

Auditing Standard for Islamic Financial Institutions No. 6

External Shari'ah Audit (Independent Assurance Engagement on an Islamic Financial Institution's Compliance with Shari'ah Principles and Rules)

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Auditing Standard for Islamic Financial Institutions (ASIFI) No. 6 "External Shari'ah Audit (Independent Assurance Engagement on an Islamic Financial Institution's Compliance with Shari'ah Principles and Rules)" is set out in paragraphs 1-44. The standard should be read in conjunction with the "International Standard on Assurance Engagements (ISAE) 3000" issued by the International Auditing and Assurance Standards Board (IAASB) and other AAOIFI standards as applicable.

Preface

- PR1 Shari’ah governance is an important component of Islamic Financial Institutions’ (IFIs) governance framework as it promotes accountability and transparency, and helps gain the confidence of the public. Shaping a proper governance structure is vital for the overall soundness of IFIs, and building a strong base of Shari’ah governance shall be the aim of every IFI.
- PR2 External Shari’ah audit is a key pillar in Shari’ah governance framework. It is an independent engagement that aims at examining and assuring Shari’ah compliance within the IFI. An independent and comprehensive external Shari’ah audit is essential for safeguarding the integrity, reputation and sustainability of IFIs.
- PR3 This standard aims at setting out the criteria for performing direct external Shari’ah audit or an attestation external Shari’ah audit and to specify the subject matter and the subject matter information for such engagement. It also provides summarized guidance on the principal procedures and key considerations for performing an external Shari’ah audit engagement as well as the reporting guidelines thereof.
- PR4 AAOIFI acknowledges the important work performed by the International Auditing and Assurance Standards Board (IAASB) in developing International Standard on Assurance Engagements (ISAE) 3000. However, due to the unique nature of the external Shari’ah audit, AAOIFI decided to develop this standard as a complementing standard to ISAE 3000 to ensure that the external Shari’ah auditors all over the world may maintain their overall approach and quality on a uniform basis.

Introduction

Overview

- IN1 This standard intends to set out the principles applicable on performance of an independent assurance engagement to ensure compliance of an IFI with the *'Shari'ah principles and rules'* (commonly referred to as an external Shari'ah audit).
- IN2 This standard encourages that all IFIs shall have external Shari'ah audits performed on at least an annual basis, in line with the provisions of this standard.

Rationale for issuing this standard

- IN3 With the expansion of the industry, it is desirable that effective governance tools including external Shari'ah audit are put in place to ensure qualitative improvements and harmonization, and in turn to enhance the public confidence on Islamic finance industry. External Shari'ah audit is increasingly becoming an important element of the Shari'ah governance framework of IFIs around the world. It is therefore imperative to standardize the practices of external Shari'ah audit and bring them in line with international best practices.

Auditing Standard for Islamic Financial Institutions (ASIFI) No. 6

“External Shari’ah Audit (Independent Assurance Engagement on an IFI’s Compliance with Shari’ah Principles and Rules)”

Objective of the standard

1. The objective of this standard is to provide guidance on performance of an independent assurance engagement (to be referred to in this standard as the external Shari’ah audit) to ensure compliance of an Islamic Financial Institution (IFI) with the ‘*Shari’ah principles and rules*’.

Relationship with other professional standards

2. This ASIFI shall be read in conjunction with the International Standard on Assurance Engagements (ISAE) 3000, “Assurance Engagements Other than Audits or Reviews of Historical Financial Information”¹.
3. The requirements of ISAE 3000, unless contrary to or inconsistent with a requirement of this standard, being specific in nature, or a requirement of Shari’ah, shall be applicable on such engagements as may be carried out under this standard.

Scope of the standard

4. This standard applies to the external Shari’ah audits conducted by independent external Shari’ah auditor(s) with an intention of providing independent assurance to various stakeholders with regard to the IFIs’ compliance with ‘*Shari’ah principles and rules*’.

Types of engagement and respective objectives

Types of engagement

5. An external Shari’ah audit engagement can take the form of either:
 - a. a direct external Shari’ah audit, preferred by this standard; or
 - b. an attestation external Shari’ah audit, in cases where required by the regulators of respective jurisdiction and where a statement of compliance with ‘*Shari’ah principles and rules*’ is required from the management of an IFI.

¹ Issued by the International Auditing and Assurance Standards Board (IAASB)

Objectives

Direct external Shari'ah audit

6. In performing a direct engagement under this standard, the objectives of the external Shari'ah auditor are:
 - a. to obtain reasonable assurance whether, based on suitable criteria (stated in paragraph 15) the IFI has, in all material respects, complied with '*Shari'ah principles and rules*' with regard to the financial arrangements, contracts, and transactions for a specific period under audit; and
 - b. to report on the matters in (a) above in accordance with the external Shari'ah auditor's findings.

Attestation external Shari'ah audit

7. In performing an attestation engagement under this standard, the objectives of the external Shari'ah auditor are:
 - a. to obtain reasonable assurance whether, based on suitable criteria (in line with paragraph 15) subject matter information i.e. the statement of compliance of Shari'ah principles and rules prepared and issued by the management of an IFI presents fairly the state of its compliance, in all material respects; and
 - b. to report on the matters in (a) above in accordance with the external Shari'ah auditor's findings.

