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ARE SHARIA AUDITING STANDARDS NECESSARY FOR AUDITORS?

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Abstrak – Pentingkah Standar Audit Syariah bagi Auditor?
Tujuan Utama - Tujuan dari penelitian ini adalah untuk menelaah apakah standar audit Syariah yang spesifik diperlukan bagi auditor eksternal di perbankan Syariah.
Metode – Penelitian ini menggunakan metode deskriptif kualitatif. Penelitian ini melibatkan dewan pengawas Syariah, praktisi, akademisi, dan auditor eksternal sebagai informan.
Temuan Utama - Standar audit Syariah diperlukan bagi auditor eksternal pada lembaga Syariah. Standar ini akan memberikan pedoman untuk melaksanakan audit kepatuhan Syariah berdasarkan prinsip-prinsip Islam. Implikasinya, kepercayaan publik akan meningkat.
Implikasi Teori dan Kebijakan – Penelitian ini menegaskan teori agensi dalam audit berbasis Syariah. Selain itu, penelitian ini menekankan adanya kebutuhan masyarakat terkait jaminan atas kepatuhan Syariah yang dilakukan oleh auditor.
Kebaruan Penelitian – Penelitian ini membahas mengenai kebutuhan profesi auditor eksternal di terhadap standar audit Syariah eksternal.

Abstract - Are Sharia Auditing Standards Necessary for Auditors?
***Main Purpose** - The objective of this study is to examine whether specific Islamic auditing standards are needed for external auditors in Islamic banking.*
***Method** - This study uses a qualitative descriptive method. The research involved Sharia supervisory boards, practitioners, academics, and external auditors as informants.*
***Main Findings** - Sharia auditing standards are needed for external auditors in Islamic institutions. This standard will provide guidelines for conducting sharia compliance audits based on Islamic principles. The implication is that public trust will increase.*
***Theory and Practical Implications** - This research confirms agency theory in Sharia-based auditing. In addition, this research emphasizes the public's need for auditors to ensure sharia compliance.*
***Novelty** - This research discusses the needs of the external auditor profession for external sharia audit standards.*

External Sharia audit is the latest innovation in Sharia governance in Islamic businesses. This is intended to maintain the validity of Islamic banks' claims of Sharia compliance, which sometimes arouse suspicion among skeptics (Haddad & Souissi, 2022). Currently, there is still skepticism regarding Sharia compliance in Sharia banks. The Sharia supervisory boards, the leading actor in Sharia auditing practices, is not always considered independent. The boards checks Sharia compliance based on fatwas or Islamic law. However, the boards is involved in the operational process of Islamic banks, such as participating in the process of forming products and services in Islamic institutions, so the boards oversees their work (Puspitasari & Handayani, 2020). In addition, there has been no re-examination of the opinions issued by Sharia supervisory boards regarding Sharia compliance in Islamic institutions. For instance, independent auditors examine financial statements prepared by management, which can increase public confidence (Faza' et al., 2023; Ridwan & Mayapada, 2022). Therefore, external audits are also expected to involve a third-party review to ensure the accuracy of the audit process conducted by Sharia supervisory boards in issuing its opinion and to provide assurance on Sharia compliance in Islamic institutions (Alam et al., 2022; Algabry et al., 2020; Dewindaru et al., 2019). Based on this issue, this research is important in the accounting field, especially regarding external sharia audits in Islamic banking. There is a lack of fully regulated external Sharia auditing standards necessary to ensure proper Sharia compliance in Islamic financial organizations. This research evaluates the need for more specific and practical external sharia auditing standards by involving various stakeholders.

This research refers to agency theory. It examines the relationship between the principal (asset owner) and the agent (auditor) in the context of external Sharia auditing. The principal is the owner or shareholder of the Sharia institution. Meanwhile, the agent is the external sharia auditor tasked with ensuring that the institution complies with sharia principles and obtains appropriate audit results. Agency theory addresses how to regulate the interests of the principal and agent to ensure that the agent operates for the principal's optimal benefit (Jan et al., 2022). External auditors play an essential role in providing independent and objective information to Islamic financial organizations about the transparency and accountability of Islamic financial organizations, including guaranteeing Sharia compliance to provide added value to the Sharia compliance opinion issued by Sharia supervisory boards. This minimizes agency conflicts and increases the principal's confidence in the results of external sharia audits. In essence, legitimacy theory can be translated into organizational systems that require entities to integrate corporate social regulations into their governance structure to ensure compliance with the morals and rules in the particular environment in which the organization operates (Tabash et al., 2022). Therefore, if a bank fails to adhere to social norms and lacks legitimacy, the bank will lose the trust of stakeholders (Alam, 2021; Alam et al., 2023; Faza' et al., 2023). Legitimacy and reputation are complex concepts related to many stakeholders. The study of Khalid & Sarea (2021) highlights the importance of stakeholders in Islamic finance associations. Therefore, for Islamic financial organizations to be of value to stakeholders, they must have spiritual or moral credibility, which requires social validity. One method of achieving this is ensuring that the organization complies with Sharia regulations, which can be verified by the Sharia supervisory boards, and then validated by independent audits.

Sharia audit is an independent assessment method that determines whether activities and operations meet specified requirements. This requires gathering and assessing sufficient and reliable data, including examining regulations and procedures in Islamic banks, such as product manuals, operational processes, and contracts (Khatib et al., 2022). In general, the concept of Sharia audit remains the same as conventional audit, which aims to obtain and collect relevant evidence. However, Sharia audits have a broader scope, including tests related to the application of Sharia principles. Maali et al. (2021) found that Sharia audits should include compliance of Sharia bank products with Sharia principles and social and environmental audits. This research supports Albarrak & El-Halaby (2019)'s thesis that Sharia audits cover the social behavior and performance of Islamic banks, including their relationships with all stakeholders. Currently, the responsibility of external Sharia auditors is to express views on whether Islamic banks' products, contracts, and ethical behavior follow the recommendations provided by the Sharia institutions' Sharia supervisory boards and the central bank's Sharia council (Anggrayni et al., 2022; Soediro & Meutia, 2018). Haddad & Souissi (2022) stated that the external financial report auditors in Islamic financial institutions rely on opinions issued by Sharia supervisory boards and, thus, they do not provide a solid audit to third parties. According to AAOIFI, the auditor's report must clearly state a view on the truth and fairness of the financial reports with Sharia regulations and principles, in addition to stating conformity with the applicable financial reporting framework.

Previous research regarding the implementation of external audits in Islamic banks highlights that this research has investigated several important issues in external Sharia audits, such as Albarrak & El-Halaby (2019), Arwani (2018), Faza et al. (2023), Ridwan & Mayapada (2022), Saidani et al. (2020), and Sani & Abubakar (2021). Nevertheless, significant knowledge gaps remain that require further investigation. One of the most critical gaps in the current understand-

Table 1. List of Informants

Pseudonym Name	Profession
Syahal	Sharia Supervisory Board
Ahmad	Sharia Business and Finance Practitioners
Siti	Academician
Riza	External Auditor/Partner

ing of this subject is the lack of clarity regarding the importance of implementing more specific and practical audit standards for Sharia auditors, the need for Sharia audit assurance by independent auditors, and the expertise required for auditors to strengthen Sharia audit practices and ensuring better Sharia compliance. By increasing the understanding of the application of external audits in Sharia banks, this research aims to provide additional insights into the auditing literature by exploring how external Sharia auditing can be improved to meet the increasingly complex demands of Islamic finance and increase public trust in Islamic organizations.

