



GUIDELINES NO. IFAU/G/3/2018

GUIDELINES ON INTERNAL SYARIAH AUDIT FRAMEWORK

FOR FINANCIAL INSTITUTIONS AND BANKS OFFERING ISLAMIC FINANCIAL PRODUCTS AND SERVICES IN BRUNEI DARUSSALAM

(1) INTRODUCTION

- (a) Autoriti Monetari Brunei Darussalam (AMBD) recently has issued the Syariah Governance Framework for Financial Institution effective from 17 April 2018. The framework provides guidelines on the Syariah governance structures, processes and arrangements to ensure that all Financial Institutions and Banks' activities and operations are in accordance with *Hukum Syara'*.
- (b) These Guidelines on Internal Syariah Audit Framework are intended to provide guidance on the Notice No. IFAU/N/2/2018. These Guidelines are designed to meet the following objectives:
 - (i) To set out the expectations of the Authority on the Financial Institutions and Banks to establish institutional arrangements and recommendations to facilitate the effective implementation of internal Syariah audit as an integral component of the Syariah Governance Framework; and
 - (ii) To provide guidance for the Financial Institutions and Banks in specifying the scope of internal Syariah audit, internal Syariah audit objectives, internal Syariah audit governance, internal Syariah audit

charter, competency of internal Syariah auditors, internal Syariah audit process and reporting for internal Syariah audit.

- (c) The Authority has developed this Internal Syariah Audit Framework (ISAF) for Financial Institutions and Banks with the primary objective of enhancing the role of the Board of Directors, the Syariah Advisory Body and the Management of the Financial Institutions and Banks in relation to Syariah financial matters as stated in the Syariah Governance Framework issued by the Authority.
- (d) All Financial Institutions and Banks regulated and supervised by the Authority offering Islamic products and services should embrace the objectives of these Guidelines and to the extent possible and practicable, taking into account the size of business and costs for implementation, adhere to the recommendations set out in these Guidelines on a “comply or explain” approach.
- (e) These Guidelines should be read together with other relevant Notices and Guidelines that have been issued by the Authority, in particular:
 - (i) Notice and Guidelines on Syariah Governance Framework (IFAU/N/1/2018 and IFAU/G/2/2018);
 - (ii) Guidelines on Corporate Governance for Islamic Banks (BU/G-2/2017/6);
 - (iii) Notice on Corporate Governance for Insurance Companies and Takaful Operators (Notice No. TIU/N-3/2017/7);
 - (iv) Guidelines on Internal Control Systems for Islamic Banks (BU/G-8/2-18/16);
 - (v) Guidelines on Compliance and Compliance Function for Islamic Banks (BU/G-6/2018/14) and
 - (vi) Guidelines on Internal Audit Function for Islamic Banks (BU/G-4/2018/12).

(2) DEFINITIONS

For the purpose of these Guidelines:

Term	Meaning
“Authority”	Means the Autoriti Monetari Brunei Darussalam (AMBD) established under section 3(1) of the AMBD Order, 2010
“The Board”	The Board of Directors of the Financial Institution or Bank
“Bank(s)”	Has the same meaning given to it in section 2 of the AMBD Order, 2010 which provides Islamic products and services, including but not limited to Islamic banking business, takaful business, Islamic financial business, Islamic development financial business and such other business as the Authority may authorise
“Financial Institution(s)”	Has the same meaning as given to it in section 2 of the AMBD Order, 2010 which provides Islamic products and services, including but not limited to takaful business, Islamic financial business, Islamic development financial business or any other business
“ <i>Fiqh al-Mu’amalat</i> ”	Commercial law of Islam
“ <i>Hukum Syara</i> ”	The laws of Islam according to the <i>Syafeite, Hanafi, Maliki</i> or <i>Hanbali</i> sect of <i>Ahlis Sunnah Waljamaah</i> as defined in Syariah Financial Supervisory Board (SFSB), 2006; Islamic Banking Order, 2008; Takaful Order, 2008 and Securities Markets Order, 2013
“Internal <i>Syariah</i> Audit”	Internal <i>Syariah</i> Audit function is part of the internal audit division that cover normal audit and <i>Syariah</i> audit
“Management”	Persons having authority and responsibility for planning, directing and controlling the activities of the Financial Institution or Bank
“ <i>Syariah</i> Advisory Body”	A body which is responsible to review, advise, give opinion and approve any Islamic products and services, and ensure the overall business and operation of the Financial Institution or Bank are in compliant with <i>Hukum Syara</i> ’

