd.)

No.	Fund	Fund Management Company
5.	MyETF Dow Jones U.S. Titans 50	i-VCAP Management Sdn Bhd
6.	Tradeplus Shariah Gold Tracker	Affin Hwang Asset Management Bhd

Source: Securities Commission (2022)

Co-operatives

The *2021 Profile of Top 100 Malaysian Co-operatives in Malaysia* issued by the Malaysia Co-operative Societies Commission (Suruhanjaya Koperasi Malaysia or SKM) reveals that the top 100 co-operatives (co-ops) have combined assets totalling RM26.15 billion as at 2021. These co-ops posted RM4.23 billion in income, with their shares and subscription fees collected amounting to RM6.21 billion. The financial services sector continues to dominate this list with 41 credit co-ops (SKM, 2021a). In addition, there are about 530 co-ops offering both financing and credit functions that amount to RM12.15 billion (SKM, 2021b). The details of these co-ops with financing and credit functions are in Table 6 below.

Table 6: Co-ops with Financing and Credit Functions

Financial Activity	Number of Co-Operatives	Loans Disbursed (RM Billion)
BANKING		
Bank Kerjasama Rakyat Malaysia Berhad	1	9.67
Koperasi Co-opbank Pertama Malaysia Berhad	1	0.46
Total Financing from Bank Function	2	10.13
CREDIT		
Co-operative Credit Function	376	1.59
Co-operative Non-Credit Function	154	0.43
Total Financing from Credit and Non-Credit Functions	530	2.02
TOTAL	532	12.15

Source: SKM (2021b)

Public trust entities (PTEs)

Apart from co-operatives, PTEs too provide Shariah-compliant offerings. PTEs are government bodies, non-governmental organisations and Islamic foundations that serve specific objectives. These entities collect funds from investors, depositors or contributing members for the special purposes outlined in their organisational visions and missions. Examples are the Employees Provident Fund (EPF), Lembaga Tabung Haji (TH), Kumpulan Wang Amanah Pencen (KWAP), Lembaga Tabung Angkatan Tentera (LTAT), Permodalan Nasional Bhd (PNB) and Yayasan Pembangunan Ekonomi Islam Malaysia (YaPEIM).

As PTEs manage funds on behalf of their depositors and the public at large, proper Shariah governance and audits for their shariah-compliant offerings must be in place to ensure the accountability and sustainability of the funds managed. The details of the main PTEs in Malaysia are shown in Table 7.

II. OVERVIEW (CONT'D.)

2.0 Introduction (cont'd.)

Table 7: Main PTEs in Malaysia

No.	Fund	Financial Performance
1.	Employees Provident Fund (EPF)	Assets: RM1.01 trillion Net Income*: RM42.08 billion (EPF Annual Report, 2020)
2.	Permodalan Nasional Bhd (PNB)	Assets: RM322.64 billion Net Income*: RM11.02 billion (PNB Annual Report, 2020)
3.	Lembaga Tabung Haji (TH)	Assets: RM82.54 billion Net Income*: RM3.42 billion (TH Annual Report, 2020)
4.	Yayasan Pembangunan Ekonomi Islam Malaysia (YaPEIM)	Assets: RM1.24 billion Revenue: RM53.77 million (YaPEIM Annual Report, 2019)

Note: Net income* = net income after tax

State Islamic Religious Councils (SIRCs)

Zakat and *waqf* institutions in Malaysia, including State Islamic Religious Councils (SIRCs), are required to provide their services in accordance with Shariah requirements. In Malaysia, SIRCs are responsible for managing Islamic wealth such as *zakat*, *waqf*, *baitulmal* and other Islamic social funds. Currently, there are 14 SIRCs in Malaysia, which are listed in Table 8 below.

Table 8: SIRCs in Malaysia

No.	SIRCs
1.	Majlis Agama Islam Wilayah Persekutuan (MAIWP)
2.	Majlis Agama Islam Selangor (MAIS)
3.	Majlis Agama Islam Negeri Sembilan (MAINS)
4.	Majlis Agama Islam Negeri Johor (MAIJ)
5.	Majlis Agama Islam & Adat Melayu Perak (MAIPk)
6.	Majlis Agama Islam Negeri Pulau Pinang (MAINPP)
7.	Majlis Islam Sarawak (MIS)
8.	Majlis Agama Islam Negeri Kedah Darul Aman (MAINK)
9.	Majlis Agama Islam & Adat Istiadat Melayu Perlis (MAIPs)
10.	Majlis Agama Islam & Adat Istiadat Melayu Kelantan (MAIK)
11.	Majlis Agama Islam & Adat Melayu Terengganu (MAIDAM)
12.	Majlis Ugama Islam & Adat Resam Melayu Pahang (MUIP)
13.	Majlis Agama Islam Melaka (MAIM)
14.	Majlis Ugama Islam Negeri Sabah (MUIS)

II. OVERVIEW (CONT'D.)

2.1 Islamic Financial System

2.1.1 Islamic Banking and Takaful

Bank Negara Malaysia (BNM) regulates and supervises Shariah compliance and governance within IFIs and other relevant entities to promote financial stability and economic growth. Figure 1 outlines the main regulatory initiatives introduced by BNM in the last four decades.

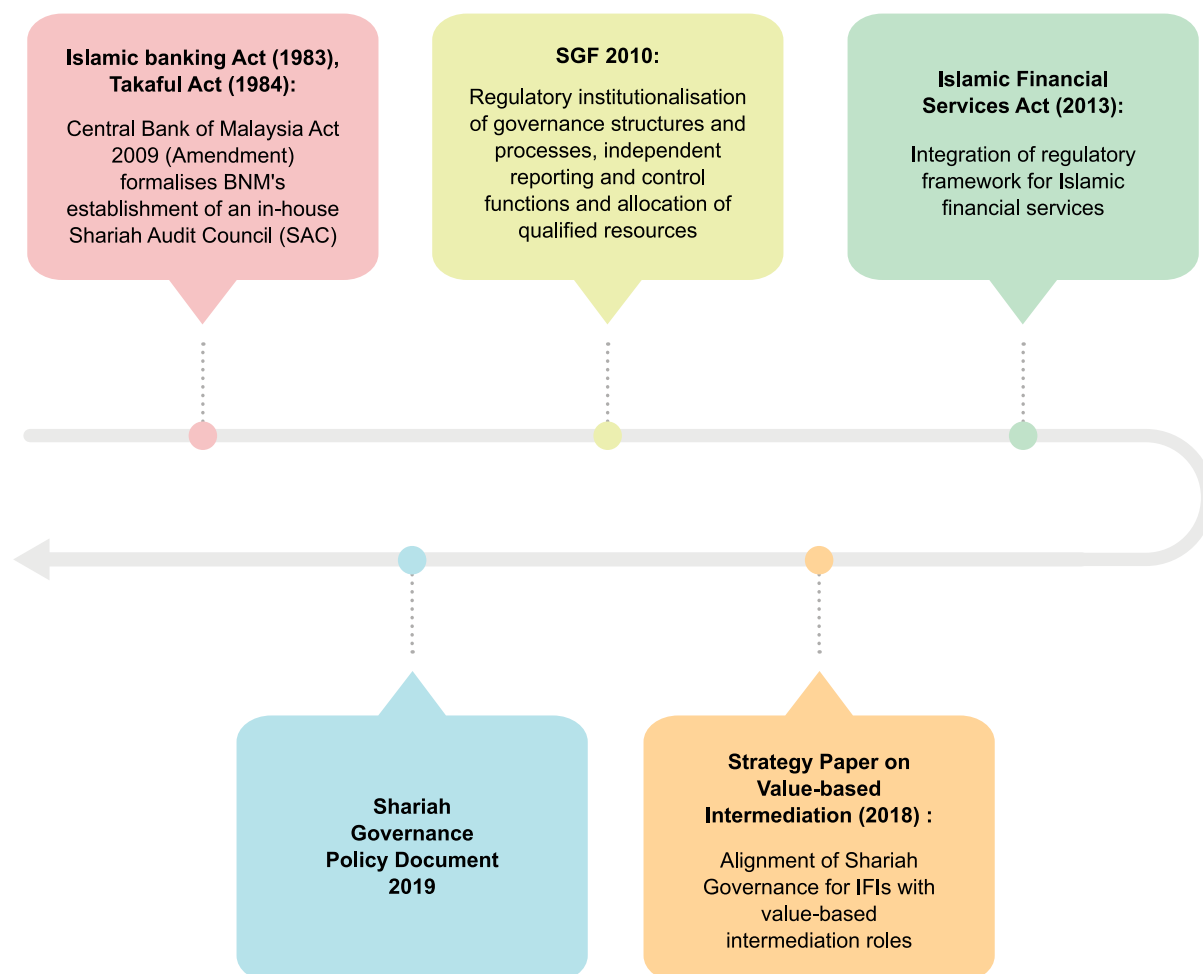


Figure 1: Legal and Regulatory Frameworks of the Islamic Banking and Takaful Industry since 1983

Figure 1 shows the evolution of Malaysia's Shariah compliance ecosystem and its progression towards the overarching goal of realising IFIs' value-based intermediation functions.

II. OVERVIEW (CONT'D.)

2.1 Islamic Financial System (cont'd.)

2.1.1 Islamic Banking and Takaful (cont'd.)

Today, the applicable regulatory standards and guidelines are as follows:

Islamic Financial Services Act (IFSA) 2013

The Islamic Financial Services Act (IFSA) together with the Financial Services Act (FSA) issued on 30 June 2013 integrates a range of financial laws “under a single legislative framework for the conventional and Islamic financial sectors respectively, namely, the Banking and Financial Institutions Act 1989 (BAFIA), Islamic Banking Act 1983, Insurance Act 1996 (IA), Takaful Act 1984, Payment Systems Act 2003 and Exchange Control Act 1953 which are repealed on the same date” (BNM, 2013).