The concept of requiring specific audit standards for Sharia audits conducted by independent auditors is based on research conducted by Kamla & Haque (2019), who stated that traditional financial audits do not match the needs of stakeholders in Islamic financial organizations. Their claim is based on the fact that the International Standards on Auditing (ISA) do not examine Sharia factors. Conventional auditors' reports assess compliance using secular law, so they have no responsibility to report omissions or errors resulting from unwise or erroneous management decisions. The lack of Sharia audit standards makes the scope of external Sharia audits less clear, so stakeholder needs for the performance of external auditors in Sharia financial associations have not been met, particularly in terms of adherence to Sharia regulations and principles. Considering the prior justification, this article seeks to investigate the perspectives of various parties on the practice of auditing by external auditors in Islamic banks to determine whether a different set of external Sharia auditing standards is required for Islamic institutions and the competencies needed for auditors to perform Sharia audits.

METHOD

This study employs qualitative descriptive method by informant interviews. Informants are considered research subjects, as they not only serve as a source of data but also determine the success or failure of the research based on the information they provide. Sources are determined purposively based on specific considerations, such as the informant's competence, capability, and relevance to the studied topic (Elgattani & Hussainey, 2020; Mohammed et al., 2019). The criteria for selecting informants include those who are directly or indirectly involved in external Sharia audit activities, those who have knowledge related to external Sharia audits, and those who have sufficient time to be asked for information. Based on these criteria, four resource persons were determined.

Table 1 shows the informants on this research. The participants in Table 1 represents various professions, such as Sharia supervisory boards, Sharia business and finance practitioners, academics, and external auditors. All four interviewees were involved in finance and auditing in Islamic financial organizations, thereby providing external auditors with a thorough understanding of how audits are conducted and why audit criteria are necessary.

The research process begins by contacting potential informants who meet the established criteria. In some cases, potential informants were sourced through the social media platform LinkedIn due to the difficulty in finding respondents who met the requirements. Those who agreed to participate were either scheduled for an in-person meeting or sent the questions via email or Google form. Following the initial contact, the researcher provided the interviewees with an introductory letter that outlined the study's aims and objectives. The interview started with the researchers thanking each participant for their interest and willingness to participate. The researchers also acquired permission to record the conversations and assured the interviewees that their identities would be kept confidential. The researchers concluded the interviews by inquiring about potential concerns that could enhance the reliability and validity of the data and research findings.

The researchers conducted a qualitative analysis of the interview transcripts using manual coding and recoding to represent the interviewees' opinions. Coding is the process of selecting significant data segments and marking them with a code, word, or brief phrase that imparts a descriptive attribute to a portion of visual data or language-based (Saldana, 2015). According to Stuckey's (2015) research, the coding process involves three steps: review the data and develop a coherent narrative (storyline), categorize the data using codes, and memos should be utilized for clarification and interpretation.

The research stages are presented in Figure 1. Based on Figure 1, creating a storyline is crucial in coding data and conducting qualitative analysis (Linneberg & Korsgaard, 2019). In this step, researchers develop the storyline by reading

the transcripts and connecting it to the research problem. Saldana (2015) stated that researchers developed a storyline based on the data to address the study problem and achieve the research objectives. This storyline serves as a guide for organizing and coding the data. The coding and categorizing stage involves assigning codes to each meaningful sentence, phrase, or paragraph and then managing those codes into specific categories. Researchers analyze the data obtained and assign codes based on a pre-agreed scheme related to the research question. If a better alternative code is identified, the resulting code can be revised. In this study, the coding was repeated twice until the researcher determined that the coding and categorization were adequate to address the research problem. The data was coded based on several phrases, including Sharia Supervisory Board, audit process, audit report, competence, ASIFI, and conventional audit standards (conventional standards). The codes were then classified into two categories: implementation and audit standards. Researchers create memos in the final stage to document their ideas and thought processes for arriving at the codes and explaining the storyline. These notes are typically informal and intended for the researcher's insight and reference (Stuckey, 2015). Furthermore, The researchers analyzed the stages and obtained a decision and conclusion on the problem formulation.

The researchers utilized semi-structured interviews with open-ended questions to investigate particular themes or responses. The researcher conducted one face-to-face interview, received one written response via email, and collected the remaining responses through a Google form. The study determined informants based on objective criteria audits, including experience, knowledge, and involvement in Islamic finance practices, particularly in external Sharia. The researcher selected informants with relevant experience and expertise in accounting, auditing, or Sharia and significant participation in the finances of the Islamic association (Adeel et al., 2022; Aribi et al., 2019; Aspiranti et al., 2023). This study follows a qualitative approach, where researchers directly interact with informants to thoroughly comprehend the phenomenon being studied. The selection of the informants was based on their aptitude to provide meaningful and relevant insights in line with the study's purpose: to evaluate the need for a more specific and compelling external Sharia auditing standard.

The interviewees were asked about their knowledge and experience in finance and auditing in Islamic organizations. The views of the respondents on the auditing of Islamic institutions and the role of the parties involved are documented in this section. The examination begins with their opinions on how Sharia auditing is implemented and the functions of the Sharia supervisory boards and external auditor. Next, the interviewees' views on the capability of external auditors to execute audits of Islamic financial organizations were discussed. The examination of the necessity for audit Sharia standards for external auditors who work with Islamic financial institutions concludes this section.

RESULTS AND DISCUSSION

Audit implementation for Islamic Financial institutions by external auditors. Islamic financial institutions differ from non-Sharia entities in their characteristics, which affects the form and standard of their supervision activities, including audit implementation. Central bank