Term	Meaning
“ <i>Syariah</i> Financial Supervisory Board”	Syariah Financial Supervisory Board established under section 3 in the Syariah Financial Supervisory Board Order, 2006
<i>Syariah</i> financial matters	Syariah matters or Syariah related matters are matters in regards to Islamic finance and as provided in Syariah Financial Supervisory Board Order, 2006
<i>Usul Fiqh</i>	Islamic jurisprudence

(3) INTERNAL SYARIAH AUDIT FRAMEWORK

(a) These Guidelines are divided into seven (7) sections:

- (i) **Section I – Scope of Internal Syariah Audit**
This section outlines the scope of internal Syariah audit
- (ii) **Section II – Internal Syariah Audit Objectives**
This section specifies the objectives of internal Syariah audit in the activities and operations of the Financial Institution or Bank
- (iii) **Section III – Internal Syariah Audit Governance**
This section highlights the level of governance, accountability and independence of internal Syariah auditors in performing the internal Syariah audit function
- (iv) **Section IV – Internal Syariah Audit Charter**
This section outlines the internal Syariah audit position within the Financial Institution or Bank
- (v) **Section V – Competence of Internal Syariah Auditors**
This section highlights expected competencies to ensure effective implementation of internal Syariah audit
- (vi) **Section VI – Internal Syariah Audit Process**
This section outlines the overall audit process in providing assurance and in performing internal Syariah audit function

(vii) **Section VII – Reporting for Internal Syariah Audit**

This section highlights the appropriate reporting structure for internal Syariah audit findings

SECTION I: Scope of Internal Syariah Audit

- (a) The scope of the internal Syariah audit should include assurance processes of the Financial Institution and Banks' Syariah compliance issues.
- (b) The internal Syariah audit function, in consultation with the Syariah Advisory Body, should recommend to the Audit Committee the auditable areas when submitting the audit plan. The Audit Committee should thereafter determine the deliverables of the internal Syariah audit function.
- (c) As recommended by the Syariah Governance Framework issued by the Authority, internal Syariah audit covers all aspects of the Financial Institution or Bank's activities and operations to be done in phases taking into account the size of business and cost for implementation:
 - (i) audit of financial statements of the Financial Institution or Bank;
(In the event where the audit is undertaken by external auditors, the Financial Institution or Bank has to be satisfied that the scope of audit by the external auditor with regard to Syariah audit is comprehensive)
 - (ii) compliance audit on organizational structure, people, process, information technology applications systems, post approval process of products and services; and
 - (iii) review of adequacy of the Syariah governance process.
- (d) In the case of internal Syariah audit of financial statements, the internal Syariah auditors should review the Syariah matters in the financial statements to be compliant with the Syariah requirements. These should include but are not limited to those related to deposits, investment, financing, recognition of income and expenses, income/ profit distribution, purification of income (if any) and *zakat* computation.
- (e) Internal Syariah audit of organizational structure should be performed to ensure the integrity of the structure to enable effective Syariah governance of the Financial

Institution or Bank as per the recommendations of the Syariah Governance Framework issued by the Authority.

- (f) Internal Syariah Audit on people should aim at providing assurance that the human resource policy addresses the need for competent staff with integrity to manage and execute the Financial Institution and Bank's activities and operations. The Management should develop the human resource policy that needs to be reviewed by the Syariah Advisory Body. The human resource policy should include that the Management, officers and staffs must undergo training in Islamic finance and Syariah concepts.
- (g) For the purpose of internal Syariah audit on Financial Institution or Bank's processes, the internal Syariah auditors shall ensure the activities, operations, contract agreements, policies and procedures are in accordance with *Hukum Syara'*.
- (h) Internal Syariah audit of Financial Institution and Bank's branches and front-liners is to ensure the activities and operations are Syariah compliant. The following are the possible Syariah audit scope related to branch audit:
 - (i) ensure that all products and services offered are those approved by the Syariah Advisory Body of the Financial Institution or Bank as well as by the Syariah Financial Supervisory Board;
 - (ii) assessment of adequate number of people which depends on the size of the institution to deal with the activities and operations;
 - (iii) assurance of proper activities and operations of Islamic financial products and services;
 - (iv) assessment of employees' understanding of Islamic financial products and services; and
 - (v) assessment of Syariah compliance of legal documentation for Islamic financial products and services.
- (i) Internal Syariah Audit of information technology should include the transaction processing system, accounting information system and any other systems adopted by the Financial Institution or Bank. This is to ensure that information technology systems and applications cater to the needs of Syariah compliant activities and