The FSA and IFSA are efforts to modernise the laws governing financial institutions’ conduct and supervision, with an eye towards effectively facilitating and maintaining financial stability, inclusive growth, and adequate consumer protection. The IFSA outlines the regulation and supervision of Islamic financial institutions, payment systems and other relevant entities, along with the oversight of Islamic money markets and Islamic foreign exchange.

Together, these laws facilitate the advancement towards a more sound, responsible and progressive financial system in Malaysia.

Shariah Governance Policy Document (SGPD) 2019

The SGPD 2019 was issued by BNM on 20 September 2019 to strengthen the oversight accountabilities of the Board of Directors, the Shariah Committee and other key organs involved in the implementation of Shariah governance. Furthermore, in line with the Shariah Committee’s objective to achieve effective management vis-à-vis Shariah non-compliance risks, this policy document bolsters the Committee’s decision-making process and internal control functions. By implementing the SGPD 2019, IFIs will be better placed to support a strong Shariah compliance risk culture given more active roles from the Board of Directors, the Shariah Committee and senior management.

There are six main parts in the SGPD 2019 covering: (i) the board of directors (BOD); (ii) Shariah Committee; (iii) senior management; (iv) control functions; (v) Shariah compliance culture and remuneration; and (vi) transparency and disclosures. The primary difference between the Shariah Governance Framework (SGF) 2010 and SGPD 2019 is the restructuring of four Shariah functions (namely, Shariah risk management, Shariah review, Shariah audit and Shariah research) into three functions. Under the restructured functions, the Shariah research function is combined with the Shariah secretariat’s function and is no longer classified under the control function. Part E of the SGPD 2019 strongly encourages IFIs to have robust Shariah compliance functions (that is, risk management, review and audit functions). Other key enhancements made in SGPD 2019 include a change in the tenure limit of Shariah members, notifications to BNM when applying stringent Shariah Committee decisions, prohibitions in appointing active politicians as Shariah Committee members, as well as the regular review of the quality and frequency of the Board’s engagement with the Shariah Committee.

II. OVERVIEW (CONT'D.)

2.1 Islamic Financial System (cont'd.)

2.1.1 Islamic Banking and Takaful (cont'd.)

Statutory Committee

Established in 1997, the Shariah Advisory Council of Bank Negara Malaysia (SAC BNM) is the Statutory Committee vested with the ultimate Shariah authority for IFI governance. The Central Bank of Malaysia Act 2009 (CBA 2009) reinforces the SAC BNM's role and function as the primary legal authority to supervise and regulate IFIs on BNM's behalf. The SAC BNM's decisions are binding on IFIs, the court, arbitration and BNM. The SAC BNM's decisions shall prevail in cases of conflicting or inconsistent Shariah opinions among Islamic banks' Shariah Committees.

The SAC's mandates as provided under section 52 of the CBA 2009 are as follows (BNM, 2009):

- i. Ascertain the Islamic law on any financial matter and issue a ruling upon reference made to it in accordance with this Part;
- ii. Advise the Bank (i.e. BNM) on any Shariah issues relating to Islamic financial business, the activities or transactions of the Bank; and
- iii. Provide advice to any Islamic financial institution or any other person as may be provided under any written law.

The SAC BNM comprises Shariah scholars, jurists and market practitioners. These members are qualified individuals with vast experience in banking, finance, economics, law and the application of Shariah—particularly in the areas of Islamic economics and finance. SAC members are appointed by the Yang di-Pertuan Agong, based on the advice of the Minister of Finance after consultation with BNM.

IFIs as Value-Based Intermediators

BNM guides Islamic financial practitioners towards achieving the value propositions of IFIs as financial intermediators that serve the real economy. In collaboration with the Islamic finance industry, BNM released a 2018 strategy paper entitled *Value-based Intermediation: Strengthening the Roles and Impact of Social Finance* for a more sustainable financial ecosystem. The strategies promote the application of value-based intermediation (VBI) practices, which will lead to an improved suite of products and services offered by Islamic Banking Institutions (IBIs) to better facilitate entrepreneurship, community well-being, and sustainable environmental protection and economic growth without compromising shareholders' returns. The intended outcomes of VBI are broadly similar to the objectives set by structures such as Environmental, Social and Corporate Governance (ESG); Sustainable, Responsible, Impact Investing (SRI); and ethical finance frameworks. With the adoption of VBI, practitioners will need to consider the impact of their activities and actions not only on financial consumers but a wider range of stakeholders, as guided by the Shariah principles that determine the underlying values and priorities of VBI.

II. OVERVIEW (CONT'D.)

2.1 Islamic Financial System (cont'd.)

2.1.1 Islamic Banking and Takaful (cont'd.)

In 2018, BNM issued three guidance documents to facilitate the practical adoption of VBI (BNM, 2018b). VBI aims to re-orient Islamic finance business models towards realising the objectives of Shariah: that is, to generate a positive and sustainable impact on the economy, community and environment through Islamic practices, processes, offerings and conduct. The gist of the three documents are as follows:

- i. The Implementation Guide for VBI provides guidance on practical value-based banking practices. It acts as a reference for IFIs that intend to adopt VBI initiatives and outlines the phases of implementation, as well as key implementation challenges and some pragmatic solutions (BNM, 2018c);
- ii. The VBI Financing and Investment Impact Assessment Framework (VBIAF), which was jointly developed with The World Bank and International Centre for Education in Islamic Finance (INCEIF), facilitates the implementation of an impact-based risk management system. It provides a schema for assessing the financing and investment activities of IBIs in line with their respective VBI commitments; (BNM, 2019b); and
- iii. The VBI Scorecard, which was jointly developed with the Global Alliance for Banking on Values, covers the purposes, key components of assessment and proposed measurement methodology of value-based intermediation (BNM, 2018d).

2.1.2 Islamic Capital Market

Malaysia's capital market regulations can be categorised into two distinct phases: before and after the issuance of the Securities Commission Malaysia Act 1993 (SCA). Prior to this Act's introduction, regulation of Malaysia's capital market was under the purview of various institutions, namely, the Registrar of Companies (ROC), Capital Issues Committee (CIC), Panel on Take-overs and Mergers (TOP), Foreign Investment Committee (FIC), Bank Negara Malaysia (BNM), Ministry of Trade and Investment (MITI) and Kuala Lumpur Stock Exchange (KLSE) (Singhand & Yusof, 2014).

The SCA promotes capital market development and streamlines regulations for the securities market by appointing a single regulator (i.e. the Securities Commission) to expedite the processing and approval of corporate transactions.

Promoting the development of the Islamic financial market is similarly crucial because this, along with the issuing of *sukuk* by leading corporations as a long-term corporate financing instrument, is the main avenue for Islamic securities and funds growth.

Hence, in terms of Shariah governance, the Shariah Advisory Council of Securities Commission Malaysia (SAC SC) was formally established in 1996 to advise the SC on issues of Shariah compliance within the Islamic capital market (ICM) and to publish Shariah Resolutions accordingly. The Shariah Resolutions act as a point of reference and provide clarity, certainty and consistency to all market players in the industry.

II. OVERVIEW (CONT'D.)

2.1 Islamic Financial System (cont'd.)

2.1.2 Islamic Capital Market (cont'd.)

The Shariah governance framework for Malaysia's ICM entails the following:

- i. The SAC SC as the apex Shariah regulatory authority for ascertaining the application of Shariah for Malaysia's ICM (Securities Commission, n.d.); and
- ii. The Shariah adviser is required to be appointed at the industry level pursuant to various guidelines. The adviser is to provide Shariah expertise and advice, as well as review and ensure ICM products and services' compliance with Shariah requirements (Securities Commission, n.d.).

Shariah requirements are also stipulated in the product guidelines issued by the SC.

Apart from the overarching Shariah governance framework in the ICM forwarded by the SAC SC and Shariah Advisers, the SC introduced a Shariah screening methodology in 1995, 15 years earlier than the SGF. The SAC SC issued its first list of Shariah-compliant securities in 1997. This initiative offers an easy guide for investors and fund managers seeking Shariah-compliant investment securities. In addition, the SC provides details of the Shariah screening methodology used to screen and determine the Shariah status of the listed securities—whether it will be classified as Shariah-compliant securities or Shariah non-compliant securities. This methodology assesses the quantitative and qualitative aspects of the listed companies, with the exact qualitative aspects decided by the SAC SC. In 2012, the SAC SC introduced a revised Shariah screening methodology featuring a two-tier quantitative assessment (Ayedh et al., 2019a; 2019b).

2.1.2.1 Securities Screening Methodology

Stock screening is the process of filtering stocks according to an investment strategy's relevant criteria. With respect to Shariah-compliant stocks, screening is used to segregate between Shariah-compliant and non-Shariah compliant stocks in a particular market (Najib et al., 2014).

There are several Shariah screening methodologies presently available worldwide. This includes the Dow Jones Islamic Market Index (DJIM), FTSE Global Islamic Market Index Series, and Standard & Poor (S&P) Islamic Market Indices. Meanwhile, in Malaysia, the SAC of the SC publishes its list of Shariah-compliant securities once every six months. This is one of the important roles played by the SC, through its SAC, in ensuring Shariah compliance in the ICM.

II. OVERVIEW (CONT'D.)

2.1 Islamic Financial System (cont'd)

2.1.2 Islamic Capital Market (cont'd.)

2.1.2.1 Securities Screening Methodology (cont'd.)

In determining the Shariah status of a listed company, the contribution of non-Shariah compliant activities to the company's group revenue and group profit before taxation will be computed and compared against the relevant business activity benchmarks as follows:

i. The 5% benchmark

The 5% benchmark is applicable to the following businesses/activities:

- conventional banking and lending;
- conventional insurance;
- gambling;
- liquor and liquor-related activities;
- pork and pork-related activities;
- non-halal food and beverages;
- Shariah non-compliant entertainment;
- tobacco and tobacco-related activities;
- interest income¹ from conventional accounts and instruments (including interest income awarded arising from a court judgement or arbitrator);
- dividends² from Shariah non-compliant investments; and
- other activities deemed non-compliant according to Shariah principles as determined by the SAC SC.