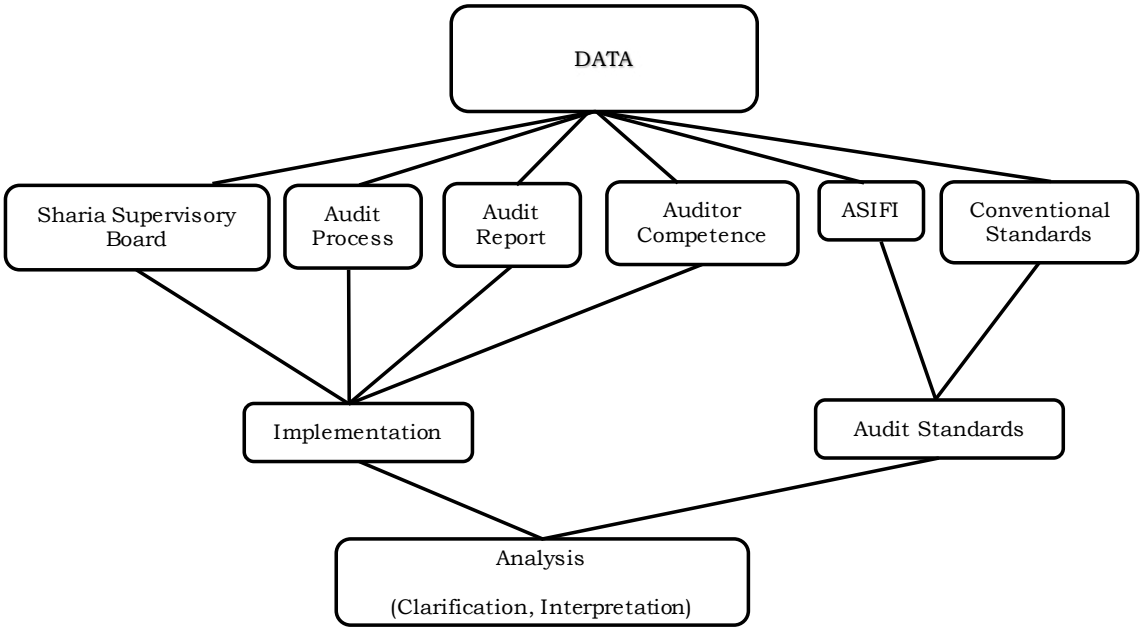


Figure 1. Research Concept
Source: Stuckey (2015) with Modification

and the national sharia council supervise islamic banks to ensure their operational activities and financial reports adhere to Sharia principles, rules, and financial accounting standards. This activity is done to achieve the goal of maqashid Syariah, which serves as a performance indicator for Islamic banks (Anggrayni et al., 2022; Soediro & Meutia, 2018).

In this context, the Sharia supervisory boards, as the representative of the National Sharia Council in Islamic Banks, provides Sharia inputs to the management of Sharia-compliant financial institutions at the time of issuance of new products. The boards also audits Sharia's compliance with products and business processes (Baklouti, 2022). The importance to those boards of ensuring contractual compliance with Sharia was stated by Syahal as follows:

> "Sharia compliance auditing is a major concern of Sharia supervisory boards. It is done through random checks of contracts in the lending or financing division, focusing on checking compliance with financing standard operating procedures" (Syahal).

Syahal's statement highlights the importance of Sharia supervisory boards ensuring that contracts comply with Sharia law. Syahal addressed that these boards conducts a Sharia compliance check once a month and reports the results to the financial services authority and central bank every semester. Additionally, Sharia supervisory boards holds regular internal meetings every two months. If any issues arise during the ongoing contracts, the boards invites the board of directors and commissioners to collaborate on finding solutions. Several previous studies align with Syahal's opinion, including those of Umar, Abduh, and Besar (2023), who expressed the opinion that the responsibility of Sharia supervisory boards is to ensure the Sharia compliance of Sharia institutions. Haddad & Souissi (2022) and Muslihun (2023) added that these boards also must mitigate the risks of Islamic banks.

Additionally, Sharia supervisory boards must prevent fraud while ensuring the application of Sharia law in Islamic banks (Anisykurlillah, 2020). Within the agency theory framework, these boards should act as an external control that helps ensure Islamic banks conduct their operations according to shareholders' interests and Sharia principles. It reduces moral hazard and malice.

However, concerns have been raised about the independence of Sharia supervisory boards when conducting audits of Sharia compliance with Islamic financial associations. Darwanto & Chariri (2019) and Haddad & Souissi (2022) stated that the appointment and expulsion of Sharia supervisory boards through the annual member meeting and even its direct appointment through the suggestions of multiple directors and shareholders are signs of the Sharia supervisory boards' lack of independence. The role of Sharia supervisory boards in Islamic institution management and the potential for concurrent employment in other Islamic financial institutions are further indicators that raise concerns about the independence (Khalid, 2020). Regarding the independence issue, Siti suggested that other parties review the work of these boards. Conversely, Riza argues that internal auditors should play an active role in correcting the boards's findings. However, Harun et al. (2020) found that internal auditors in Islamic financial institutions do not participate in Sharia compliance audits. This finding is consistent with Syahal's statement:

> "If the boards (Sharia supervisory boards) focuses on Sharia compliance audits, internal auditors conduct more general audits related to banking regulations because they may not have in-depth knowledge of Sharia aspects. Therefore, if there is a problem related to Sharia compliance, the boards can identify it" (Syahal).

Syahal believes Sharia supervisory boards is responsible for ensuring Islamic banks' operations adhere to Sharia laws. These boards have extensive knowledge of aspects of Sharia, including the rules and principles underlying Islamic banking. Albarrak & El-Halaby (2019) and Tooranloo & Azizi (2018) stated that Sharia supervisory boards verifies that the bank's services and products break no Sharia law. On the other hand, internal auditors are responsible for performing general audits related to banking regulations. However, they may not have the same expertise in Sharia compliance as because these boards have a more in-depth knowledge of Sharia aspects. It is important to note that internal auditors do not specifically deal with Sharia compliance (Arifah & Hudayati., 2023; Nomran & Haron, 2020). Thus, Syahal's statement illustrates how Sharia supervisory boards and internal auditors can complement each other in general ensuring Sharia compliance and compliance with banking regulations in an Islamic banking environment.

However, Puspitasari & Muhammad (2019) found that it is common for Sharia supervisory boards to delegate tasks and functions to other governance bodies within the organization, such as the internal audit department or the compliance department, due to the limited time that Sharia supervisory boards have to perform these functions in detail. In addition, the absence of a professional code of ethics, such as that of an external auditor, causes the these boards to be guided only by the moral and religious values in carrying out its responsibilities (Arwani, 2018).

In light of legitimacy theory, assigning Sharia supervisory boards responsibilities and acti-

vities to other governance bodies, like compliance or internal audit departments, may result in less accountability and openness in the supervisory process. Furthermore, these boards may perform their jobs with less professionalism and accountability if no professional code of conduct is tailored to their needs. Suppose Islamic institutions' Sharia Supervisory Boards only adhere to moral and religious principles without explicit rules. In that case, they may encounter difficulties maintaining consistency and objectivity in supervising Sharia compliance. To preserve the public's trust, these boards must transparently conduct their business and conform to accepted ethical norms. Failure to do so can reduce the legitimacy of Islamic organizations in the view of stakeholders and the public in general (Sani & Abubakar, 2021; Sencal & Asutay, 2021).

Some of these things have led to the emergence of the issue of independence in Sharia supervisory boards, which eventually led to Ahmad and Siti's opinion regarding the need for an independent external auditor to conduct Sharia compliance audits in Sharia financial organizations.

> "I agree with the issue. There is a high likelihood of a conflict of interest. An alternative solution would be to conduct an independent external Sharia audit" (Ahmad).

> "In addition to the sharia supervisory Board, other parties should also ensure Sharia compliance" (Siti).

Ahmad concurred with the discussed issue of the high possibility of conflicts of interest. Conflicts of interest may arise when the entity conducting the audit is involved or interested in the audited activity, which can reduce the audit's objectivity. Ahmad suggested an alternative solution: conducting an independent external Sharia audit. Ahmad's statement aligns with Algabry et al. (2020) suggestion to engage external auditors with no direct involvement or interest in the operations of the Sharia bank being audited. This approach aims to enhance objectivity and trust in evaluating Sharia compliance. ASIFI No.6 outlines the guidelines for external Sharia audits, emphasizing the significance of an independent external audit in ensuring the integrity and objectivity of the Sharia compliance assessment.