Definitions

8. Any term or expression, unless defined in this standard, shall have the same meaning as assigned to it under ISAE 3000. The following specific terms have the meanings attributed below:
 - a. Attestation External Shari'ah Audit – is a type of external Shari'ah audit engagement in which the external Shari'ah auditor reports on a "statement of compliance with Shari'ah principles and rules" issued by the management of the IFI;
 - b. Direct External Shari'ah Audit – is a type of external Shari'ah audit engagement in which the external Shari'ah auditor reports directly on the compliance of an IFI with the criteria (see paragraph 15) with regard to the subject matter i.e. compliance with '*Shari'ah principles and rules*' applicable to its financial arrangements, contracts and transactions during a specific period (see paragraph 13);
 - c. External Shari'ah Audit – is an independent assurance engagement to provide reasonable assurance that an IFI complies with the '*Shari'ah principles and rules*' applicable to its financial arrangements, contracts and transactions during a specific period (see paragraph 13) based on a specific set of '*Shari'ah principles and rules*' contained in the criteria (see paragraph 15);

- d. External Shari’ah auditor – is a firm having professional knowledge and competence of auditing and relevant ‘*Shari’ah principles and rules*’, duly fulfilling the fit and proper criteria laid down by the respective regulator (the Central Shari’ah Board, if applicable) for appointment as an external Shari’ah auditor, who, at the request of the IFI, provides an independent assurance report on the state of compliance by an IFI with the ‘*Shari’ah principles and rules*’. The external auditor may also be appointed as the external Shari’ah auditor of the IFI;
- e. Internal Shari’ah review / audit function – is a function as a part of the governance organs of an IFI with a primary objective to ensure that the management of an IFI discharges its responsibilities in relation to the implementation of the ‘*Shari’ah principles and rules*’;²
- f. Internal Shari’ah reviewer / auditor – is one who performs the activities of internal Shari’ah review / audit function;
- g. Islamic Financial Institutions (IFIs) – are financial institutions that operate in line with ‘*Shari’ah principles and rules*’ performing banking, insurance / Takaful, capital markets and similar activities and include the stand-alone branches, divisions and windows of conventional financial institutions that offer products and services in line with ‘*Shari’ah principles and rules*’.

Compliance requirements

Compliance with this standard

- 9. The external Shari’ah auditor shall not assert compliance with this standard unless he has complied with all the requirements of this standard.

Ethical requirements

- 10. The external Shari’ah auditor shall comply with the requirements of the “Code of Ethics for Accountants and Auditors of Islamic Financial Institutions” issued by AAOIFI as well as the requirements of the relevant code of ethics, as applicable.

Quality control

- 11. In addition to meeting the other professional requirements for quality control such as International Standard on Quality Control (ISQC) 1 “Quality Control for Firms That Perform Audits and Reviews of Historical Financial Information, And Other Assurance and Related Services Engagements”, the external Shari’ah auditor shall ensure that it has adequate capability in terms of resources and knowledge of the criteria to fulfill

² See AAOIFI GSIFI 3 “Internal Shari’ah Review”. In certain jurisdictions this function is called “internal Shari’ah audit” according to their respective governance frameworks. Internal Shari’ah review shall not be confused with the Shari’ah compliance function (which is referred to as Shari’ah review in certain jurisdictions) as it is a management function and is not independent of the management.

the responsibilities under the engagement in a professional manner. This shall entail active involvement of Shari’ah expert(s) throughout the engagement.

Interaction with Shari’ah supervisor(s)

12. The external Shari’ah auditor may need to interact with, communicate with, request Fatawa, rulings and specific opinions from, including on the observations identified by the Shari’ah supervisor(s) of the IFI. Normally an IFI’s Shari’ah Supervisory Board, or their nominee shall be the person(s) suitable for this purpose.

Underlying subject matter and criteria

Underlying subject matter

13. Underlying subject matter of a direct external Shari’ah audit shall comprise “assessing compliance of the IFI’s financial arrangements, contracts, and transactions with *‘Shari’ah principles and rules’*” for a specific period.
14. Subject matter information of an attestation external Shari’ah audit shall be a “statement of compliance of the IFI’s financial arrangements, contracts and transactions with Shari’ah principles and rules” for a specific period, duly approved and issued by the management of an IFI.

Criteria

15. The criteria for assessment for the external Shari’ah audits with regard to the subject matter information (see paragraph 13) shall comprise “the *‘Shari’ah principles and rules’* defined by the following hierarchy, as appropriate:
 - a. the Shari’ah standards issued by Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI);
 - b. the regulations issued by the respective jurisdiction’s regulator insofar as these entail the regulatory Shari’ah requirements;
 - c. the rulings of the Central Shari’ah Board for the respective jurisdiction;
 - d. requirements of the applicable Financial Accounting Standards as issued by AAOIFI insofar as these entail Shari’ah related requirements; and
 - e. approvals and rulings given by the Shari’ah Supervisory Board of the IFI.”

[Explanation: In case of an ambiguity, identified during a compliance, audit or rating exercise, as the case may be, with regard to interpretations related to (a) to (d) above, the Shari’ah Supervisory Board’s clarification shall prevail.]

Attestation external Shari’ah audit

16. In case of an attestation external Shari’ah audit, the management shall evaluate the underlying subject matter (see paragraph 13) against the criteria (see paragraph 15), and shall prepare a statement thereon, namely the “statement of compliance with Shari’ah principles and rules” (for specimen statement, see Appendix B2). The external Shari’ah auditor shall report as to whether the subject matter information (i.e. the

statement of compliance with Shari’ah principles and rules) developed by an IFI’s management presents fairly the state of affairs of the IFI with regard to the underlying subject matter (i.e. compliance with ‘*Shari’ah principles and rules*’), in all material respects (i.e. the same is free from any material misstatement and / or omission).