For the above-mentioned businesses/activities, the contribution of the Shariah non-compliant businesses/activities to the Group revenue or Group profit before taxation of the company must be less than 5%.

ii. The 20% benchmark

The 20% benchmark is applicable to the following businesses/activities:

- share trading;
- stockbroking business;
- rental received from Shariah non-compliant activities; and
- other activities deemed non-compliant according to Shariah principles as determined by the SAC SC.

For the above-mentioned businesses/activities, the contribution of Shariah non-compliant businesses/activities to the Group revenue or Group profit before taxation of the company must be less than 20%.

¹ Interest income and dividends from Shariah non-compliant investments will be compared against the Group revenue. However, if the main activity of the company is holding of investments, the dividends from Shariah non-compliant investments will be compared against the Group revenue and Group profit before taxation.

² Interest income and dividends from Shariah non-compliant investments will be compared against the Group revenue. However, if the main activity of the company is holding of investments, the dividends from Shariah non-compliant investments will be compared against the Group revenue and Group profit before taxation.

II. OVERVIEW (CONT'D.)

2.1 Islamic Financial System (cont'd)

2.1.2 Islamic Capital Market (cont'd.)

2.1.2.1 Securities Screening Methodology (cont'd.)

Financial Ratio Benchmarks

For the financial ratio benchmarks, the SAC SC takes into account the following:

- a. **Cash over total assets**
Cash only includes cash placed in conventional accounts and instruments, whereas cash placed in Islamic accounts and instruments is excluded from the calculation.
- b. **Debt over total assets**
Debt only includes interest-bearing debt whereas Islamic financing or *sukuk* is excluded from the calculation.

The above-mentioned financial ratio is intended to measure *riba* and *riba*-based elements within a company's statements of financial position. Hence, in classifying a company as Shariah-compliant, cash over total assets and debt over total assets ratios must be less than 33%.

In addition to the above two-tier quantitative criteria, the SAC SC also takes into account the qualitative aspect which involves public perception or image of the company's activities from the Islamic perspective.

In 2013, the SC revised the Shariah screening methodology for two reasons. Chiefly, it aims to reflect the current development and sophistication of the Islamic finance industry, as well as bolster the competitiveness of the Malaysian Islamic equity market and Islamic fund management industry by building its scale and international reach (Securities Commission Malaysia 2013b). The revision of the screening methodology mainly affects the quantitative assessment of stocks.

The new methodology applies a two-tier quantitative assessment. The first-tier quantitative assessment is similar to the previous Shariah screening methodology, except that the business activity benchmark has been revised from four benchmarks (i.e. 5%, 10%, 20% and 25%) to only two benchmarks (i.e. 5% and 20%). The 5% level of business activity benchmark is mainly designed to assess the level of contributions from activities that are prohibited by Shariah. Meanwhile, the 20% level of activity benchmark assesses the level of contributions from activities that are generally permissible according to Shariah and have an element of *maslahah* (public interest), though other factors may affect the Shariah status of these activities.

The second tier introduces a financial ratio benchmark to measure *riba'* (usury) and *riba'*-based elements in the company's balance sheet. In calculating the financial ratio, cash will only include cash placed in conventional accounts and instruments, while debt includes only interest-bearing debt. Table 9 details the differences between the initial and revised Shariah screening methodologies in Malaysia.

II. OVERVIEW (CONT'D.)

2.1 Islamic Financial System (cont'd)

2.1.2 Islamic Capital Market (cont'd.)

2.1.2.1 Securities Screening Methodology (cont'd.)

Table 9: Key Differences between the Initial and Revised Shariah Screening Methodologies in Malaysia

[illegible]

Source: Zainudin et al. (2014)

Due to the importance of the ICM sector, with 81% of Bursa-listed companies being Shariah-compliant as of 25 November 2022, it is vital to foster market discipline and promote public confidence in the continued Shariah compliance of industry players.

2.1.2.2 Appointment of Shariah Advisers for ICM Products and Services

The SC adopts a two-tier Shariah governance framework for the capital market (Securities Commission, n.d.).

The first tier is the Shariah Advisory Council. In addition, the SC has an internal secretariat. The Islamic Capital Market Development Business Group acts as a dedicated Secretariat responsible for reviewing each product submitted to ensure compliance with Shariah requirements and product guidelines, and for undertaking Shariah-related research.

The second tier is the Shariah advisers at the industry level who must be registered with the SC; their appointment, role and responsibilities are specified in the Guidelines on Islamic Capital Market Products and Services.

II. OVERVIEW (CONT'D.)

2.1 Islamic Financial System (cont'd)

2.1.2 Islamic Capital Market (cont'd.)

2.1.2.2 Appointment of Shariah Advisers for ICM Products and Services (cont'd.)

As at January 2023, there are 66 individuals, 20 corporations, 17 licensed Islamic banks as defined in the Islamic Financial Services Act 2013 and various licensed banks or licensed investment banks as defined in the Financial Services Act 2013 that have been approved by Bank Negara Malaysia to engage in Islamic banking and who are registered as Shariah advisers with the SC (BNM 2021; Securities Commission, 2023).

The appointment of Shariah advisers is mandated under the Guidelines on Islamic Capital Market Products and Services for any issuance of ICM products and services such as Islamic unit trust funds, Islamic real estate investment trusts, Islamic exchange-traded funds, Islamic wholesale funds, *sukuk*, asset-backed *sukuk* and Islamic-structured products. The Guidelines on Islamic Capital Market Products and Services also specify other relevant Shariah requirements for the issuing of any ICM products and services.

These advisers are independent parties to the ICM product or service providers. With regards to Islamic fund management, the product and service providers are required to have in place compliance officers and internal audit functions to monitor Shariah compliance. Other companies that manage real estate investment trusts and exchange-traded funds similarly need to appoint compliance officers. These are forms of Shariah governance that are unique to the ICM, since the SAC regulates Islamic products and services rather than the institutions offering them.

Much like the SGPD 2019 introduced by BNM, the SC's Guidelines on Islamic Capital Market Products and Services has benefited the Islamic fund management sector by establishing the relevant key organs for Shariah compliance, namely, Shariah review and audit, which is supported by Shariah risk management and research. Nevertheless, in the SC guidelines, the onus in managing shariah risk management is on the business units that manage the portfolio; while the Shariah adviser must (i) review the Islamic collective investment scheme's (CIS) compliance report and investment transaction report to ensure that they comply with Shariah; and (ii). prepare a report to be included in the Islamic CIS' fund report stating its opinion whether the Islamic CIS has been operated and managed in compliance with Shariah, including rulings, principles and concepts endorsed by the SAC SC for the financial period concerned.

On 28 November 2022, the SC enhanced the Guidelines on Islamic Capital Market Products and Services to address the lifetime registration of Shariah Advisers, their continuous professional development and conduct requirements. Further comparative information on the previous and new Guidelines on Islamic Capital Market Products and Services is provided in Appendix 1.

II. OVERVIEW (CONT'D.)

2.1 Islamic Financial System (cont'd)

2.1.2 Islamic Capital Market (cont'd.)

2.1.2.2 Appointment of Shariah Advisers for ICM Products and Services (cont'd.)

Notably, the Guidelines on Islamic Capital Market Products and Services enable the role of independent Shariah Advisers in providing continuous oversight with regards to Shariah governance and compliance. Nonetheless, the industry faces a shortage of qualified Shariah advisers who are well versed in both the Shariah and operational aspects of the ICM sector. There is a need for human capital development to train existing and new Shariah advisers in ICM-related matters.

2.2 Co-operatives

As economic agents with a strong social bent, co-operatives have contributed significantly to the wider community's development through their operations in areas such as banking, credit/finance, plantations, housing, industry, consumer goods, construction, transport and services. Through these operations, Ahmad Bello (2005) states that co-operatives play an increasingly important role worldwide in poverty reduction, job creation, economic growth and social development.

Moreover, co-operatives have many opportunities for lifting the poor out of poverty and other forms of deprivations. According to Birchall (2003), the co-operative sector could create opportunities on the supply and demand sides. On the supply side, they can create opportunities for the poor by stimulating economic growth and making markets work for the poor. On the demand side, they help the poor take advantage of opportunities by building their confidence through education, training, and self-organisation for various common interests.

In Malaysia, the co-operative society was first established in 1922 to improve its members' wellbeing, eradicate poverty and redistribute national wealth. Suruhanjaya Koperasi Malaysia (SKM), a commission established on 1 January 2008, regulates this sector; it governs, among others, co-operative registration, supervision and monitoring. It replaced the Department of Co-operative Development, which was founded under the Co-operative Act 1948 (Revised 1983), as the de jure regulator for this sector. Prior to SKM's takeover, the Department of Co-operative Development—which was initially known as The Office of The Director of Co-operation—was responsible, under the Co-operative Societies Enactment 1922 that preceded the Co-operative Act, for the registration and development of co-operatives. Currently, the sector is regulated under the Co-operative Act 1993 (Act 502), which was enacted to solidify regulatory requirements for Malaysia's co-operatives.

The co-operative sector's growth is driven by Angkatan Koperasi Kebangsaan Malaysia Berhad (ANGKASA), which was officially registered as a national union following the Second Co-operative Congress. ANGKASA is considered the lead national co-operative and "implements co-operative transformation programs through its participation in high-value economy projects in seven 7 key economic sectors; Financial Services, Wholesale & Retail, Tourism & Healthcare, Agriculture & Agro-Base Industry, Plantation, Telecommunication, and Property Development" (International Co-operative Alliance, (n.d.).