Furthermore, Siti emphasized that ensuring Sharia compliance is not the sole responsibility of one entity or institution, such as the Sharia Supervisory Board. Ensuring cooperation among all concerned parties is crucial. Other parties, such as bank management, compliance teams, or regulatory supervisory agencies, also have an essential role in enforcing Sharia compliance (Arifah & Hudayati, 2023; Muslihun, 2023). Cooperation among different parties can enhance the supervisory system and minimize the risk of violations (Faza' et al., 2023; Mukhibad et al., 2020; Puspitasari & Handayani, 2020). Based on Ahmad and Siti's perspectives, it can be inferred that there is a drive to mitigate conflicts of interest through independent external Sharia audits while highlighting the significance of collaboration among various parties to ensure comprehensive Sharia compliance. In this case, external auditors are expected to fulfill this role to enhance public trust in the Sharia compliance of Islamic institutions. This conclusion pertains to Alam et al. (2022), who identified the necessity of independent external Sharia auditors to guarantee adherence to Sharia in Islamic organizations' operations.

Under agency theory, Sharia supervisory boards acts as an agent responsible for ensuring Sharia banks adhere to Sharia principles. However, the appointment and dismissal of the boards through the general meeting process or even at the proposal of directors and shareholders may lead to agency conflicts that affect the independence of the boards. This independence issue may lead to weaknesses in the supervision of Islamic banks and increase moral hazard and malice. The recommendation to involve other parties in reviewing the performance of the boards and the role of internal and external auditors in balancing the findings of the boards also reflects an attempt to improve agent control within the parameters of agency theory.

So, the independence of the external auditors and Sharia supervisory boards will significantly determine the credibility of financial reporting, which users of financial reports will later use to make decisions such as investments. The greater the independence of these two institutions, the more customers and the public will trust the concerned bank, which will benefit it in the future (Can, 2021; Darwanto & Chariri, 2019). Meanwhile, external auditors conducting audits on Islamic institutions are limited to examining the presentation of financial statements per Sharia financial accounting standards. However, external auditors are generally required to be aware of the applicable regulations in the client's industry and ensure compliance. This obligation to understand the client's business and industry is under the professional standards of a public accountant.

Conventional audit standards are a reference determined to be a measure of quality that public accountants must follow in providing their services. Public accountants providing professional services must adhere to conventional audit standards. As a result, external auditors apply this standard to Islamic and non-Islamic institutions during the audit process.

The audit process is a sequence of actions the auditor conducts when conducting an audit engagement with a client. There are four stages in the audit process: audit engagement, audit planning, audit implementation, and audit reporting. Futhermore, Riza stated that:

> "There is no difference in the stages of the audit of Islamic and non-Islamic banks. The difference is only in the accounting standards used as criteria in auditing" (Riza).

Riza emphasized that the audit stages, including audit planning, evidence gathering, internal control testing, substantive testing, risk assessment, and report submission, are not dependent on whether the financial institution is Sharia-based or conventional. However, Albarrak & El-Halaby (2019) and Sani & Abubakar (2021) argued that the absence of Islamic audit standards results in a gap between audit practice and performance in the audit process of Sharia banks. The cause of this disparity is the use of traditional audit standards. Furthermore, the main difference highlighted by Riza is the use of accounting standards as audit criteria. Islamic banks follow Sharia financial accounting standards in financial recording and reporting, while conventional banks follow financial accounting standards (Muhdar et al., 2023; Salami, 2021). The main difference in auditing between Islamic and non-Islamic banks lies in the accounting standards. Based on the statement above, it can be concluded that external auditors conduct audits of Islamic organizations according to conventional auditing standards.

Primarily, external auditors provide financial statement auditing services at Islamic banks and do not conduct audits related to Sharia compliance. Ahmad and Riza state that Sharia compliance audits can be performed if stated in the audit's scope. Ahmad and Riza added their explanation as follows:

> "External auditors are not obligated to conduct Sharia compliance audits unless agreed upon by the auditee" (Ahmad).

> "Ensuring compliance of Islamic institutions is part of the process of understanding the business and environment of the audit client, where external auditors are required to understand the regulations that apply to industrial clients and ensure that the client is compliant. However, in the case of a general audit of financial statements, the external auditor does not examine this in detail unless a special audit is carried out related to compliance" (Riza).

It highlights the flexibility in deciding the scope of the audit by the audited party, which may or may not include a Sharia compliance audit depending on the agreement made (Khatib et al., 2022). In this context, the external auditor performs an independent audit of the financial statements to ensure compliance with relevant standards, whether Islamic or conventional (Muhdar et al., 2023; Salami, 2021). If the auditee requests a Sharia compliance audit as part of the external audit, the external auditor may include it in their scope of work. This statement confirms the argument from Saidani et al. (2020) and Triyanto (2022) that the decision to conduct a Sharia compliance audit is mutually agreed upon by the audited party and the external auditor, considering the specific needs and requirements of the audited entity. Therefore, external auditors not conducting Sharia compliance audits can impact the credibility and transparency of Islamic banks in the public's eyes. Sharia compliance audits are an additional service for clients that may increase company costs.

Meanwhile, Riza's statement emphasizes the significance of ensuring Sharia compliance in Islamic financial organizations as part of the audit process. External auditors must understand the regulations for industry clients and ensure compliance with these rules. Khatib et al. (2022) and Mnif & Tahari (2022) argued that auditors must comprehend the client's business and surroundings to detect and analyze risks. However, Haddad & Souissi (2022) argued that in the case of a general audit of financial statements, external auditors do not examine this in detail unless a specific compliance-related audit is conducted. It highlights the importance of external auditors' comprehensive understanding of the business and industry regulations their clients operate, including Sharia regulations in the context of an Islamic financial organization. The auditors' understanding and verification of Sharia compliance is a crucial aspect of the audit process, mainly when it is significant to their client's operations. However, during a general financial statement audit, the auditor's main objective is to assess the accuracy and reliability of the financial information presented. In contrast, a specialized Sharia compliance audit may be necessary to evaluate the client's adherence to Sharia principles (Khatib et al., 2022; Triyanto, 2022).

It can be inferred from the available data that the conventional audit standards do not specifically require external auditors to verify the Sharia compliance of Islamic associations. Riza stated:

> "Generally, we must know the regulations that apply to the client's industry and ensure compliance. If there is non-compliance, we need to discuss it with management or those charged with governance."

The statement confirms Riza's previous assertion that external auditors must understand the regulations applicable to their client's industry and ensure compliance with them. If there is non-compliance, the auditor must hold discussions with management or the party responsible

for governance. It highlights the importance of cooperation between external auditors and authorized parties in maintaining compliance with applicable regulations. In Sharia compliance auditing, the external auditor must understand general business aspects and principles that govern Islamic institutions' operations (Alam, 2022; Saidani et al., 2020). It includes assessing their clients' compliance with Sharia principles, such as the prohibition of usury, fairness in profit and risk sharing, and uncertainty in Sharia contracts (Khatib et al., 2022). If non-compliance is identified, external auditors should discuss the matter with management or the TCWG to find appropriate solutions and provide recommendations to improve compliance. To conduct Sharia compliance audits effectively, external auditors must possess adequate knowledge of Sharia principles and relevant accounting standards (Harun et al., 2020). Additionally, they should maintain effective communication with management to address any Sharia compliance issues. This approach will ensure that Sharia compliance audits are conducted properly and benefit clients in meeting established Sharia principles.