operations of the Financial Institution or Bank. Examples of Syariah information technology risk include use of conventional terms in the application system, inability of the system to operate according to the sequence of events of Syariah contracts, system error resulting in specific *Aqad* not executed upon renewal or disbursement.

- (j) The Internal Syariah audit should assess and reasonably assure that the Syariah governance process as recommended by the Syariah Governance Framework issued by the Authority is adequately addressed by the Financial Institution or Bank. The internal Syariah auditors should audit the roles and functions of the Board of Directors and the Management in ensuring the Syariah compliant activities and operations are in place. This includes the audit of the Syariah review, Syariah risk management and Syariah research functions. As stated in the Syariah Governance Framework issued by the Authority, the Syariah review and Syariah research are under the Syariah Department and Syariah risk management directly report to the Risk Management Committee. The implementation for the Syariah governance structure model is taking into account the size of business and cost for implementation.
- (k) The internal Syariah audit should assess and reasonably assure that the formal reporting channel on Syariah matters is carried out effectively and in a timely manner.
- (l) The internal Syariah audit should assess and reasonably assure the effectiveness and efficiency of the internal control system for Syariah compliance. Syariah internal control system should consist of policies and procedures, adequate system and control to provide the Management with objective assurance of the Financial Institution or Bank's Syariah compliance. The internal Syariah audit should also assess the adequacy of the Syariah risk management process.
- (m) The established Syariah criteria should include the following, but not limited to:
 - (i) the Syariah resolutions and decisions of the Syariah Financial Supervisory Board of the Ministry of Finance and Economy;
 - (ii) the Syariah resolutions and decisions of the Syariah Advisory Body of the Financial Institution or Bank; and
 - (iii) the approved product manuals and the Standard Operating Procedures of the Financial Institution or Bank.

- (n) Internal Syariah audit should be performed at least annually or on an ad-hoc basis upon a formal written request by the Syariah Advisory Body, the Management, and/or the Authority. However, any Ad-hoc internal Syariah audit is subject to the approval of the Audit Committee.

SECTION II: Internal Syariah Audit Objectives

- (a) The primary objective of internal Syariah audit is to provide an independent assessment and objective assurance that the Financial Institution or Bank comply to the Syariah requirements in its activities and operations.
- (b) The internal Syariah audit objectives in relation to Syariah compliance requirements should include:
 - (i) clearly specified internal control objectives;
 - (ii) adequacy of the internal control system;
 - (iii) the effectiveness of the implementation of internal control system;
 - (iv) the adequacy and completeness of the Standard Operating Procedures;
 - (v) the adequacy, completeness, timeliness and reliability of the reporting system; and
 - (vi) the adequacy, completeness and reliability of information technology applications system.

SECTION III: Internal Syariah Audit Governance

- (a) For effective implementation of internal Syariah audit, the Financial Institution or Bank should establish internal Syariah audit function as part of the internal audit division taking into account the size of business and cost for implementation. The internal Syariah audit function should be independent from the Management and the Syariah department, and accountable directly to the Audit Committee. The internal audit division should consult with the Syariah Advisory Body in the planning, examining and reporting of internal Syariah audit.

- (b) The Audit Committee should ensure that the internal audit division has adequate and competent staff taking into account the size of business and cost for implementation as well as adequate funds to ensure the effective performance of internal Syariah audit function.
- (c) The Audit Committee, upon consultation with the Syariah Advisory Body, should determine the deliverables of the internal Syariah audit. The Audit Committee should review and endorse the internal Syariah audit plan. The internal Syariah audit findings should be submitted for consideration and deliberation of the Audit Committee and Syariah Advisory Body.
- (d) The Audit Committee should be guided by the Syariah resolutions and decisions of the Syariah Advisory Body, Syariah Financial Supervisory Board and, if necessary, international standards to effectively execute their oversight function.
- (e) The Audit Committee should consider appointing at least one (1) member of the Syariah Advisory Body as a member of the Audit Committee that could serve as a bridge between the Audit Committee and the Syariah Advisory Body. The presence of the member of Audit Committee with sound Syariah knowledge would foster greater understanding and appreciation amongst the Audit Committee on the decisions made by the Syariah Advisory Body and Syariah Financial Supervisory Board.
- (f) The internal Syariah auditors should be accorded the freedom to perform their audit, in determining the scope of the audit, accessing the evidence and communicating the outcome of the audit. Internal Syariah auditors should be impartial and unbiased and should avoid any situation likely to give rise to a conflict of interest.