II. OVERVIEW (CONT'D.)

2.2 Co-operatives (cont'd.)

ANGKASA has the following mandates (International Co-operative Alliance, (n.d.):

- i. To unite and represent Malaysia's co-operatives at the national and international level;
- ii. To stimulate and develop the co-operative business by identifying and advancing new business areas, developing and strengthening existing business, and creating a national and international network; and
- iii. To boost the understanding and practice of co-operative values and principles aligned with International Labour Organization (ILO) Recommendation 193, which recognises co-operatives as a vehicle for socioeconomic development.

To cater for the growth of Islamic co-operatives, ANGKASA established KOPSYA ANGKASA Berhad, a body registered with SKM in July 2011. KOPSYA ANGKASA offers innovative Islamic financing, deposit and investment products and services to its member co-operatives under the supervision of its Shariah Advisory Committee.

The credit co-operatives sector, which is represented by two co-operative banks and 572 credit co-operatives, is significant as it contributes nearly 84% to total sector turnover as shown in Table 10.

Table 10: Summary Interim Statistics of Co-operatives in Malaysia as at 30 June 2021

No.	Function	Numbers of Co-operatives	Asset (RM Million)	Turnover (RM Million)
1.	Banking	2	120,170.22	13,345.40
2.	Credit	572	14,936.39	2,370.91
3.	Agricultural	3,262	3,925.09	664.52
4.	Housing	304	1,008.13	101.25
5.	Industrial	345	78.34	14.89
6.	Consumer	5,482	2,177.21	1,112.25
7.	Construction	250	158.01	28.17
8.	Transportation	481	335.16	304.54
9.	Services	3,959	9,375.69	953.00
Total		14,657	152,164.24	18,894.93

Source: SKM (2021)

The growth in financing extended by the credit co-operatives, as evinced by the RM14,936.39 million in assets at end June 2021, coupled with increased awareness on Shariah-compliant financing, necessitates a strategy for Shariah governance and assurance on the part of regulators and co-operative operators.

2.2.1 Shariah Governance in Co-operatives

Suruhanjaya Koperasi Malaysia (SKM) consistently works to strengthen Islamic co-operatives' adherence to Shariah rules. According to Itam, Hasan, & Alhabshi, (2016), SKM has taken several actions to achieve the aforementioned. Under the Malaysia Co-operative Societies Commission Act 2007, for instance, SKM may consult with the SAC BNM on any co-operative business matters relating to Islamic financial services.

II. OVERVIEW (CONT'D.)

2.2 Co-operatives (cont'd.)

2.2.1 Shariah Governance in Co-operatives (cont'd.)

As with financial institutions, Shariah governance and audit in non-bank financial institutions improved significantly with the growth of Malaysia's Shariah legal framework—specifically when SKM introduced *Garis Panduan 28: Shariah Governance Guidelines* (GP28), on 1 July 2015. GP28's implementation is applicable to co-operatives engaged in the following businesses:

- banking
- credit
- financing
- *Ar-Rahnu*

GP28 was issued under section 86B of the Co-operative Societies Act 1993 to regulate co-operatives offering Shariah compliant products; it covers co-operatives' formation of a Shariah committee and its Shariah governance. It is a proactive initiative to further develop an Islamic financial system that must meet increasingly complex consumer and business needs. GP28 provides Shariah compliance guidance that will strengthen public confidence in the credibility of the Islamic *muamalat* system, especially in the co-operative sector.

Guidelines for conventional co-operative governance were issued earlier in May 2015 through GP27, which emphasises the role of the board and management. In contrast, GP28 complements GP27 through its Shariah focus. It emphasises the overall role of the following components: the board, management, internal audit and Shariah committees.

These four functions are obligated to ensure that the operations of an Islamic co-operative are in line with Shariah rules. The roles of each Shariah organ function are described in Appendix 2.

In the formation of a Shariah Committee, moreover, there should be at least one secretariat to serve the Shariah Committee. In terms of qualifications, SKM stipulates that the secretariat must possess at least a Diploma in Shariah or *Usul Fiqh* and *Fiqh al'Mu'amalat*.

2.3 Public Trust Entities (PTEs)

PTEs collect funds from investors, depositors or contributing members for special purposes, as outlined by their organisational vision or provisions in parliamentary acts. Examples are the Employees Provident Fund (EPF), Lembaga Tabung Haji (TH), Kumpulan Wang Amanah Pencen (KWAP), Lembaga Tabung Angkatan Tentera (LTAT), Permodalan Nasional Bhd (PNB) and Yayasan Pembangunan Ekonomi Islam Malaysia (YaPEIM).

Some of these entities were established under a parliamentary act or a foundation. The provisions in the act, or objectives of a foundation, lay out the PTE's responsibilities. Some PTEs are established to reduce poverty among the poor and needy, as well as provide cheaper health services and affordable education and housing. Others collect public savings to invest in Public Listed Companies (PLCs) or other companies, including SMEs in Malaysia.

II. OVERVIEW (CONT'D.)

2.3 Public Trust Entities (PTEs) (cont'd.)

The depositors of these investment trust companies or investment holding entities enjoy returns based on their amount of investment. This investment is suitable for risk-averse individuals, given that PTEs mostly invest in low-risk portfolios such as treasury bonds and *sukuk*.

Many countries have set up such entities to serve the poor and needy. PTEs are entrusted to collect money from the public to provide such services with lesser financial regulatory requirements as compared to financial institutions. A PTE of particular interest is Lembaga Tabung Haji. TH collects money from depositors who save money to perform Umrah or Hajj. This function of collecting money from the public is similar to commercial banks. However, TH is not under the supervision of Bank Negara Malaysia but the Minister of Religious Affairs in the Prime Minister's department.

2.3.1 Lembaga Tabung Haji (TH)

Lembaga Tabung Haji is a statutory body established by the Government of Malaysia in 1963 and supervised by the Minister of Religious Affairs in the Prime Minister's Department. This PTE is governed by the Tabung Haji Act 1995 (Act 535) and is mandated by law to facilitate Malaysian Muslims' savings for hajj. TH was the first Islamic financial institution established in Malaysia; in comparison, Bank Islam Malaysia Berhad was established in 1983.

As the only hajj-facilitating institution in the country, TH endeavours to strengthen the Malaysian Muslim economy by offering options for savings and Shariah investments. To date, TH has more than 9 million depositors and 125 branches with 10,000 customer touchpoints nationwide (TH 2020). TH also operates offices in Jeddah, Kingdom of Saudi Arabia, under the purview of the Malaysian Consulate.

Prior to TH's founding, there was no Islamic financial institution that enabled Malaysian Muslims to save for hajj expenses. Even though several banks were already operating then, not a single one was an Islamic bank.

Under the Tabung Haji Act 1995 (Act 535), the government only serves as a custodian of the deposits and ensures that depositors' investments are protected. Tabung Haji cannot and should not invest in non-Shariah instruments.

TH Investment Policy & Framework

Tabung Haji has an internal Shariah investment policy and framework. There is a Shariah unit to vet through investments, including risks and compliance, and it reports to TH's Shariah Advisory Committee. TH's Shariah Advisory Committee in turn reports to the board committee.

TH's annual report, which includes a Shariah report, discloses the status of its business and operations' Shariah compliance every year.

II. OVERVIEW (CONT'D.)

2.3 Public Trust Entities (PTEs) (cont'd.)

2.3.2 Employees Provident Fund (EPF)

Established in 1951, the Employees Provident Fund (EPF) is the de jure employee retirement fund for the Malaysian workforce in accordance with the Employees Provident Fund Act 1991. All private-sector employees are required by law to contribute 9% of their monthly salary to EPF. Public sector employees ineligible for pensionable schemes must likewise do so. EPF is mandated by law to invest in equities, assets or other financial products to deliver a reasonable annual dividend pay-out to its contributors.

Simpanan Shariah

EPF has introduced a Shariah-compliant account known as Simpanan Shariah for its contributors. Simpanan Shariah is a savings option managed and invested by EPF in line with Shariah principles. To ensure that Simpanan Shariah is managed according to Shariah as required under section 43A of the EPF Act, a Shariah governance framework has been established.

Contributors can thus opt to have their contributions channelled to Shariah-compliant investments or otherwise. However, the amount invested in Shariah-compliant companies is not yet reported in EPF's annual reports. It is also not clear whether a Shariah audit unit has been established within the internal audit department.

A Shariah Advisory Committee governs EPF's management of Shariah-compliant accounts and investments; its appointment and functions are outlined below.

Establishment of Shariah Advisory Committee

Section 23A of the EPF Act (1991) stipulates the establishment of its Shariah Advisory Committee.

1. The Board shall establish a Shariah Advisory Committee which shall be the authority for the ascertainment of Shariah matters to advise the Board and the Investment Panel in ensuring that the management of the accounts of the members of the Fund whose elections under section 43A have come into effect complies with Shariah principles, including the contributions, investment and dividend.
2. The Shariah Advisory Committee may determine its procedures.

Functions of Shariah Advisory Committee

Section 23B of the EPF Act (1991) details the functions of the above Shariah Advisory Committee:

1. To ascertain the application of Shariah principles on any matter relating to the accounts of the members of the Fund whose elections under section 43A have come into effect;
2. To advise the Board and the Investment Panel on any matter relating to Shariah and the application of Shariah principles on any matter relating to the accounts of the members of the Fund whose elections under section 43A have come into effect; and
3. Such other functions as may be prescribed by the Board.

II. OVERVIEW (CONT'D.)

2.3 Public Trust Entities (PTEs) (cont'd.)

2.3.2 Employees Provident Fund (EPF) (cont'd.)

Appointment of Shariah Advisory Committee Members

Section 23C of the EPF Act (1991) covers the appointment of Shariah Advisory Committee members as follows:

1. The Board shall appoint such number of persons, which shall not be less than three, from amongst persons who are qualified in Shariah, or who have knowledge or experience in Shariah and banking, finance, law or such other related disciplines, as members of the Shariah Advisory Committee.
2. Members of the Shariah Advisory Committee shall not be entitled to any remuneration but may be paid such honorarium, any travelling and subsistence allowances, as the Board may determine.