At the international level, audit standards for Islamic organizations differ from those used for non-Islamic institutions (Algabry et al., 2020). The Accounting and Auditing Organizations for Islamic Financial Institutions (AAOIFI) has published an international Sharia audit standard. Related to this topic, Syahal and Riza argued that:

> "The existing Islamic accounting standards are sufficient for external auditors to ensure Sharia compliance of an Islamic bank" (Syahal).

> "I did not see the need for an audit standard different from the current one. The difficulties experienced today are not caused by the absence of specific Sharia auditing standards but because of the need for an understanding of specific transactions in Sharia financial institutions" (Riza).

Syahal's statement highlights that the current Islamic financial accounting standards are adequate for external auditors to confirm Sharia compliance with a Sharia bank. It suggests that the current Islamic accounting standards offer comprehensive guidance for external auditors to assess the sharia adherence of an Islamic financial institution. Salami (2021) stated that by referring to these standards, auditors can verify whether transactions comply with established Sharia principles. Riza's statement emphasizes that the main challenge in Sharia compliance auditing is not the absence of Sharia auditing standards but rather the complexity and uniqueness of Sharia transactions that require auditors to have an in-depth understanding and handle them carefully. However, it is understandable that Syahal and Riza's statements may be subjective, as external auditors who audit Islamic banks typically only verify the appropriateness of recording bank transactions against financial accounting standards in the financial statements. However, Sharia auditing encompasses more than just recording accounting transactions; it also includes ensuring operational and environmental compliance with Sharia principles (Anggrayni et al., 2022; Haddad & Souissi, 2022). This argumentation is evident from Ahmad's argument as follows:

> "The current audit standards have not incorporated the governance standards from AAOIFI as global best practices. Therefore, adopting these international standards for auditing practices in Islamic institutions is urgent" (Ahmad).

Ahmad believes that adopting international audit standards in financial institutions is crucial. They argue that implementing auditing standards incorporating governance principles issued by AAOIFI will enhance audit quality and ensure better Sharia compliance in the country. AAOIFI's governance standards provide a comprehensive framework for managing and supervising Islamic institutions. The standards cover transparency, accountability, independence, and protection of shareholder and customer interests (Aspiranti et al., 2023; Olayemi et al., 2018). By adopting these standards, auditors will have clear guidelines to assess the governance performance of an Islamic financial institution and identify and address risks associated with poor governance practices. Adopting governance standards from AAOIFI can improve consistency and compliance in auditing practices in Islamic financial institutions worldwide (Algabry et al., 2020). It can also facilitate easier comparison between audits conducted by different auditors and increase stakeholder confidence in audited financial statements. Ahmad highlighted the significance of promptly implementing these standards to enhance governance and Sharia compliance in Islamic finance organizations.

In agency theory, implementing these standards can enhance agency relationships between external stakeholders and Islamic banks by ensuring effective and transparent implementation of controls and compliance with Sharia principles. In terms of legitimacy theory, this move reflects the efforts of Islamic institutions to maintain or enhance their legitimacy in the eyes of the public and stakeholders by adopting internationally recognized standards to improve audit quality and governance.

The following discussion concerns the independent auditor's report, which only provides assurance of the fairness of financial statements but does not guarantee Sharia compliance. An audit

of an Islamic institution should include assessing Islamic financial reports and compliance of an Islamic bank complying with Sharia itself concerning products and company operations in general. Responding to this condition, Riza argued that:

> "The structure of the independent auditor's report, as regulated by conventional audit standards, especially SA 700, has met the needs of stakeholders regarding Sharia compliance assurance. If the Islamic financial institution industry needs more, it can refer to SA 701. SA 701 regulates the obligation to submit key audit matters to issuers. If the regulator of Islamic financial institutions requires it, this can be applied" (Riza).

According to the this statement, Riza believes that the auditor's report, prepared under SA 700, has provided transparency and trust to stakeholders regarding the level of Sharia compliance of Islamic organizations. In fact, auditor reports under SA 700 do not explicitly state the company of Sharia compliance. In contrast, based on Sani & Abubakar (2021)'s argument, auditors must use clear, concise, and objective language when reporting on their clients' compliance with these principles. Ambiguity in the auditor's report can have a negative impact on Sharia compliance and undermine stakeholder confidence in Islamic institutions. Contrary to Riza's statement, Ahmad and Siti stated that:

> "The structure of the independent auditor's report regulated in the conventional audit standards does not provide Sharia compliance assurance, especially Sharia compliance operational audit assurance" (Ahmad).

> "The structure of the independent auditors has not fully assured Sharia compliance" (Siti).

According to Ahmad, the independent auditor's report may provide information on financial aspects, internal controls, and risk management. However, it may not focus on the Sharia compliance aspect of operations, which could result in stakeholder's uncertainty regarding the Islamic institution's level of Sharia compliance. Siti shared a similar view that the structure of the independent auditor's report does not fully ensure Sharia compliance. The independent auditor's report may provide information on financial condition and internal control processes but does not provide sufficient assurance on overall Sharia compliance. It is important to note that this statement is objective and free from biased language. The statement aligns with Ridwan & Mayapada (2022) who stated the necessity of enhancing the structure of the independent auditor's report to provide more robust assurance regarding Sharia compliance. Sani & Abubakar (2021) and Sencal & Asutay (2021) stated that Sharia compliance includes operational and other aspects to meet stakeholders' expectations and needs in the Islamic institution. It can certainly increase the company's value and public trust.

In agency theory, this gap in oversight and accountability can increase the risk of agency conflict between external stakeholders and Islamic institutions. So, remedial measures are necessary to structure the independent auditor's report. These measures should ensure adequate Sharia compliance assurance, thereby increasing the legitimacy and trust of Islamic institutions in the view of the public and stakeholders.

Therefore, Ahmad considers it essential to make separate rules regarding the structure of the independent auditor's report for Islamic Banks. He added that:

> "To become one of the world's Islamic financial centers, the state should adopt Sharia standards, accounting standards, audit standards, governance standards, and code of ethics from AAOIFI, the global standard setter in Islamic finance" (Ahmad).

Ahmad stated that implementing internationally recognized standards is a must to become a leading Islamic finance center. Adopting AAOIFI standards, widely acknowledged as best practices in the industry, will strengthen Islamic finance infrastructure. Adopting these standards can improve the quality of its Islamic financial services, increase transparency, and enhance the confidence of stakeholders, both domestic and international, in the country's Islamic finance industry. It will also help integrate the national Islamic finance market into the global market and expand access to Islamic finance for local and foreign investors.

Moreover, several competencies are required to carry out its function as a Sharia auditor or auditor at Islamic institutions that can ensure Sharia compliance, including knowledge of *fiqh muamalah*, Islamic law, accounting and auditing skills, and specific Sharia auditor characteristics (Ananda et al., 2021; Harun et al., 2020). The various competencies that must be possessed by an external auditor in conducting Sharia audits are a challenge for external auditors to be able to maximize their role as Sharia auditors. Related to this argument, Riza stated that:

> "To conduct a general audit of financial statements in Islamic banks, need not only the basic competencies regulated by the public accounting law but also a knowledge of Sharia. The Sharia knowledge can be provided through

> further professional education to public accountants who will provide services to Islamic financial institutions" (Riza).