Assessing the suitability of the criteria

17. The external Shari’ah auditor shall assess the suitability of criteria with regard to the respective IFI and shall document the detailed requirements thereof. For IFIs functions and products, whereby nothing specific is available in the criteria mentioned above, the external Shari’ah auditor shall interact with the Shari’ah supervisor(s) of the IFI and form the details for criteria accordingly.
18. In cases where the external Shari’ah auditor is unable to conclude as to the suitability of criteria, he shall either withdraw from the engagement or disclaim the external Shari’ah audit opinion.

Principal procedures

Shari’ah audit process flow

19. The following chart depicts the summarized principal procedures to be performed by the external Shari’ah auditor in an external Shari’ah audit engagement.



Key considerations

20. The above chart shall be read in line with the principal requirements of ISAE 3000 and the key considerations provided in paragraphs 21 to 34.

Materiality

21. Generally, for any assurance engagement, the materiality consideration is the significance of the matter either quantitatively or qualitatively, which can result in an adverse impact on the decisions of stakeholders with regard to the underlying subject matter i.e. compliance with '*Shari'ah principles and rules*'. With regard to an external Shari'ah audit, this notion has certain peculiarities which need to be considered while planning, executing and reporting on an external Shari'ah audit engagement.

22. Examples of the materiality considerations include the materiality in terms of amount relevant for decision making, the tolerable amount and observed rate of deviation (quantitative considerations), and the nature and cause of any observed deviation. However, it should be noted that at times these values would not be arrived at as the same values for a financial statements audit because the decision making protocols and tolerance limits of the stakeholders might be different from the financial performance perspective. Additionally, in several areas the quantitative as well as the significance or severity of an observation from the Shari'ah perspective or the significance of an observation for specific set of stakeholders (qualitative considerations).

Internal controls (including governance framework): overall objective and limitation

23. An external Shari'ah audit is a reasonable assurance exercise on the IFIs compliance with '*Shari'ah principles and rules*'. Accordingly, while planning and performing an engagement, the external Shari'ah auditor shall perform adequate procedures selected for the engagement depending on his professional judgment, including the assessment of the risks of material non-compliance with the '*Shari'ah principles and rules*'. In making those risk assessments, the external Shari'ah auditor shall consider and test the internal control (including governance framework) relevant to the IFIs compliance with the '*Shari'ah principles and rules*' in order to design procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of such controls. External Shari'ah auditor's comments on internal control shall be included in its long form report (see paragraph 40).

Sampling

24. The external Shari'ah auditor shall determine the adequacy or otherwise the use of sampling, and the type of sampling that needs to be applied. Such determination shall be based on the principal risk assessment including the inherent and control risks related to Shari'ah non-compliance and the materiality considerations including in particular, the qualitative materiality considerations. Once having determined the need of application of sampling, the pertinent factors shall be considered including the suitability of applying sampling in respect of each area / function and the relevant controls and the characteristics of the population from which the sample will be drawn. Such suitability and relevant sample sizes shall be responsive to the risk of Shari'ah non-compliance (inherent risk, control risk and in case of testing of details the combined risk) and the materiality considerations, as discussed above.
25. To determine a sample size, the external Shari'ah auditor shall apply statistical approaches and judgment with regard to risk of Shari'ah non-compliance. The sample selection shall be based on statistical techniques and in case of identified instances of Shari'ah non-compliance, the sample sizes shall be increased adequately. In the matters of qualitative materiality i.e. more sensitive for the risk of Shari'ah non-compliance, the sample selection shall take into consideration the qualitative aspects of individual items of population.

Written representations

26. The written representations from the management shall have particular emphasis on the management's confirmation for adequacy of the internal control and governance system for Shari'ah compliance and fiduciary responsibilities as well as product documentation and process flows. These shall additionally emphasize on the completeness and relevance of all information and access thereto, provided to the external Shari'ah auditor. These shall further include the confirmation of disclosure of any non-compliance with '*Shari'ah principles and rules*' having regard to criteria and local laws as well as any known deficiency in design or application of controls, particularly with regard to product approvals and related process flows.
27. The date of the written representations shall be as near as practicable to the date of the external Shari'ah auditor's report, but not after such date. All significant events subsequent to the period covered by the IFI's external Shari'ah audit, shall be included in the written representations.
28. In case of an attestation external Shari'ah audit, the primary written representation is the statement prepared by the management of the IFI on the subject matter information i.e. the statement of compliance with Shari'ah principles and rules (see Appendix B2). However, additional written representations in line with professional requirements shall be obtained.
29. In case of a direct external Shari'ah audit, the matters included in the sample statement of compliance with Shari'ah principles and rules as applicable in case of an attestation external Shari'ah audit (see Appendix B2) may also be considered relevant to be included in the written representations.
30. If the IFI refuses to provide one or more of the written representations requested the external Shari'ah auditor shall disclaim his opinion.

Using the work of internal Shari'ah review (internal Shari'ah audit) / Shari'ah review and the report of the Shari'ah supervisor(s)

31. The external Shari'ah auditor shall assess the existence of internal Shari'ah related functions including but not limited to the internal Shari'ah review (internal Shari'ah audit), Shari'ah review, and the report of the Shari'ah supervisors and their respective independence and reliability. The primary criterion for assessing the usability of such work is its relative independence from the management. For the same reason, the Shari'ah related management functions e.g. Shari'ah compliance department (or function) shall not be considered for this purpose. Their work, however, can be considered as a part of effective internal controls but not to be used as a part replacement for external Shari'ah auditor's work.
32. Once determined to be independent of the management and reliable, the external Shari'ah auditor shall assess usability of such work and accordingly, obtain and review the reports issued during (or with regard to) the period under coverage of the engagement by all such relevant, independent and reliable functions. Where necessary, the external Shari'ah auditor shall consider reviewing their working papers in addition to the reports to support the conclusions reached.