Reference to the Shariah Advisory Committee on Shariah matters

Section 23D of the EPF Act (1991) highlights references to the Shariah Advisory Committee as follows:

1. The Board and the Investment Panel shall refer to the Shariah Advisory Committee any matter relating to Shariah and any matter which requires the ascertainment of Shariah principles by the Shariah Advisory Committee relating to the accounts of the members of the Fund whose elections under section 43A have come into effect.
2. The advice given by the Shariah Advisory Committee on any matter referred under subsection (1) shall be binding on the Board and the Investment Panel.

2.3.3 Permodalan Nasional Berhad (PNB)

Permodalan Nasional Berhad (PNB), which was established on 17 March 1978 as an instrument of the Government's New Economic Policy, is run by Yayasan Pelaburan Bumiputra to ensure the equitable redistribution of national wealth to all Malaysians. Since its founding, PNB has become one of the largest fund management companies in Malaysia with assets under management (AUM) of RM343.1 billion as at 30 November 2022 (PNB, 2022). PNB's portfolio covers strategic investments in Malaysia's leading corporates, global equities, private investments and real estate.

Amanah Saham Nasional Berhad (ASNB) is the unit trust company of PNB with 32 branch offices and more than 2,600 agent branches nationwide. Since the launch of its first unit trust fund in 1981, ASNB now manages 1417 unit trust funds with a total of 273.3 billion units in circulation (UIC) and 14.7 million accounts. Of these 17 unit trust funds, six (6) are fixed price funds and eleven (11) are variable price funds (PNB, 2022).

PNB awarded its Shariah Advisory Council responsibility for giving Shariah advice and views, as well as monitoring matters relating to PNB/ASNB unit trust fund investments to ensure that these investments comply with the Shariah rules suggested by the National Fatwa Council. PNB also has in place Shariah control functions comprising Shariah Management, Internal Assurance, Compliance and Risk Management.

II. OVERVIEW (CONT'D.)

2.3 Public Trust Entities (PTEs) (cont'd.)

2.3.3 Permodalan Nasional Berhad (PNB) (cont'd.)

In 2020, PNB's investment had successfully achieved a 75% Shariah compliance rate according to the SC's Shariah screening methodology, while the other 25% is Shariah-compliant according to PNB's Maqasid Al-Shariah screening methodology. PNB has developed the Maqasid Al-Shariah screening and undertaken several other initiatives to improve and structure PNB's investments, with the broader aim of attaining its organisational objectives while ensuring Shariah compliance.

2.3.4 Yayasan Pembangunan Ekonomi Islam Malaysia (YaPEIM)

Yayasan Pembangunan Ekonomi Islam Malaysia (YaPEIM) was established as a foundation by the Federal Government on 13th October 1976 and incorporated by the Trustees (Incorporation) Act 1952. The Lembaga Pemegang Amanah—a board of trustees and management team—leads YaPEIM's administration. Among YaPEIM's corporate objectives are as follows (YaPEIM, n.d.):

Social Business

1. Providing microcredit financing facilities, platforms and support for entrepreneurial development to spur socioeconomic development as well as social well-being.
2. Running profitable businesses with efficient financial management & administration practices, as well as good governance, to strengthen the institution's position.

Socio-Economy & Charitable Development

1. Cultivate and provide enabling and reliable infrastructure to the community.
2. Deliver charitable donations to beneficiaries using a variety of transparent, effective, and community-assisting approaches.

Most of the funds are distributed to students, poor families, entrepreneurs, orphans, the B40, educational institutions and NGOs. In this sense, its activities directly contribute to realising Maqasid Al-Shariah.

However, based on its annual report and website information, it is not clear whether a Shariah governance framework, or Shariah audit and assurance unit, exists within YaPEIM. A series of roundtable discussions may be useful to garner further input and insight on YaPEIM's Shariah governance and audit practices.

II. OVERVIEW (CONT'D.)

2.4 State Islamic Religious Councils (SIRCs)

2.4.1 Governance of SIRCs

In Malaysia, State Islamic Religious Councils (SIRCs) advise the Head of Islamic Religion on all Islamic matters except for Islamic law and the administration of justice, which falls under the purview of the Shariah courts and muftis. The SIRCs also manage Islamic wealth such as *zakat*, *waqf*, *baitulmal* and other Islamic funds.

Currently, there are 14 SIRCs in Malaysia. Each SIRC is established in accordance with the Federal Constitution’s Ninth Schedule List II (the State List), which authorises states to govern the collection of *zakat fitrah*, *baitulmal* or other similar Islamic funds (Mahadi et al., 2018). SIRCs are to report *zakat* and *waqf* management and performance to their respective State Ruler (Norzilan, 2018). Due to this reporting structure, each state has distinct management practices and legislation for *zakat* and *waqf* governance (Aziz & Ali, 2018).

In 2004, the Department of *Waqf*, *Zakat* and *Hajj* (JAWHAR) was established with the aim of promoting systematic and effective *zakat* and *waqf* administration throughout the country (Norzilan, 2018; Suhaimi et al., 2014). Malaysia’s current *zakat* and *waqf* governance structure is depicted in Figure 2 below.

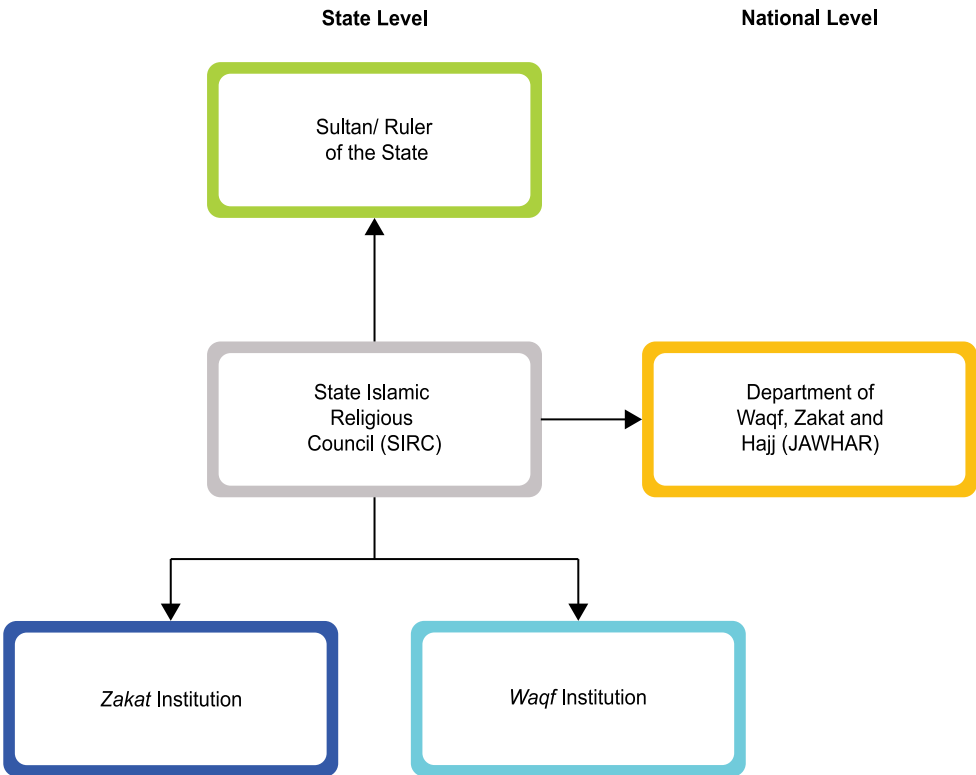


Figure 2: Zakat and Waqf Governance Structure in Malaysia

II. OVERVIEW (CONT'D.)

2.4 State Islamic Religious Councils (SIRCs) (cont'd.)

2.4.1 Governance of SIRCs (cont'd.)

There are 17 *zakat* institutions from 14 states in Malaysia. Table 11 presents a list of these institutions, their structure and their functions. Eight (8) institutions have been corporatised, whereas the remaining nine (9) *zakat* institutions are non-corporatised according to the following categorisation:

1. Traditional: both the *zakat* collection and distribution functions under the same entity are not corporatised (Johor, Kedah, Kelantan, Perak, Perlis and Terengganu);
2. Semi-corporatised: the *zakat* collection and distribution functions are separated into different entities. The *zakat* collection entity is corporatised but the *zakat* distribution entity is not (Melaka, Pahang and Wilayah Persekutuan); and
3. Corporatised: both the *zakat* collection and distribution functions fall under the same corporatised entity (Negeri Sembilan, Penang, Sabah, Sarawak, Selangor)

Table 11: *Zakat* Institutions under SIRCs in Malaysia

State	<i>Zakat</i> Institution	Structure	Function
Johor	Majlis Agama Islam Johor (MAIJ)	Non-Corporate	Collection & Distribution
Kedah	Lembaga Zakat Negeri Kedah (LZNK)	Non-Corporate	Collection & Distribution
Kelantan	Majlis Agama Islam Kelantan (MAIK)	Non-Corporate	Collection & Distribution
Perak	Majlis Agama Islam dan Adat Istiadat Melayu Perak (MAIPk)	Non-Corporate	Collection & Distribution
Perlis	Majlis Agama Islam dan Istiadat Melayu Perlis (MAIPs)	Non-Corporate	Collection & Distribution
Terengganu	Majlis Agama Islam dan Adat Istiadat Melayu Terengganu (MAIDAM)	Non-Corporate	Collection & Distribution
Melaka	Majlis Agama Islam Melaka (MAIM)	Non-Corporate	Distribution
Pahang	Majlis Ugama Islam dan Adat Resam Melayu Pahang (MUIP)	Non-Corporate	Distribution
Wilayah Persekutuan	Majlis Agama Islam Wilayah Persekutuan (MAIWP)	Non-Corporate	Distribution
Negeri Sembilan	Perbadanan Baitulmal Negeri Sembilan (PBMALNS)	Corporate	Collection & Distribution
Penang	Zakat Pulau Pinang	Corporate	Collection & Distribution
Sabah	Pusat Zakat Sabah MUIS (PZS-MUIS)	Corporate	Collection & Distribution
Sarawak	Tabung Baitulmal Sarawak (TBS)	Corporate	Collection & Distribution
Selangor	Lembaga Zakat Selangor (LZS)	Corporate	Collection & Distribution

II. OVERVIEW (CONT'D.)

2.4 State Islamic Religious Councils (SIRCs) (cont'd.)

2.4.1 Governance of SIRCs (cont'd.)

Table 11: *Zakat* Institutions under SIRCs in Malaysia (cont'd.)