Riza emphasized the significance of integrating robust accounting skills with a profound comprehension of Sharia principles when conducting audits in Islamic institutions. In this regard, further professional education offers an excellent opportunity for public accountants to acquire additional knowledge on specific aspects of Islamic finance, such as the prohibition of *riba*, the principle of fairness in profit and risk sharing, and other requirements that are distinctive to Islamic financial transactions. Proper training and skills development can enhance public accountants' understanding of Sharia and enable them to apply this knowledge in their audit practices in Islamic financial associations. Harun et al. (2020) stated that continued professional education on Sharia for public accountants can enhance the quality of audits in Islamic financial associations. It ensures that the audit process thoroughly evaluates Sharia compliance and other economic aspects. This statement aims to increase the transparency and trustworthiness of the Islamic finance sector, thereby boosting stakeholder confidence in the financial statements issued by Islamic banks (Albarrak & El-Halaby, 2019; Algabry et al., 2020). Futhermore, Riza added:

> "We need the role of public accountant association to create a curriculum or further professional education regarding auditing in Islamic financial institutions" (Riza).

Riza's statement shows an understanding of the importance of equipping public accountants with the required knowledge and skills to conduct efficient audits in the Islamic finance sector. By involving association in this process, a thorough and relevant curriculum or further professional education program that covers essential aspects of auditing in Islamic financial organizations can be established. It includes Sharia principles, Islamic accounting standards, best practices in Sharia auditing, and an understanding of unique Islamic financial transactions. It is relevant to Harun et al. (2020) who stated that a curriculum or further professional education program can help public accountants develop a solid understanding and necessary skills to tackle the challenges and complexities of auditing in the Islamic finance organization. Related to this topic, Ahmad and Siti have the same opinion on this matter as follows:

> "External auditors who conduct audits of Islamic financial institutions not only need to have a Sharia accounting certification (SAS) but also a Certified Shari'ah Advisor and Auditor (CSAA) certification and a Certified Islamic Professional Accountant (CIPA) issued by AAOIFI" (Ahmad).

> "External auditors at Islamic institutions require special expertise and must continuously upgrade their knowledge and competence" (Siti).

Ahmad's statement highlights the significance of possessing comprehensive knowledge and appropriate skills in Islamic financial practices to conduct audits in Islamic financial institutions effectively and professionally. External auditors should have a strong understanding of Sharia principles, accounting standards, and best practices in Sharia auditing, as emphasized by these certifications. External auditors with these certifications can provide more substantial assurance of Sharia compliance and meet stakeholder expectations for audit quality in the Islamic financial industry. Other certifications are needed. It is aligned with the finding from Dewi & Sawarjuwono (2019) that Sharia accounting certification held by the accountant association focuses solely on accounting principles, while Sharia audit principles are not covered. Therefore, further certification is required to evaluate the skills of Sharia auditors.

Siti's statement emphasizes Islamic finance organizations' intricate and ever-changing nature. It also highlights the significance of external auditors' continuously updating and expanding their knowledge of Sharia principles, accounting standards, and auditing practices. Therefore, external auditors in Islamic banks must maintain up-to-date training and professional development to ensure effective performance of their audit duties and compliance with industry standards.

Both Ahmad and Siti emphasize the significance of possessing the appropriate knowledge, skills, and certification for external auditors who conduct audits in Islamic banks. By ensuring that external auditors have the necessary qualifications and continuously improve their competencies, the quality of audits in the Islamic financial association is expected to improve. It will provide more robust assurance of Sharia compliance and increase stakeholder confidence in Islamic financial associations (Harun et al., 2020; Khalid et al., 2018).

In the other side, the capability of external auditors is an obstacle to implementing audits at Islamic associations. Related to this argument, Riza and Syahal has his own opinion:

> "Some of the obstacles for external auditors in providing Sharia compliance services are the limited number of Sharia organizations" (Riza).

> "There is a need to enhance religious understanding based on the valid ar-

guments of the Qur'an and hadith. This is also supported by external auditors' moral and religious attitude" (Syahal).

Riza argued that the limited number of institutions or organizations that apply Sharia principles is a challenge faced by external auditors. Supported by Ridwan & Mayapada (2022) and Sencal & Asutay (2021), it reduces the opportunity to provide Sharia compliance audit services, which can hinder external auditors from growing their business and expanding their client portfolio in Islamic finance. Furthermore, it may impact the accessibility of opportunities to acquire expertise and specialized skills in Sharia compliance auditing for external auditors in this field. So, it is crucial to establish the infrastructure that facilitates the expansion of the Islamic finance industry.

Syahal's statement suggests that for external auditors to conduct Sharia compliance auditing, they must have a comprehensive understanding of Islamic principles, including those found in the Qur'an and hadith, and how to apply them in their audit practice. The focus on improving religious understanding also demonstrates an appreciation for the significance of ethics and morality in audit practice, particularly in Islamic finance, which is based on Sharia principles (Alam, 2021; Khalid & Sarea, 2021). External auditors with strong moral and religious values can carry out their responsibilities with integrity, honesty, and fairness, ensuring that the audits conducted adhere to high professional, ethical standards. Furthermore, the regulation of professional ethics related to Islamic principles is not included in the professional public accountants' standards and code of ethics, which guide public accountants when conducting audits.

Figure 2 shows the construction diagram of the previous elaboration, and it can be seen that external auditors' implementation of audits of Islamic banks is still limited to auditing financial statements. Within the agency theory framework, this description illustrates the critical role of external auditors in auditing Sharia compliance in Islamic financial institutions as a response to doubts about the independence of Sharia supervisory boards as a party acting as a Sharia auditor. In this context, the external auditor is regarded as a party whose independence is not in doubt and is expected to ensure Sharia compliance to reduce the risk of agency conflict between external stakeholders and Islamic banks. However, there are