33. The external Shari'ah auditor shall determine the impact of such report(s) on:
 - a. the nature, timing and extent of the work to be performed with regard to the engagement; and
 - b. the report of the external Shari'ah audit.

Residual risk and testing of details

34. The external Shari'ah auditor shall assess the residual risk which is not adequately addressed by the procedures performed in different stages of the external Shari'ah audit and shall consider obtaining further evidence and performing the testing of details including analytical and detailed verification. These procedures shall be performed to an extent that would enable the external Shari'ah auditor to provide a reasonable assurance opinion in line with this standard. This will include detailed verification of transactions e.g. requiring more data and evidence, verifying the same and performing additional procedures e.g. physical inspections and confirmations, if needed. These may also involve re-computation and analytical reviews of computations and quantitative data involved e.g. in case of profit and loss distribution to the investment account holders. In case the external Shari'ah auditor is unable to reduce the risk to an acceptably low level, he shall consider impact on the external Shari'ah audit report.

Documentation and archiving

35. The documentation of performance of external Shari'ah audit and relevant evidence shall be developed in line with the international best practices. The key consideration is that the documentation shall be sufficient (quantitatively) and appropriate (qualitatively) to enable an experienced Shari'ah auditor (or otherwise an experienced assurance professional) to understand the procedures, results and conclusions considering the underlying subject matter and the criteria. Documentation should be supporting the adequacy of the professional judgments applied.
36. Details with regard to observations, their conclusions and management, Shari'ah supervisor(s) and other parties' comments thereon shall be adequately documented, along with their impact on the report of external Shari'ah auditor. In particular, the details with regard to differences, if any, against the criteria defined in paragraph 15, with the Shari'ah supervisor(s) view and the conclusions reached shall be documented. Evidence of involvement of the subject matter (Shari'ah) experts in the team and the procedures and reviews performed by them, as well as, their views on specific Shari'ah issues shall be documented appropriately.
37. The external Shari'ah auditor shall develop and apply a consistent policy in line with the international best practices with regard to the completion of documentation and its archiving and any changes to the same after archiving.

Preparing the external Shari'ah auditor's report

Contents of the external Shari'ah auditor's report

38. The external Shari'ah auditor's report shall include the following basic elements, in line with ISAE 3000:
- a. a title – as appropriate in line with this standard;
 - b. an addressee (the shareholders of the IFI, unless otherwise required by the regulators of respective jurisdiction);
 - c. identification of:
 - i. the underlying subject matter (see paragraph 13);
 - ii. the criteria (see paragraph 15) applied to evaluate the underlying subject matter; and / or
 - iii. the subject matter information (if applicable i.e. in case of an attestation external Shari'ah audit) (see paragraph 14);
 - d. a statement that (the management of) the IFI is responsible for:
 - i. the underlying subject matter i.e. the IFI's compliance with '*Shari'ah principles and rules*'; and / or
 - ii. the development of subject matter information (if applicable i.e. in case of an attestation external Shari'ah audit) (see Appendix B2);
 - e. a statement that the engagement was performed in accordance with this standard read with ISAE 3000 which require the external Shari'ah auditor to comply with ethical requirements and plan and perform procedures to obtain reasonable assurance about the evaluation of underlying subject matter against criteria (and the subject matter information, if applicable);
 - f. a statement about the ethical principles (including AAOIFI's code of ethics) and quality control standards applicable on the external Shari'ah auditor;
 - g. a summary of the external Shari'ah auditor's procedures to obtain reasonable assurance and a statement of the external Shari'ah auditor's belief that the evidence obtained is sufficient and appropriate to provide a basis for the external Shari'ah auditor's opinion;
 - h. a statement about the involvement of subject matter (Shari'ah) experts;
 - i. the external Shari'ah auditor's opinion, expressed in the positive form:
 - i. in case of a direct engagement – on whether, in all material respects, based on suitable criteria, the IFI meets the underlying subject matter; or
 - ii. in case of an attestation engagement – on whether the subject matter information presents fairly the state of affairs of the IFI with regard to the underlying subject matter, in all material respects;

- j. the date of the external Shari’ah auditor’s report, which shall be no earlier than the date on which the external Shari’ah auditor has obtained sufficient appropriate evidence on which to base the opinion – including the report of the Shari’ah supervisor(s) of the IFI;
 - k. the name of the external Shari’ah auditor – including the name of the firm and the engagement partner, if applicable, and the location in the jurisdiction where the external Shari’ah auditor practices;
 - l. the statement that a long form report being issued to those charged with governance; and
 - m. in case of an attestation engagement – without modifying the external Shari’ah auditor’s opinion, a reference to any material non-compliance(s) of ‘*Shari’ah principles and rules*’ which is / are adequately described by the management in the subject matter information.
39. Specimens of the external Shari’ah auditor’s reports are provided in Appendices A and B1 for direct external Shari’ah audits and attestation external Shari’ah audits, respectively.

Long form report

40. A long form report shall be issued alongside the short form report duly addressed to those charged with governance primarily containing the key audit matters and observations, particularly such material observations that have been resolved through adjustment, charity or reversals or other corrective measures. Principal contents of such report are provided in Appendix C.

Modified opinions

41. If the external Shari’ah auditor concludes that there is / are material non-compliance(s) with ‘*Shari’ah principles and rules*’, or in case of an attestation engagement the subject matter information does not reflect a material information, or if the external Shari’ah auditor is unable to obtain sufficient appropriate evidence to reach proper conclusions; the external Shari’ah auditor’s opinion shall be modified in form of a qualified, adverse or disclaimer of opinion, as appropriate in the circumstances.
42. The external Shari’ah auditor’s assurance report shall contain a clear description of the reasons for the modification(s) in the report.