State	<i>Zakat</i> Institution	Structure	Function
Melaka	Pusat Zakat Melaka (PZM)	Corporate	Collection
Pahang	Pusat Kutipan Zakat Pahang (PKZP)	Corporate	Collection
Wilayah Persekutuan	Pusat Pungutan Zakat MAIWP (PPZ-MAIWP)	Corporate	Collection

Source: Kamaruddin & Hanefah (2021b.)

Meanwhile, seven (7) *waqf* institutions under the SIRCs can be classified as corporations while seven (7) other *waqf* institutions are departments directly under these SIRCs. Despite this distinction, both types of institutions remain under the SIRCs respective jurisdictions (Kamaruddin & Hanefah, 2021a). Table 12 lists the 14 *waqf* institutions, their structure and their governance.

Table 12: *Waqf* Institutions under SIRCs in Malaysia

State	SIRCs	Structure	<i>Waqf</i> Institutions
Wilayah Persekutuan Selangor	Majlis Agama Islam Wilayah Persekutuan (MAIWP) Majlis Agama Islam Selangor (MAIS)	Corporation Corporation	Pusat Wakaf MAIWP Sdn Bhd (PWMSB) Perbadanan Wakaf Selangor (PWS)
Negeri Sembilan	Majlis Agama Islam Negeri Sembilan (MAINS)	Corporation	Perbadanan Baitulmal Negeri Sembilan (PBMALNS)
Johor	Majlis Agama Islam Negeri Johor (MAIJ)	Corporation	Waqaf An-Nur Corporation Berhad (WANCorp)
Perak	Majlis Agama Islam & Adat Melayu Perak (MAIPk)	Corporation	Wakaf Perak Ar-Ridzuan (WPAR)
Pulau Pinang	Majlis Agama Islam Negeri Pulau Pinang (MAINPP)	Corporation	Wakaf Pulau Pinang Sdn Bhd (WPP)
Sarawak	Majlis Islam Sarawak (MIS)	Corporation	Tabung Baitulmal Sarawak (TBS)
Kedah	Majlis Agama Islam Negeri Kedah Darul Aman (MAINK)	Department	Bahagian Wakaf MAINK
Perlis	Majlis Agama Islam & Adat Istiadat Melayu Perlis (MAIPs)	Department	Bahagian Pembangunan Wakaf, Hartanah & Mal MAIPs
Kelantan	Majlis Agama Islam & Adat Istiadat Melayu Kelantan (MAIK)	Department	Unit Wakaf MAIK
Terengganu	Majlis Agama Islam & Adat Melayu Terengganu (MAIDAM)	Department	Seksyen Wakaf MAIDAM
Pahang	Majlis Ugama Islam & Adat Resam Melayu Pahang (MUIP)	Department	Unit Wakaf MUIP
Melaka	Majlis Agama Islam Melaka (MAIM)	Department	Bahagian Pembangunan Hartanah MAIM
Sabah	Majlis Ugama Islam Negeri Sabah (MUIS)	Department	Bahagian Wakaf & Baitulmal MUIS

Source: Kamaruddin & Hanefah (2021a)

III. SHARIAH AUDIT: DEFINITION, PROCESS AND SCOPE

3.1 Definition of Shariah Audit

Shariah audit practices in Malaysia began as part of IFIs' internal audit function. In a similar vein, the SGPD's (2019) definition of Shariah audit for IFIs is adapted from the Definition of Internal Auditing in the Institute of Internal Auditors' (IIA) International Professional Practices Framework. According to the IIA, internal auditing refers to an independent, impartial assurance and consulting activity designed to add value and improve an organisation's operations (IIA, 2022). Internal audit helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Therefore, the SGPD (2019) defines Shariah audit as "a function that provides an independent assessment on the quality and effectiveness of the IFI's internal control, risk management systems, governance processes as well as the overall compliance of the IFI's operations, business, affairs and activities with Shariah". This broad definition adapted from the IIA suits each sector's varying activities/operations, regulations, and needs in complying with Shariah principles. Implementing Shariah audit challenges the auditing fraternity to be more versatile and agile in integrating Shariah compliance within the existing auditing framework.

The Shariah audit function constitutes what is known as the last line of defence in ensuring Shariah compliance. The three lines of defence principle is a long and well-established concept deployed in myriad industries and situations. Typical examples of the activities falling under the three lines of defence are as follows:

- i. Management: the day-to-day running of operations and the front office
- ii. Risk and compliance: the continuous monitoring of the business through the establishment and improvement of risk and compliance functions
- iii. Audit: the periodic checking of management, risk and compliance practices to provide assurance that activities under the first and second line meet expectations

The three lines of defence model for Shariah assurance is depicted in Figure 3 below.

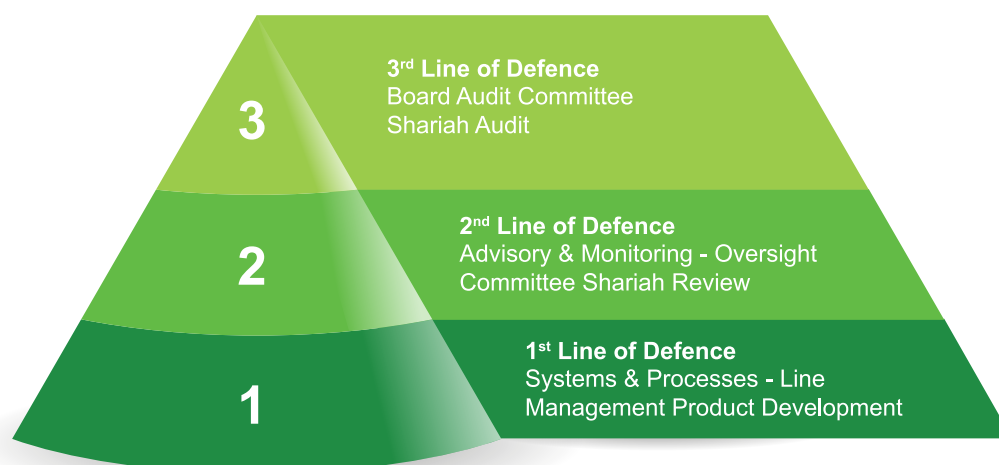


Figure 3: Three Lines of Defence Model

III. SHARIAH AUDIT: DEFINITION, PROCESS AND SCOPE (CONT'D.)

3.2 Shariah Audit Process and Scope

The Shariah audit function's definition and process highlighted in the SGPD (2019) reflects the existing practice of internal auditors. It addresses the Shariah element that is present in the overall product and IFIs' operations; hence, it requires the internal auditor to have knowledge of accounting, auditing and Shariah knowledge. The scope of Shariah audit can be determined based on its definition; specifically, it covers the aspects of internal control, risk management and governance of the institutions' operations, business, affairs and activities in line with Shariah principles. According to the SGPD (2019), a Shariah audit function, at minimum, must:

- a. Establish an audit methodology to assess the risk profile and vulnerabilities of each auditable area;
- b. Generate an audit plan for the assignments to be performed;
- c. Establish clear documented audit programs that guide the internal auditors on gathering information, auditing procedures and audit assessment; and
- d. Communicate results to the board and Shariah committee through an audit report, detailing the audit findings and recommendations for rectification measures, as well as the auditee's responses and action plans.

In terms of Shariah audit methodology, several researchers have emphasised the importance of a risk-based Shariah audit (RBSA) approach (Allegrini and D'Onza, 2003; Koutoupis and Tsamis, 2008). The RBSA approach directs the focus of the Shariah audit exercise to key auditable areas which bear potentially significant Shariah non-compliance risk (SNCR) given the constraints of limited audit time and resources (Abdul Rahman, 2020). Thus, RBSA results in a more valuable final Shariah audit report, wherein findings are tied to risk implications.

IV. ISSUES AND CHALLENGES IN SHARIAH GOVERNANCE AND AUDIT

4.0 Introduction

Shariah audits are currently performed by IFIs in Malaysia for two main reasons. First, this follows paragraph 28 of the IFSA (BNM, 2013), which emphasises the need for IFIs to consistently ensure that their aims and operations, business, affairs and activities are Shariah compliant. Second, Shariah non-compliance in sectors established for the purposes of providing Shariah products and services leads to financial losses and non-financial reputational impact (Sani and Abu Bakar, 2021).

As such, establishing and improving widespread Shariah audit practices is both urgent and critical. This need presents both a challenge and opportunity for the auditing fraternity, as it highlights a demand and supply gap for integrated auditing and Shariah competencies.