SECTION IV: Internal Syariah Audit Charter

- (a) The Financial Institution or Bank should have an internal Syariah Audit Charter under the internal Audit division as stated in the Syariah Governance Framework issued by the Authority that specifies the following aspects:
 - (i) the nature of internal Syariah auditing;
 - (i) the internal Syariah audit objectives;
 - (ii) the scope of internal Syariah audit work;

- (iii) the responsibilities of internal Syariah auditors;
 - (iv) the authority of internal Syariah auditors; and
 - (v) the independence of internal Syariah auditors.
- (b) The internal Syariah Audit Charter should clearly specify the planning, examination and reporting of the internal Syariah audit. The internal audit division should plan the internal Syariah audit activities for the year and the plan should be communicated to the Syariah Advisory Body and Syariah department once the audit work is to be executed.
- (c) The internal Syariah audit function has to be independent and have direct access to the Board without any intervention from Management. This is to ensure efficiency and effectiveness of the internal Syariah audit function.

SECTION V: Competency of Internal Syariah Auditors

- (a) The internal Syariah auditors should possess the following:
- (i) knowledge in Syariah;
 - (ii) knowledge in Islamic finance;
 - (iii) knowledge and understanding of the functions of the Financial Institution or Bank and the Islamic products and services;
 - (iv) proficiency in applying auditing standards and procedures; and
 - (v) proficiency in accounting principles and techniques.
- The internal Syariah auditors may engage the Financial Institution or Bank's Syariah officers in performing the audit, so long as the objectivity of the audit is not compromised.
- (b) Knowledge in Syariah covers the following areas:
- (i) *usul fiqh* relevant to *Fiqh al-Mu'amalat*;
 - (ii) sources of Syariah;
 - (iii) principles of Islamic financial contracts;

- (iv) prohibited elements in Islamic financial contracts; and
 - (v) Islamic financial contracts relevant to Financial Institution and Bank in Brunei.
- (c) Internal Syariah auditors should be well versed in the Islamic principles underlying the Islamic financial contracts and basic activities and operations of the specific Financial Institution or Bank in accordance to Section V, paragraph (a) (iii) above.
- (d) The internal Syariah auditors should have the ability to construct relevant and appropriate audit tests in line with the internal Syariah audit objectives of any particular area of the audit. This is to correctly identify testing procedures in order to verify evidence for different auditable areas to ensure Syariah compliance.
- (e) The internal Syariah auditors who do not possess Bachelor degree's qualification should at least have relevant previous working experience in auditing or in an Islamic financial institution for a minimum of 5 years which is in line with best practices and to be at par with the normal auditing requirement. Completion of relevant professional programmes and specialized training courses may also be considered.

SECTION VI: Internal Syariah Audit Process

- (a) The following are essential matters of the internal Syariah audit process:
- (i) formulation of audit plan to include auditable area on Syariah compliance requirements, Syariah compliance system and objectives;
 - (ii) assessment of the adequacy of Syariah compliance;
 - (iii) establishment and implementation of risk-based audit process and procedures that evaluate the effectiveness of implementation of internal Syariah compliance requirements and internal control objectives;
 - (iv) audit documentation in the form of audit programme, audit objectives (with reference to Syariah compliance requirements and control objectives), internal Syariah control system, relevant source and related documents; and
 - (v) formulation of audit opinion and recommendation on the effectiveness of the internal Syariah control system, adequacy and completeness of Syariah compliance.