Application guidance

43. Detailed application guidance in form of an External Shari’ah Audit Manual is being issued separately.

Effective Date

44. This standard is effective for external Shari’ah auditors’ reports covering periods beginning on or after 01 January 2019. Early adoption is encouraged.

APPENDICES

Appendix A: Sample external Shari'ah audit report – direct form

Independent assurance report on compliance with the Shari'ah principles and rules (external Shari'ah audit)

To the _____ of [_____ / _____ – Islamic Financial Institution]

Introduction

We have undertaken an independent reasonable assurance engagement (external Shari'ah audit) of [_____ / _____ – [IFI] (the Islamic Financial Institution) for assessing compliance of the IFI's financial arrangements, contracts, and transactions with Shari'ah principles and rules for the year ended _____.

Applicable criteria

The criteria for the assurance engagement against which the underlying subject matter (Shari'ah compliance of the IFI's financial arrangements, contracts, and transactions for the year ended _____) is assessed comprise the Shari'ah principles and rules that for the purpose of external Shari'ah audit mean the following, in the sequence provided below:

- a. The Shari'ah standards issued by Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI);
- b. The regulations issued by the [_____ - the Regulator] insofar as these entail the regulatory Shari'ah requirements;
- c. The rulings of the Central Shari'ah Board [_____];
- d. Requirements of the applicable Financial Accounting Standards as issued by AAOIFI insofar as these entail Shari'ah related requirements; and
- e. Approvals and rulings given by the Shari'ah Supervisory Board of the IFI.

The above criteria were evaluated for their implications on the financial statements of the IFI for the year ended _____, which are annexed.

Management's responsibility for Shari'ah compliance

IFI's management is responsible to ensure that the financial arrangements, contracts and transactions having Shari'ah implications, entered into by the IFI with its customers, other financial institutions and stakeholders and related policies and procedures are, in substance and in their legal form, in compliance with the requirements of Shari'ah principles and rules. The management is also responsible for design, implementation and maintenance of appropriate internal control procedures with respect to such compliance and maintenance of relevant accounting records.

Our Independence and Quality Control

We have complied with the independence and other ethical requirements of the Code of Ethics for Accountants and Auditors issued by AAOIFI as well as the Code of Ethics for Professional Accountants [or other code of ethics applicable in the jurisdiction], which are founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

The firm applies International Standard on Quality Control (ISQC) 1 “Quality Control for Firms That Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements” and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

This engagement was conducted by a multidisciplinary team including assurance practitioners and subject matter (Shari’ah) experts.

Our responsibility and summary of the work performed

Our responsibility in connection with this engagement is to express an opinion on compliance of the IFI’s financial arrangements, contracts, and transactions with Shari’ah principles and rules, in all material respects, for the year ended _____ based on the evidence we have obtained. We conducted our reasonable assurance engagement in accordance with International Standard on Assurance Engagements 3000, ‘Assurance Engagements other than audits or reviews of historical financial statements’, issued by the International Auditing and Assurance Standards Board and the Auditing Standard for Islamic Financial Institutions (ASIFI) 6 “Independent Assurance Engagement on an IFI’s Compliance with Shari’ah Principles and Rules (External Shari’ah Audit)”, issued by AAOIFI. These standards require that we plan and perform this engagement to obtain reasonable assurance about whether the IFI’s financial arrangements, contracts, and transactions are compliant with Shari’ah principles and rules in all material respects.

The procedures selected by us for the engagement depended on our judgment, including the assessment of the risks of material non-compliance with the Shari’ah principles and rules. In making those risk assessments, we considered and tested the internal control relevant to the IFI’s compliance with the Shari’ah principles and rules in order to design procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the IFI’s internal control. In this connection, we have also reviewed the work carried out by the internal Shari’ah review / audit function and the internal audit function, as well as, the Shari’ah reviews carried out under the supervision of the Shari’ah Supervisory Board.

We have designed and performed necessary verification procedures on various financial arrangements, contracts, classes of transactions and related policies and procedures based on judgmental and systematic samples with regard to the compliance with Shari’ah principles and rules. In performing our audit procedures necessary guidance on Shari’ah matters was provided by the subject matter (Shari’ah) expert(s) referred above.

We believe that the evidences we have obtained through performing our procedures were sufficient and appropriate to provide a basis for our opinion [or modified opinion].

Description of the matter(s) giving rise to the modified conclusion (if any)

- a. _____;
- b. _____;
- c. _____; [insert material modifications to report, if any]

Conclusion

Based on our reasonable assurance engagement, we report that in our opinion, [except for the effect of the matters reported in paragraph(s) _____ above], the IFI's financial arrangements, contracts and transactions for the year ended _____ are in compliance with the Shari'ah principles and rules, in all material respects.

A long form report highlighting key matters noted during the course of engagement is being issued separately to the board of directors of the IFI as of the date.

Date: _____

Name of firm

[Place / city]

Name of engagement partner

Appendix B1: Sample external Shari’ah audit report – attestation form and sample management report on compliance with Shari’ah principles and rules

Independent assurance report on statement of compliance with the Shari’ah principles and rules (external Shari’ah audit)

To the _____ of [_____ / _____ – Islamic Financial Institution]

Introduction

We have undertaken an independent reasonable assurance engagement (external Shari’ah audit) of [_____ / _____ – [IFI] (the Islamic Financial Institution) for assessing as to whether the statement of compliance of the IFI’s financial arrangements, contracts, and transactions with Shari’ah principles and rules for the year ended _____ as developed by the management of the IFI reflects fairly the statement of affairs of the IFI for the period in line with the applicable criteria, in all material respects.