In recent years, moreover, market players have advocated for a more holistic Shariah audit that achieves the broader objectives of *Maqasid al-Shariah* (MIA & IBFIM, 2021). The way a business is run must comply with the whole concept of Shariah. Shariah audit should go beyond compliance in using Shariah contracts for financial instruments to include income determination, use of assets, human resource policies, marketing policies, ESG reporting, *zakat* calculation and reporting, *waqf* disclosure, cleansing of non-Shariah compliant income, and the adoption of Shariah screening for Shariah-compliant companies. Further, with IFIs increasingly wading into the VBI space, there is an opportunity to expand the Shariah audit function with an eye towards providing assurance on the effectiveness of VBI implementation.

This paper complements the above snapshot of opportunities in the Shariah audit landscape with further elaboration on the pressing issues and challenges in this space, which were obtained from four roundtable discussions (RTDs) conducted from April until June 2021. Among those present were Shariah auditors, as well as Chief Internal Auditors and Shariah officers from the Islamic banking and takaful sector, Islamic capital market, Public Trust Entities, Islamic co-operatives and ar-rahn and State Islamic Religious Councils.

Table 13 provides a summary of participants that attended the roundtable sessions.

Table 13: Summary of Participants

Roundtable Sessions	Summary of Participants
Islamic banking and Takaful	15 participants from 12 entities: <ul style="list-style-type: none"> • 8 Islamic banks • 4 Takaful
Islamic Capital Market and Public Trust Entities	16 participants from 16 entities: <ul style="list-style-type: none"> • 2 i-REITs • 3 Islamic brokers • 1 crowdfunding company • 8 Islamic fund management companies • 2 PTEs

IV. ISSUES AND CHALLENGES IN SHARIAH GOVERNANCE AND AUDIT (CONT'D)

4.0 Introduction (cont'd)

Table 13: Summary of Participants (cont'd.)

Roundtable Sessions	Summary of Participants
Co-operatives and ar-rahnu	49 participants from 25 co-operatives, including Suruhanjaya Koperasi Malaysia and ANGKASA
State Islamic Religious Councils	32 individuals from 16 entities including JAWHAR, Lembaga Zakat Kedah, Perbadanan Wakaf Selangor, Waqaf An-Nur Corporation Berhad, Yayasan Waqaf Malaysia, MAIWP, MAIS, MAIDAM, etc.

4.1 Islamic Banking and Takaful

Industry players noted that IFIs have currently embedded Shariah audit within their operational audit and risk-based audit coverage. As regulators have yet to issue a specific Shariah audit framework, these IFIs use the existing IIA auditing standards to guide their audit. This corroborates the findings of a previous study by Othman and Ameer (2015), which indicated that most IFIs use conventional auditing methods because of the absence of a Shariah auditing approach.

Further, based on polls conducted during the RTD session, the sector's top three issues are as follows:

- Inadequate knowledge in operational Shariah issues.
- Inadequate training programs related to internal Shariah audit
- Inadequacies in performing risk-based Shariah audit.

In addition, participants pointed out that Shariah auditors should have experience in business and control functions such as Compliance, Shariah Compliance Review and Risk Management. Auditors with a more holistic understanding of these areas will be more effective in detecting failure points.

The above issues highlighted by the respondents relates to the need for multiple competencies. Shariah auditors must have some awareness of various Shariah issues and regulations which impact IFIs' financial statements and overall operations. In order to bring Shariah compliance to the next level, it is crucial to not only formalise Shariah rules and frameworks but also to have the right talents with adequate skills and knowledge in both Shariah and accounting disciplines. This will be key to driving the industry's implementation of Shariah compliance.

4.2 Islamic Capital Market

For the ICM sector, the top three issues in relation to Shariah governance and assurance are:

- Inadequate knowledge of operational Shariah issues by frontliners
- Insufficient number of internal auditors well-versed in the Islamic capital market and Islamic fund management
- Dearth of talent for the appointment of Compliance Officers

IV. ISSUES AND CHALLENGES IN SHARIAH GOVERNANCE AND AUDIT (CONT'D.)

4.2 Islamic Capital Market (cont'd.)

In turn, these issues complicate the establishment of the following functions, which participants deemed to be necessary to the practice of internal Shariah audit:

- a. Internal Audit and Compliance Officers are required for Islamic Fund Management Companies
- b. Compliance Officers are required for Real Estate Islamic Trusts and Exchange Traded Funds
- c. Some entities require Shariah Advisers to perform the review/audit, while others have internal audit units performing reviews and submitting reports to Shariah Advisers

Further, participants raised the following top three issues with regards to implementing Shariah audits and Shariah compliance reviews:

- a. Insufficient expertise for Shariah compliance reviews and the development of Shariah audit programs
- b. Internal auditors are not well-versed in the Islamic capital market and Islamic fund management activities
- c. Shariah Review officers' limited knowledge about new financial products

Based on the RTD findings, the outstanding problem relates to knowledge and talent management in the areas of Shariah Review and Compliance.

4.3 Co-operatives

Co-operatives face a more pressing hurdle, as there is no specific Act that governs Islamic co-operatives. This absence may trigger issues in cases where the current regulation may not comply with Shariah principles or may hinder the process of Shariah compliance (Itam et al., 2016). It also raises the question of whether present mechanisms can ensure compliance with Islamic Shariah principles and the *maqasid*, and how to resolve inconsistent practices such as the use of ar-rahn contracts versus tawarruq as the underlying contract for micro-financing offered by ar-rahn operators and co-operatives.

Presently, ANGKASA conducts audits for co-operatives interested in obtaining a Shariah-compliant product status. Although Suruhanjaya Koperasi Malaysia has issued Shariah governance guidelines for co-operatives, i.e. GP28 which is mainly for credit co-operatives, implementation is not widespread because adoption is not mandatory.

At the KOPSYA-ANGKASA level, Shariah governance mechanisms are being explored as part of the Management and Shariah Development functions. KOPSYA's model of governance and assurance could serve as a benchmark for other co-operatives. Concerns about Shariah compliance have introduced a new dimension under the broader umbrella of corporate governance frameworks. Enhancing this multi-dimensional governance in Islamic co-operatives would support the members in maintaining Shariah compliance and protecting the rights of involved parties.

IV. ISSUES AND CHALLENGES IN SHARIAH GOVERNANCE AND AUDIT (CONT'D.)

4.3 Co-operatives (cont'd.)

During the RTD sessions, co-operative and ar-rahnu representatives highlighted the following Shariah governance matters:

- a. Some co-operatives have internal Shariah Committees, while others outsource depending on the size of the co-operative
- b. Limited number of available Shariah scholars to serve on the Shariah Committee
- c. SKM is in the process of establishing its own Shariah Division and Shariah Advisory Council (Bahagian Syariah dan Jawatankuasa Penasihat Syariah)

The above has led to certain pain points and inconsistencies relating to the internal Shariah audit practices of co-operatives:

- a. Internal Shariah audit is either performed by the Shariah Officer/Internal Audit or an externally appointed Shariah Committee/Adviser
- b. Smaller-sized co-operatives and ar-rahnu have limited resources, thus there is no segregation of duties between the Shariah Officer and Shariah Auditor
- c. Limited number of staff with knowledge of Shariah concepts and audit techniques
- d. Requests by industry players for a standardised audit checklist endorsed by SKM and the Malaysian Institute of Accountants

Further, participants highlighted the top three issues related to the implementation of Shariah audit:

- a. Inadequate knowledge of operational Shariah issues
- b. Inadequate training programs related to internal Shariah audit
- c. Inadequacies in implementing risk-based internal Shariah audit

The co-operative sector faces more issues and challenges in both the Shariah governance and audit aspects. Hence, the strategic strengthening of governance and audit practices is especially key for this sector.

4.4 Public Trust Entities (PTEs)

TH and YaPEIM only invest in Shariah-compliant companies. As such, they have established Shariah advisory committees and Shariah units to oversee their investments. Audits are undertaken by an internal audit department, but there is no documented evidence in their annual report or websites which state that these PTEs conducted Shariah audits specifically. Since TH and YaPEIM strictly invest in Shariah-compliant companies and businesses only, these entities should establish Shariah audit teams to conduct Shariah audit.

On the other hand, since their establishment, EPF and PNB have been investing in both conventional and Shariah-compliant companies. Therefore, dividends from non-compliant declared securities need to be cleansed. Internal Shariah governance frameworks ensure that the appropriate mechanisms are in place to oversee the cleansing of non-shariah compliant income from mixed portfolios.

IV. ISSUES AND CHALLENGES IN SHARIAH GOVERNANCE AND AUDIT (CONT'D.)

4.4 Public Trust Entities (PTEs) (cont'd.)

In 2017, EPF created the Simpanan Shariah account for its contributors. To oversee these investments, EPF established a Shariah unit and Advisory Council to ensure that all investments are Shariah compliant. Nonetheless, although EPF and PNB have an internal audit department, they lack an internal Shariah audit unit or department.

As PTEs are also fund managers, their RTD session was shared with the Islamic capital market sector. The issues raised by PTE representatives are those discussed in Section 4.2.

4.5 State Islamic Religious Councils (SIRCs)

Implementing shariah audit in SIRCs and its related institutions, such as *zakat* and *waqf* institutions, comes with its own set of hurdles. As the focus of SIRCs is the management of *waqf*, *zakat* and other Islamic social initiatives, the value of shariah audit assurance is to enhance and nurture public confidence in these institutions' accountability and transparency.

During the sessions, participants discussed current internal audit practices and pain points in SIRCs and their related institutions:

- a. Shariah audit is implemented within the scope of internal audit. The line of reporting is within Internal Audit & Governance, under the oversight of the Audit & Risk Committee
- b. There is insufficient human capital with the necessary knowledge, skills & experience to perform Shariah Audit (i.e. budget allocation, compact audit plan)

Additionally, participants highlighted the top three issues in implementing Shariah internal audit:

- a. Inadequate implementation of risk-based Shariah internal audit
- b. Difficulties in identifying the Shariah internal audit scope
- c. A lack of Shariah internal audit training programs available in the market

V. THE WAY FORWARD

This paper provides an overview of the current state of Shariah governance and audit practices. It highlights two main issues.