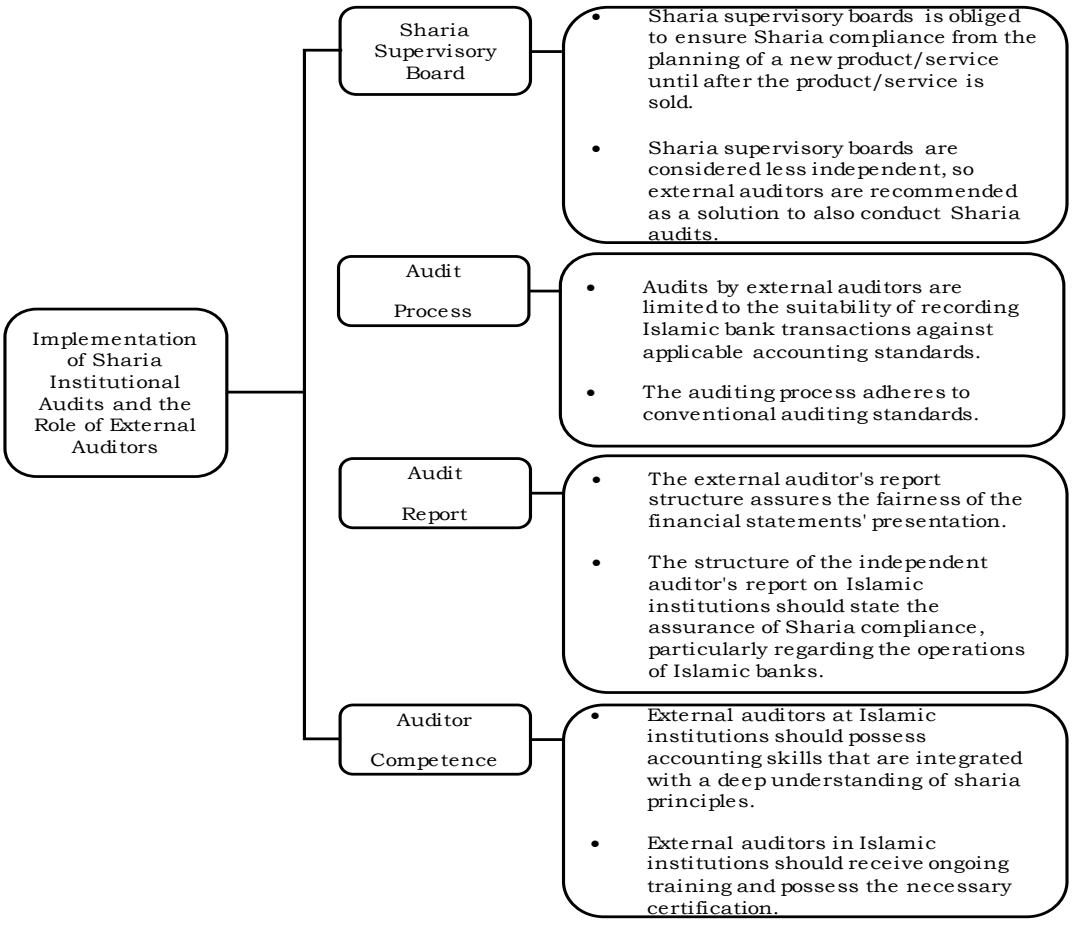


Figure 2. Construction Diagram of External Audit Implementation at Sharia Institutions

still weaknesses related to the absence of Sharia audit standards for external auditors, including the structure of independent auditor reports that do not fully cover aspects of Sharia compliance. It creates a gap in the oversight and accountability mechanism, which may undermine public trust in institutions of Islamic finance. Therefore, to increase the confidence and legitimacy of Sharia institutions in the view of the public and stakeholders, corrective measures are needed in the process and reporting of Sharia audits. Guidelines for external auditors should be established to minimize the risk of agency conflicts and increase transparency and accountability in implementing sharia compliance audits, which should align with agency theory.

In a nutshell, external auditors face several obstacles when carrying out the function of a Sharia auditor, including things things. First, there is currently a lack of professional standards to guide external auditors in conducting Sharia audits or reporting opinions on Sharia compliance. External auditors must use appropriate and relevant auditing standards to evaluate Sharia compliance in Islamic institutions to minimize agency conflict (Jan et al., 2022). The role of external auditors in guaranteeing Sharia adherence in Sharia banks is expanding, strengthening public confidence in such institutions' Sharia compliance (Alam et al., 2023; Faza' et al., 2023). The applicable auditing standards should cover relevant Sharia-specific aspects (Algabry et al., 2020). External auditors' reports require strengthening to enhance the assurance of Sharia compliance (Sani & Abubakar, 2021). It can be achieved by considering new auditing standards that address crucial audit issues related to Sharia compliance, including operations and other aspects. External auditors must pay attention to ethics and morality in their audit practices, particularly in Islamic finance, which is based on Sharia principles, which align with legitimacy theory. A solid moral and religious stance will help ensure that auditors conduct audits with integrity, honesty, and fairness. It is recommended that this be regulated in the code of ethics of the public accounting profession.

Second, sharia auditing requires professionals to possess multiple competencies. External auditors who conduct audits in Islamic financial institutions should possess adequate knowledge of Sharia principles (fiqh muamalah) and their application in an economic context. This knowledge is crucial to ensuring the proper conduct of audits and adherence to Sharia principles by Islamic financial institutions (Albarrak & El-Halaby, 2019; Harun et al., 2020). External auditors must have appropriate certification and training in Sharia compliance auditing. This section covers certifications such as Certified Sharia Advisor and Auditor (CSAA) and Certified Islamic Professional Accountant (CIPA) issued by AAOIFI. Furthermore, to ensure adequate audit conduction, additional training in Sharia is necessary.

Third, to enhance the knowledge of external auditors in Sharia auditing, cooperation between the government and professional organizations is necessary to provide educational institutions, certification, and professional development curricula. This will support the ability of auditors or internal parties in the Sharia auditing process. Although expensive, this policy will bring benefits to every party in the future.

The significance of implementing AAOIFI's sharia auditing standards as a guide for external auditors in delivering professional services to institutions of islamic finance. External Sharia auditor is the term used in this study to denote external auditors who carry out audits in Islamic financial institutions, where external auditors not only audit the fairness of financial statements but also carry out Sharia audits or operational audits of Sharia compliance (Alshubiri & Ani, 2023). Generally, the external Sharia auditor's job is to determine if Islamic banks' contracts, products, and behavior follow the national sharia council or the central bank's fatwas. The Sharia audit might also address Sharia compliance as specified in AAOIFI's international Sharia standards (Alam, 2022; Khatib et al., 2022).

However, there is a need to adopt the international Sharia audit standards issued by AAOIFI (Arwani, 2018). External auditors use conventional audit standards to give professional services to both Islamic and non-Islamic entities due to the absence of Sharia audit standards. Although AAOIFI's international auditing standards have not been formally adopted, it is essential to recognize their distinct advantages in the context of Islamic financial associations. AAOIFI's auditing standards are designed to fulfill the requirements of financial institutions that follow Sharia law for audits (Ridwan & Mayapada, 2022; Zain et al., 2021).

AAOIFI has released international accounting, auditing, Sharia, ethics, and governance standards. In auditing, this institution has issued rules of ethics and five auditing standards for independent auditors to date. The auditing standards issued by AAOIFI are commonly called auditing standards for Islamic financial institutions (ASIFI). These standards offer detailed guidelines for auditing Islamic institutions following Sharia principles. ASIFI No. 1 covers the 'Appointment, Obligations and Responsibilities of External Auditors in institution of Islamic finances, while ASIFI No. 2 covers 'Audit Procedures for Islamic Financial Institutions'. The standards also outline the ethical principles auditors must follow when performing their duties. AAOIFI's auditing standards provide clear and comprehensive guidelines for external auditors to conduct audits of Islamic financial institutions. It ensures consistency in

audit practices and increases public confidence in Sharia compliance. The subsequent discussion will review the fundamental differences between ASIFI's and public accountants' professional standards.

Tahri et al. (2023) argued that in ASIFI's code of ethics, ethical values are distinct from religious precepts and are far more extensive. ASIFI is founded on Islamic principles and rules, while public accountants' professional standards are not based on spiritual values. A detailed comparison of ASIFI and conventional audit standards reveals their fundamental differences. ASIFI acknowledges the significance of ethics in Islamic finance and asserts that ethical values encompass a wide range of moral and behavioral values, not only related to religious teachings. ASIFI's ethical standards are comprehensive and detailed, covering various aspects of Islamic finance practice.