Applicable criteria

The criteria for the assurance engagement against which the underlying subject matter information i.e. the statement of compliance with the Shari’ah principles and rules (financial arrangements, contracts, and transactions for the year ended _____) is assessed comprise the Shari’ah principles and rules that for the purpose of external Shari’ah audit mean the following, in the sequence provided below:

- a. The Shari’ah standards issued by Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI);
- b. The regulations issued by the [_____ - the Regulator] insofar as these entail the regulatory Shari’ah requirements;
- c. The rulings of the Central Shari’ah Board [_____];
- d. Requirements of the applicable Financial Accounting Standards as issued by AAOIFI insofar as these entail Shari’ah related requirements; and
- e. Approvals and rulings given by the Shari’ah Supervisory Board of the IFI.

The above criteria was applied for its implications on the financial statements of the IFI for the year ended _____, which are annexed.

Management’s responsibility for Shari’ah compliance and presentation of the statement of compliance with Shari’ah principles and rules

IFI’s management is responsible to ensure that the financial arrangements, contracts and transactions having Shari’ah implications, entered into by the IFI with its customers, other financial institutions and stakeholders and related policies and procedures are, in substance and in their legal form, in compliance with the requirements of Shari’ah principles and rules. The management is also responsible for design, implementation and maintenance of appropriate internal control procedures with respect to such compliance and maintenance of relevant accounting records. Based on the same, and in line with the regulatory requirements, the management is also responsible for fair presentation of the state of affairs of such compliance in its statement of compliance with Shari’ah principles and rules.

Our Independence and Quality Control

We have complied with the independence and other ethical requirements of the Code of Ethics for Accountants and Auditors issued by AAOIFI as well as the Code of Ethics for Professional Accountants [or other code of ethics applicable in the jurisdiction], which are founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

The firm applies International Standard on Quality Control (ISQC) 1 “Quality Control for Firms That Perform Audits and Reviews of Historical Financial Information, And Other Assurance and Related Services Engagements” and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

This engagement was conducted by a multidisciplinary team including assurance practitioners and subject matter (Shari’ah) experts.

Our responsibility and summary of the work performed

Our responsibility in connection with this engagement is to express an opinion on compliance of the IFI’s financial arrangements, contracts, and transactions with Shari’ah principles and rules, in all material respects, for the year ended _____ based on the evidence we have obtained. We conducted our reasonable assurance engagement in accordance with International Standard on Assurance Engagements 3000, ‘Assurance Engagements other than audits or reviews of historical financial statements’, issued by the International Auditing and Assurance Standards Board and the Auditing Standard for Islamic Financial Institutions (ASIFI) 6 “Independent Assurance Engagement on an IFI’s Compliance with Shari’ah Principles and Rules (External Shari’ah Audit)”, issued by AAOIFI. These standards require that we plan and perform this engagement to obtain reasonable assurance about whether the IFI’s financial arrangements, contracts, and transactions are compliant with Shari’ah principles and rules in all material respects.

The procedures selected by us for the engagement depended on our judgment, including the assessment of the, risks of material non-compliance with the Shari’ah principles and rules. In making those risk assessments, we considered and tested the internal control relevant to the IFI’s compliance with the Shari’ah principles and rules in order to design procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the IFI’s internal control as well as the controls relevant for the collection of relevant data and preparation of the management’s statement for compliance with Shari’ah principles and rules. In this connection, we have also reviewed the work carried out by the internal Shari’ah review / audit function and the internal audit function, as well as, the Shari’ah reviews carried out under the supervision of the Shari’ah Supervisory Board.

We have designed and performed necessary verification procedures on various financial arrangements, contracts, classes of transactions and related policies and procedures based on judgmental and systematic samples with regard to the compliance with Shari’ah principles and rules and fair presentation of the same along with other statements made in the statement of compliance with Shari’ah principles and rules. In performing our audit procedures necessary guidance on Shari’ah matters was provided by the subject matter (Shari’ah) expert(s) referred above.

We believe that the evidences we have obtained through performing our procedures were sufficient and appropriate to provide a basis for our opinion [or modified opinion].

Description of the matter(s) giving rise to the modified conclusion (if any)

- a. _____;
- b. _____;
- c. _____; [insert material modifications to report, if any]

Conclusion

Based on our reasonable assurance engagement, we report that in our opinion, [except for the effect of the matters reported in paragraph(s) _____ above], the management's statement of compliance with Shari'ah principles and rules, as annexed herewith, for the year ended _____ presents fairly the state of it's compliance with the Shari'ah principles and rules, in all material respects, during the period covered by such statement.

Without qualifying our opinion, we draw attention the paragraph(s) ____ (to ____) of the annexed management's statement of compliance with Shari'ah principles and rules stating the identified non-compliances of Shari'ah requirements during the period under audit.

A long form report highlighting key matters noted during the course of engagement is being issued separately to the board of directors of the IFI as of the date.

Date: _____

Name of firm

[Place / city]

Name of engagement partner

Appendix B2: Management's statement of compliance with the Shari'ah principles and rules to the shareholders of [_____]

Introduction

This statement of compliance is being issued by the management of _____ (the institution) as regards the state of compliance of the institution's financial arrangements, contracts, and transactions with Shari'ah principles and rules for the year ended _____.