First, the need to clarify a framework and guidance with regards to the scope and scale of Shariah audit.

Second, talent development. There is a talent crunch when it comes to Shariah auditors with the requisite skills and knowledge on business and operations, as well as on applicable Shariah principles and requirements.

Given its mission to develop the accountancy profession for economic growth and nation-building, the Malaysian Institute of Accountants advocates for and supports the building and nurturing of competence in Shariah auditing. In order to strategically realise this objective, one recommendation is to publish a Roadmap that enunciates action plans and milestones for the next five years to solve the current crop of issues and challenges faced by these sectors, particularly in relation to talent management and professional development. Furthermore, there is an opportunity for the issuing of Best Practice Guides which cover the audit process, scope of audit and required skillset for Shariah auditors in the relevant sectors. This would, in the long run, promote talent development in the Shariah audit space, advance standardisation and standard-setting for the industry, and ultimately strengthen Malaysia's global edge in the realm of Islamic finance.

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APPENDIX 1

Guidelines on Islamic Capital Market Products and Services

No.	Requirements in the Guidelines	Previous Guidelines (Registration of Shariah Advisers Guidelines, 2009)	New Guidelines
1	Qualification	<p><u>Paragraph 4.02</u></p> <p>The applicant should have at least a degree in Shariah, particularly in <i>fiqh muamalat</i> or Islamic jurisprudence from an institution recognised by the Malaysian government.</p>	<p><u>Paragraph 5.05(a)(ii)</u></p> <p>Holds, at minimum, a degree in any of the following:</p> <ol style="list-style-type: none"> Shariah; or Law, with a focus on Shariah; or Islamic Studies; <p>In which the degree must include study in <i>fiqh muamalat</i> (Islamic transaction/commercial law) or <i>usul fiqh</i> (Islamic jurisprudence).</p>
2	Experience	<p><u>Paragraph 4.03</u></p> <p>The applicant should -</p> <ol style="list-style-type: none"> Have at least two years of relevant experience and/or exposure in Islamic finance; or Have at least one year of relevant experience and/or exposure in Islamic finance and have attended at least five relevant Islamic finance courses/workshops. 	<p><u>Paragraph 5.05(a)(iii)</u></p> <p>An applicant has at least three consecutive years of relevant working experience in Islamic finance preceding the application.</p>
3	Fit and proper criteria	<p><u>Paragraph 4.04 & 4.06</u></p> <p>The applicant must not –</p> <ol style="list-style-type: none"> have been convicted, whether within or outside Malaysia, of an offence involving fraud or other dishonesty or violence or the conviction of which involved a finding that he acted fraudulently or dishonestly. have been convicted of an offence under the securities law. have contravened any provision made by or under any written law appearing to the SC to be enacted for protecting members of the public against financial loss due to dishonesty, incompetence or malpractice by persons concerned in the provision of financial services or the management of companies; or 	<p><u>Appendix 1</u></p> <p>A person is considered to be fit and proper if–</p> <ol style="list-style-type: none"> the person– <ol style="list-style-type: none"> has not been convicted, whether within or outside Malaysia, of an offence involving fraud or dishonesty or violence or the conviction of which involved a finding that he acted fraudulently or dishonestly. has not been convicted, whether within or outside Malaysia, of an offence under securities laws or any laws relating to capital market. has not been issued, whether within or outside Malaysia, with any

No.	Requirements in the Guidelines	Previous Guidelines (Registration of Shariah Advisers Guidelines, 2009)	New Guidelines
3	Fit and proper criteria (cont'd.)	<p>d. have contravened any provision made by or under any written law appearing to the SC to be enacted for protecting members of the public against financial loss due to the conduct of undischarged bankrupts.</p>	<p>compounds or subject to any administrative action taken by a regulator or law enforcement agency for any offence involving bribery, fraud, dishonesty, mismanagement of a company or violence.</p> <p>d. has no pending investigations or criminal charge against him in any court of law, whether within or outside Malaysia, for an offence involving bribery, fraud, dishonesty, mismanagement of a company or violence.</p> <p>e. has not had any civil enforcement action filed against him in any court of law by any regulator or law enforcement agency, whether within or outside Malaysia.</p> <p>f. is not an undischarged bankrupt or is in the course of being wound up or otherwise dissolved, as the case may be, whether within or outside Malaysia.</p> <p>g. has no execution against him in respect of a judgment debt, whether within or outside Malaysia.</p> <p>h. Has not, whether within or outside Malaysia, entered into a compromise or scheme of arrangement with its creditors, being a compromise or scheme of arrangement that is still in operation.</p> <p>i. is not disqualified to be a director, whether within or outside Malaysia, under the corporation laws or securities laws; and</p> <p>j. has not have any receiver, receiver and manager or an equivalent person appointed, whether within or outside Malaysia, in respect of any of his property; and</p>

No.	Requirements in the Guidelines	Previous Guidelines (Registration of Shariah Advisers Guidelines, 2009)	New Guidelines
			<p>2. the SC is satisfied that–</p> <ul style="list-style-type: none"> a. the person is not engaged in any business practices appearing to the SC to be deceitful, oppressive, or otherwise improper, whether unlawful or not, or which otherwise reflect discredit on his method of conducting business. b. the person is not engaged in or has not been associated with any other business practices or has not conducted himself in such a way as to cast doubt on his competence and soundness of judgment. c. the person is not engaged in or has not been associated with any conduct that cast doubt on his ability to act in the best interest of investors, having regard to his reputation, character, financial integrity, and reliability. d. the person is suitably qualified to assume the position including having the relevant experience and track record. e. there are no other circumstances which are likely to lead to the improper conduct of operations by the person, or reflect discredit on the manner the person would carry out his duties; and f. it would not be contrary to public interest to register the person.
4	Foreign Shariah Adviser	<p><u>Paragraph 4.08</u></p> <p>Required to submit Form 3 and a copy of the letter of appointment that demonstrates appointment as Shariah adviser from a foreign institution.</p>	<p><u>Paragraph 5.01 until 5.07</u></p> <p><u>Follow the same requirement for local applicants.</u></p>

No.	Requirements in the Guidelines	Previous Guidelines (Registration of Shariah Advisers Guidelines, 2009)	New Guidelines
5	Validity/Tenure of registration	<p><u>Paragraph 6.02</u></p> <p>The registration will be valid for three years after the date it is issued or on such a later date as may be specified by the SC in writing.</p>	<p><u>One-time initial registration with no expiry date (perpetual).</u></p>
6	Continuous Professional Development	<p><u>Paragraph 7.01 & 7.02</u></p> <p>A registered Shariah adviser is encouraged to keep abreast with current developments in Islamic finance.</p> <p>The applicant when applying for registration or renewal of registration is encouraged to notify the SC of any relevant experience in Islamic finance, such as-</p> <ol style="list-style-type: none"> Courses attended; Courses facilitated Contributions made to the development of Islamic finance. 	<p><u>Paragraph 7.01(a)(ii) & 7.01(b)(ii) (Continuous Obligations)</u></p> <p>The Shariah adviser and the Shariah officer (in the case where the Shariah adviser is a corporation), must attend at least 3 Securities Industry Development Corporation (SIDC)'s Continuing Professional Education (CPE) - approved courses on capital market annually before the anniversary date of their registration.</p>
7	Imposition of fees for registration	No fee is required.	Fees for registration are charged.
8	Conduct requirements	No conduct requirements.	<p><u>Paragraph 8.01</u></p> <p>In carrying out his roles and responsibilities, the Shariah adviser must-</p> <ol style="list-style-type: none"> act honestly and uphold the principles of Shariah; take all reasonable steps to ensure fair treatment in discharging his duties; and carry out any other duties or responsibilities as may be specified by the SC relating to Shariah matters. <p><u>Paragraph 8.02 until 8.05</u></p> <p>Requirement for Shariah adviser to identify and avoid any actual or potential conflict of interest.</p>

Source: Securities Commission Malaysia (2009, 2022)

APPENDIX 2

The Roles of Shariah Governance Organs in Co-operatives

Component	Roles
Co-operatives Board	<ul style="list-style-type: none"> To monitor the performance of the Shariah committee. To be responsible for the overall Shariah governance compliance of the Co-operative based on the advice of the Shariah committee To ensure effective communication within the organisation To establish a suitable mechanism to carry out the responsibilities, including oversight and other governance-related tasks. To assure the Shariah committee understand their fiduciary responsibility.
Shariah Committee	<ul style="list-style-type: none"> To identify the issues of concern and propose the preventive and corrective measures, if necessary. To be aware of and responsible for all the decisions, views and opinions relating to Shariah matters. To perform the roles of supervision on Shariah related to the business operations and activities of the co-operative. To report directly to the Board of Co-operatives.
Co-operative Management	<ul style="list-style-type: none"> To implement the decisions made by the Shariah committee. To establish Shariah-compliant culture in the co-operative To ensure the policies and the procedures of the Shariah can be accessed at any time To identify and refer any Shariah issues to the Shariah committee for its decision. To submit promptly complete and accurate information to the Shariah committee and to be transparent about any area that requires clarification by the Shariah committee. To allocate resources and sufficient workforce to support Shariah governance. To provide education and continuous training program to the Board and Shariah committee.
Internal Audit Committee	<ul style="list-style-type: none"> To ensure a robust, effective internal control and risk management system. To monitor the implementation of recommendations, comments or opinions issued by the Shariah committee. To investigate any matter as directed by the Shariah Committee. To review the adequacy of the Shariah governance process. To investigate and inform the Shariah committee of any suspicious transactions. To ensure the management adheres to the policies and procedures regarding the Shariah matters as decided upon by the Shariah committee. To inform the Shariah committee and Board of any inconsistencies that occur in the administration, financial management and activities of the co-operative.

Source: GP28: Shariah Governance Guidelines (2015)



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