Additionally, ASIFI includes the idea of Sharia supervisory boards. Therefore, the auditor must reference the personnels of Sharia supervisory boards in their report and produce an audit report. It implies that external auditors are accountable for ensuring Sharia compliance in their audits and should also communicate with the boards. The opinion in the independent auditor's report in ASIFI includes the client's compliance with Sharia principles and rules (ASIFI No. 2: Auditor's Report, 1996), which are not stated in the conventional audit standards. However, in traditional audit standards, there are provisions regarding financial statement audits with particular purposes, and even traditional audit standards also include a statement regarding the ongoing concern of the client entity in the audit report, which is not regulated in ASIFI. In other words, ASIFI emphasizes Sharia compliance, while conventional audit standards emphasize compliance with financial accounting standards and audit procedures. It highlights the importance of independent auditors understanding and following the standards relevant to the economic environment in which they operate. They should also comprehensively and accurately assess their clients' focus and needs.

Besides that, standards related to audit evidence are not yet available in ASIFI, but these standards have been detailed in several conventional audit standards. Conventional audit standards govern independent auditors' collection, evaluation, and use of audit evidence to support their audit conclusions. The standard specifies requirements for the quality, relevance, and competence of the evidence collected by the independent auditor to perform the audit appropriately and effectively (Mnif & Tahari, 2022). In contrast, ASIFI provides a standard for external auditors to assess compliance with Sharia norms and principles, which is not included in conventional audit standards. Although ASIFI does not have specific audit evidence standards, it provides standards for external auditors to assess compliance with Sharia norms and principles. It emphasizes the

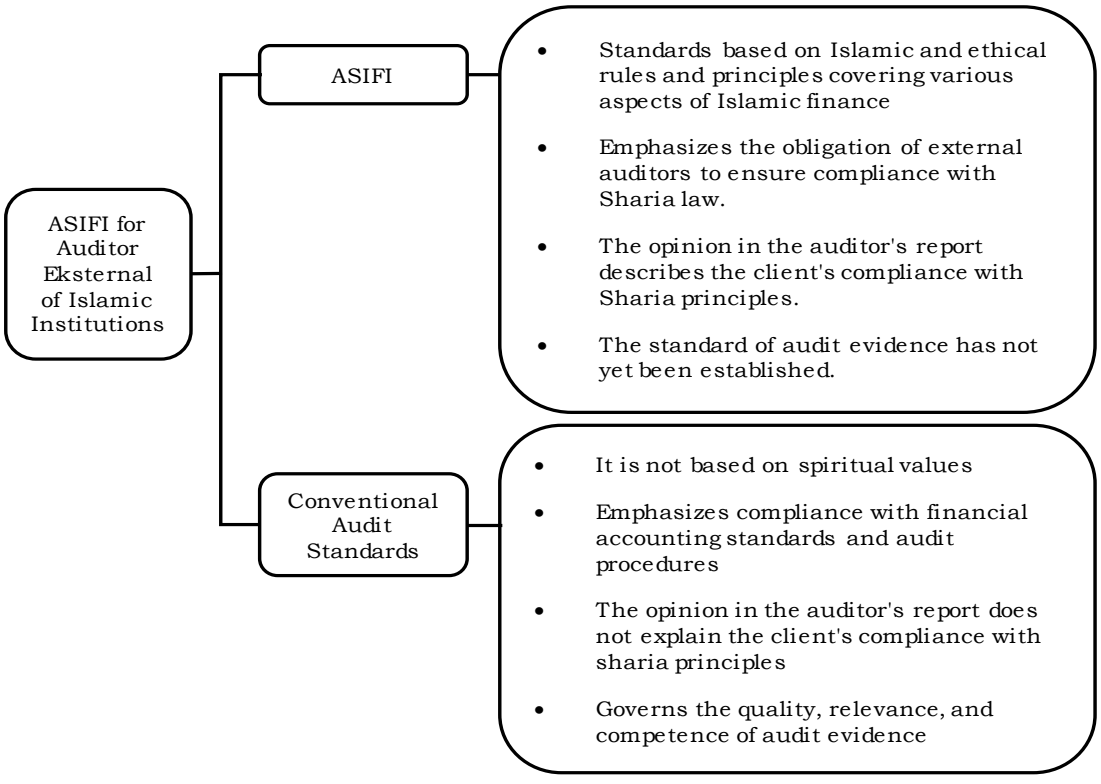


Figure 3. Construction Diagram of the Need to Implement Sharia Audit Standards

significance of independent auditors in Islamic finance organizations in evaluating their clients' compliance with financial accounting standards and the Sharia principles underlying their operations. The importance of comprehending and incorporating Sharia requirements into the audit process of Islamic financial organizations is emphasized.

Figure 3 reveals the diagram construction of the earlier explanation. It is clear that ASIFI or audit standards issued by AAOIFI are narrower than conventional audit standards and are based on Sharia principles and rules. However, given Sharia values and the unique concept of Sharia institutions regulated in ASIFI, where this is not contained in the conventional audit standards, the authorities must adopt this auditing standard to become a guideline for conducting audits in Sharia financial institutions, where this standard can be applied in conjunction with other rules and audit standards that already exist.

In the context of agency theory, this action can be interpreted as an effort to enhance transparency, accountability, and Sharia compliance in Islamic institutions (Jan et al., 2022; Ridwan & Mayapada, 2022; Tabash et al., 2022). Adopting AAOIFI's auditing standards provides clear guidelines for conducting audits considering Islamic financial institutions' Sharia values and distinctive concepts (Zain et al., 2021). It is achieved by reducing agency conflicts between external stakeholders and Islamic banks through a specialized and comprehensive framework that ensures Sharia compliance. For this reason, it would be better if not only Islamic institutions with spiritual and moral credibility but also external auditors who assure spiritual and moral credibility in the Islamic bank's operations also have the same spiritual and ethical values (Alam, 2021; Mukhibad et al., 2020). It can be achieved if the external auditor has audit standards based on Sharia values and concepts. Adopting AAOIFI audit standards could expand access to Islamic finance and enhance its global position as a leading Islamic finance center. Adopting AAOIFI auditing standards can improve the legitimacy and trust of Islamic institutions from the public and stakeholders' point of view. Therefore, financial regulatory authorities and relevant institutions should seriously consider adopting AAOIFI audit standards to strengthen the quality of audit services and bolster the Islamic finance market in the country.

CONCLUSION

This research ultimately corroborates the existence of agency theory, which posits that external auditors are solely responsible for ensuring the conformity of financial statements to applicable accounting regulations and principles in Sharia institutions. Meanwhile, Sharia supervisory boards performs the Sharia compliance audit. However, the independence of these boards has been called into question, which impacts public trust. External auditors at Islamic banks are expected to ensure Sharia conformity and the fairness of the client's financial statements. It is evident that external auditors require support from various parties, including establishing regulations and educational facilities (training, certification, and so forth), to enhance their competence in the field of Sharia principles and regulations.

The conventional audit standards do not currently incorporate Sharia principles and regulations. Furthermore, no regulations require external auditors to conduct Sharia compliance audits, nor is there any mention in the independent auditor's report of ensuring client Sharia compliance. Implementing these measures could enhance public confidence and trust in the Sharia compliance of Islamic associations. Therefore, there is a need for Sharia-compliant audit standards to guide external auditors in conducting audits at Islamic institutions. These requirements should be used with other applicable regulations and standards to boost public confidence in Islamic financial organizations' adherence to Sharia principles and regulations. It applies to the creation of financial statements and the execution of business operations.

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