Acknowledgement of management's responsibility for compliance with Shari'ah principles and rules

We, as management of the institution, are responsible to ensure that the financial arrangements, contracts and transactions having Shari'ah implications, entered into by the institution with its customers, other financial institutions and stakeholders and related policies and procedures are, in substance and in their legal form, in compliance with the requirements of Shari'ah principles and rules in line with the applicable criteria as provided below.

Applicable criteria

The criteria for the compliance with Shari'ah principles and rules comprises the following, in the sequence provided below:

- a. The Shari'ah standards issued by Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI);
- b. The regulations issued by the [_____ - the Regulator] insofar as these entail the regulatory Shari'ah requirements;
- c. The rulings of the Central Shari'ah Board [_____];
- d. Requirements of the applicable Financial Accounting Standards as issued by AAOIFI insofar as these entail Shari'ah related requirements; and
- e. Approvals and rulings given by the Shari'ah Supervisory Board of the institution.

Confirmations and representations

We confirm that during, and with regard to, the year ended _____:

- a. the institution has developed and implemented a sound and robust system of corporate and Shari'ah governance, in line with the AAOIFI governance standards and other related requirements and best practices including regulatory requirements;
- b. the management has developed and maintained internal control including internal control necessary to ensure compliance with Shari'ah principles and rules and to prevent any material non-compliance thereof. In fulfilling this responsibility, estimates and judgments are required to assess the expected benefits and related costs of controls. We confirm that institution's system of internal control is sound in design and has been effectively implemented and monitored, as well as, updated and improved for identified non-compliances, if any;

- c. the financial statements for the year ended _____ reflect fairly the Islamic finance transactions and Shari’ah related matters;
- d. the management complied with all aspects of contractual agreements that would have had a material effect on the institution’s compliance with Shari’ah principles and rules and in the event of a material non-compliance thereof, have reported the same in the respective sections of this statement below;
- e. we are not aware of any transactions, accounts or material agreements or arrangements with Shari’ah implications which have not been fairly described, or properly recorded in the financial and accounting records underlying the financial statements;
- f. we confirm that there have been no frauds or irregularities involving management or employees who have significant roles in the accounting and system of internal control or any irregularities involving others that could have a material effect on the financial statements or compliance with Shari’ah principles and rules;
- g. the management has provided fair and transparent information and access to records to the external Shari’ah auditors, internal Shari’ah auditors, Shari’ah compliance officials and the members of Shari’ah supervisory board for all matters that may have a Shari’ah implication; and
- h. the management has developed a code of conduct for the institution and code(s) of ethics for employees, directors and other officials of the institution in line with the Shari’ah requirements and we confirm that all employees, directors and other officials have provided confirmation of compliance with the respective code(s) of ethics and we, the management, confirm that the institution has complied with the institutional code of conduct.

Unresolved issues and non-compliance of Shari’ah principles and rules

We are not aware of any issues with regard to the Shari’ah compliance of the institution which remained unresolved till the date of this Statement or are established as a material non-compliance with Shari’ah principles and rules having an impact on the period under coverage of this Statement, except for the following:

- a. _____;
- b. _____;
- c. _____;

All immaterial non-compliances with Shari’ah principles and rules have been satisfactorily resolved and matters have been concluded in light of the approvals and guidelines of the Shari’ah supervisory board.

Charity

We confirm that any amounts determined to be payable / transferable to charity fund have been transferred to the charity fund within reasonable time of identification and as of the

date of the financial statements, there is no amount of charity pending transfer to the charity fund. We further confirm that all amounts allocated to charity fund were spent in accordance with the approved charity policy, as approved by the Shari’ah Supervisory Board, and that there is no unreasonable delay in spending of such charity amount.

Explanations on Shari’ah supervisory board reporting matters

Following is the management point of view and explanations in respect of the matters reported by the Shari’ah supervisory board in its report:

- a. _____;
- b. _____;
- c. _____;

Statement of compliance

Based on our above made representations and confirmations, we conclude and confirm to the best of our knowledge and belief that in our opinion, [except for the effect of the matters reported in paragraph(s) _____ above], the institution’s financial arrangements, contracts and transactions for the year ended _____ are in compliance with the Shari’ah principles and rules, in all material respects, in line with the criteria for compliance with Shari’ah principles and rules as described above, and, where applicable, have been reflected adequately in the financial statements of the institution as of that date.

Date: _____

Head of Shari’ah Compliance (or equivalent)

Chief Financial Officer

Chief Executive / President

Appendix C: Long form report – suggested contents

The long form auditors' report for External Shari'ah Audit (to be read in conjunction with the short form report (opinion) shall include the following suggested aspects, as a minimum:

- a. Objective and scope of the engagement;
- b. Key audit matters including risks and observations / findings including those related to the following:
 - i. the overall Shari'ah compliance environment;
 - ii. the risks associated with Shari'ah non-compliance;
- c. the capacity and quality of the risk management system to measure, manage and mitigate these risks:
 - i. the level of awareness and sensitization of the management and those charged with governance in addressing the said risks; and
 - ii. any other issues deemed significant by the Shari'ah auditor.
- d. Management's and external Shari'ah auditor's responsibilities and other important terms of engagement;
- e. Broad description of the procedures performed³;
- f. Limitations with respect to the engagement involving performance of the procedures;
- g. Detailed description of the factual findings resulting from the external Shari'ah auditor's work identifying the gap / issue and the recommendation to address the same;
- h. Statement that the procedures performed do not constitute either an audit or a review under the applicable standards and, as such, no assurance is expressed; and
- i. The name and qualifications of the subject matter (Shari'ah) expert(s) appointed by the external Shari'ah auditor for the said engagement.

³ Detailed, as compared to short form report

Appendix D: Adoption of the standard

This standard was presented for the approval in the AAOIFI Governance and Ethics Board's meeting No. 6 held on 18-19 Rabi' I 1439H, corresponding to 6-7 December 2017 and was duly approved.

Members of the Board

1. Dr. Ishrat Husain – Chairman
2. Sh. Esam Ishaq – Deputy Chairman
3. Dr. Abdulbari Mashal
4. Dr. Abdurrahman Habil
5. Mr. Ahmad Mishari Al Faris
6. Mr. Ebrahim Sidat
7. Mr. Fawad Laique
8. Dr. Gaffar Abdalla Ahmed Khalid
9. Dr. Hussein Said Saifan
10. Mr. Mohammad Farrukh Raza
11. Mr. Mohammad Mahdy Mohammad Radwan
12. Mr. Kazi Mohammad Mortuza Ali
13. Mr. Sohaib Umar
14. Dr. Walid Hegazy

Reservation

The standard was approved unanimously.

Working group, special working group and team

1. Mr. Ebrahim Sidat – Chairman Special Working Group
2. Dr. Walid Hegazy – Chairman Working Group
3. Dr. Abdulbari Mashal
4. Mr. Fawad Laique
5. Mr. Mohammad Farrukh Raza
6. Mr. Mohammad Mahdy Mohammad Radwan

7. Mr. Sohaib Umar
8. Mr. Muhammad Shazam Ziad Butt (The Institute of Chartered Accountants of Pakistan)
9. Mr. Omar Mustafa Ansari (AAOIFI)
10. Mr. Mohammad Majd Bakir (AAOIFI)
11. Ms. Zahra Jassim AlSaraifi (AAOIFI)
12. Ms. Merjan Abid (AAOIFI)
13. The Committee for Accounting and Auditing Standards for the Interest Free Modes of Finance – The Institute of Chartered Accountants of Pakistan

Appendix E: Brief History of the Preparation of the Standard

- H1 The newly formed AAOIFI Governance and Ethics Board (AGEB) held its first meeting on 21 Jumada II 1437H, corresponding to 30 March 2016 at Ramee Grand Hotel, Seef District, Kingdom of Bahrain. In this meeting overall approach and plan of the standard was discussed and approved.
- H2 The Institute of Chartered Accountants of Pakistan (ICAP) under an understanding has been working with AAOIFI to draft the standard and the guidelines as a supported project.
- H3 On the 28 - 29 Dhul Hijja 1437H, corresponding to 30 September and 1 October 2016, the second Board meeting was held at Ramee Grand Hotel, Seef District, Kingdom of Bahrain. The outline of the external Shari'ah audit standard was reviewed and approved by the Board and it was decided to discuss some of the issues raised with the working group members.
- H4 The first working group meeting was held on 29 Safar 1438H, corresponding to 29 November 2016 via video conferencing. The members discussed the consultation notes as well as the content of the standard.
- H5 The Institute of Chartered Accountants of Pakistan's Committee for Accounting and Auditing Standards for Interest Free Modes of Finance, under an understanding with AAOIFI provided its input in the whole process including support for development of the standard and guidelines (in process). The Committee in its meeting dated 13 Jamada I 1438H corresponding to 10 February 2017 approved in principle the draft of the standard presented before the Committee.
- H6 The third meeting of the Board was held on the 22-23 Rabi' I 1438H, corresponding to 21-22 December 2016, in the Kingdom of Bahrain. The Board reviewed in detail the content of the standards and agreed on various changes to be incorporated and presented to the Board in the next meeting.
- H7 The fourth meeting of the Board was held on 29 Jamada II and 1 Rajab 1438H, corresponding to 28-29 March 2017, at College of Banking and Finance Studies, Muscat, Sultanate of Oman. The Board reviewed the changes made by the secretariat in the draft standard and subject to certain specific guidance and changes identified in principle, directed the secretariat to redraft the contents so as to enhance the text and format of the standard.
- H8 A special working group was formed to revise the body text in line with the views of different members of the Board. The special working group was formed on 6 Sha'ban 1438H corresponding to 3 May 2017 by the Chairman of the Board, and held multiple meetings and video conferences on 21 Sha'ban 1438H corresponding to 18 May 2017, 26 Sha'ban 1438H corresponding to 23 May 2017, 27 Sha'ban 1438H corresponding to 24 May 2017 and 12 Ramadan 1438H corresponding to 7 June 2017, after which a revised version of the standard was approved to be issued as exposure draft by the Board by circulation on 10 Ramadan 1438H corresponding to 15 June 2017.

- H9 The Public Hearings for the standard were conducted in Egypt, Pakistan and Bahrain in the months of Muharram and Safar 1439H, corresponding to October and November 2017.
- H10 The working group meeting to discuss all comments received for the exposure draft from public hearing events and the industry at large was held on 10 Rabi' I 1439H, corresponding to 28 November 2017 and further discussions continued on 12 Rabi' I 1439H corresponding to 30 November 2017.
- H11 The final standard was presented at the sixth meeting of the Board held on 18-19 Rabi' I 1439H, corresponding to 6-7 December 2017. The Board concluded on the recommendations of the working group and principally approved the standard for issuance.
- H12 Comments and views of the Shari'ah Board's Committee for Review of Accounting and Governance Standards were obtained during the meeting held on 21 Jumada I 1439H, corresponding to 6 February 2018. The final version of the standard was approved by the Board in its 7th meeting held on 17-18 Jumada II 1439H, corresponding to the 6- 7 March 2017 at AAOIFI Head Office.