- (b) Internal Syariah audit planning should be adequately developed to understand the Financial Institution or Bank's operations in terms of products, size of operation, location, branches, subsidiaries and divisions. The planning should take into account existing resolutions currently enforced by the Syariah Financial Supervisory Board and Syariah Advisory Body.
- (c) The internal Syariah audit function should develop Syariah audit programme which refers to a manual based document that specifies the internal Syariah audit control objectives and step by step procedures to execute an audit. Internal Syariah audit programme can be designed and developed based on products and services, operations, processes, policies and branches.
- (d) Internal Syariah auditors should examine the following auditable areas taking into account the size of business and costs for implementation, which normally include:
 - (i) understanding of the management awareness, commitment and compliance control procedures for adherence to the Syariah;
 - (ii) risk assessment of the Syariah non-compliance risks to assess the risk profile of Financial Institution or Bank's activities and operations in order to prioritize the auditable areas;
 - (iii) assessment of the adequacy of internal control system for Syariah compliance;
 - (iv) audit of contracts and agreements;
 - (v) audit of product manuals and standard operating procedures;
 - (vi) audit of minutes of meeting, policies and procedures;
 - (vii) audit of relevant personnel; and
 - (viii) audit of profit computation and distribution, *zakat* computation and distribution, penalty computation and manner of distribution.
- (e) The internal Syariah audit activity should assist the Financial Institution or Bank in maintaining effective controls by evaluating the effectiveness and efficiency, and promoting continuous improvement. The internal Syariah audit activity should evaluate the adequacy and effectiveness of controls encompassing the Financial Institution or Bank's governance, operations, and information systems. These should include:

- (i) reliability and integrity of financial and operational information;
 - (ii) effectiveness and efficiency of activities and operations;
 - (iii) safeguarding of assets; and
 - (iv) compliance with laws, regulations and contracts.
- (f) Internal Syariah audit should assess the adequacy of the Syariah risk management processes including the assurance of:
- (i) Syariah non-compliance risk arising from activities and operations are identified and prioritized;
 - (ii) the level of Syariah non-compliance risks have been adequately determined by the Management and the Board;
 - (iii) risk mitigation activities are designed and implemented to reduce, or otherwise manage, risk at levels that were determined to be acceptable to the Board and the Management; and
 - (iv) on-going monitoring activities are conducted to periodically assess Syariah non-compliance risk and the effectiveness of controls to manage the risk.
- (g) Internal Syariah auditors should play a consulting role in advising with the initial establishment of Syariah risk management and internal control for Syariah compliance. However, internal Syariah auditors should not “own” or be responsible for the management of risks and internal controls.
- (h) The Financial Institution or Bank may appoint or employ an external party to conduct a Syariah audit on the activities and operations of the Financial Institution or Bank, if it considers it is desirable or in the interest of the Financial Institution or Bank to do so. However, proper procedures should be in place to ensure that the external party is doing their due diligence to apply what has been recommended in these Guidelines. It is still within the responsibility of the Financial Institution or Bank to ensure that proper internal Syariah audit as recommended within these Guidelines are conducted as if it was carried out by the Financial Institution or the Bank itself. To ensure independence, the external auditor engaged by the Financial Institution or Bank may not conduct the internal Syariah audit.

SECTION VII: Reporting for Internal Syariah Audit

- (a) Reporting is the final phase of the internal Syariah audit process. It is the communications of the findings of the internal Syariah audit conducted which includes recommended rectifications to improve Syariah assurance.

- (b) The objectives of the internal Syariah audit report are:
 - (i) report the findings of Syariah non-compliance (if any);
 - (ii) assess the degree of recurrence of non-compliance and its systemic effect on the Financial Institution or Bank as a whole;
 - (iii) recommend corrective actions, improvements and rectifications necessary by identified persons in-charge with such rectifications, corrections and improvements;
 - (iv) suggest timelines for such rectifications to be completed; and
 - (v) track and monitor the progress of rectifications from past recommendations of previous internal Syariah audit report.

- (c) Internal Syariah audit can be initiated or requested by:
 - (i) Audit Committee;
 - (ii) Syariah Advisory Body;
 - (iii) Board of Directors;
 - (iv) Management; and
 - (v) Authority.

- (d) Internal Syariah audit report should be undertaken and the report can also be made at regular intervals or on ad-hoc basis. The report should be endorsed by the Audit Committee. A copy of the report should be submitted to the Board of Directors, Syariah Advisory Body, Management and the Authority. The report to the Authority should be submitted within 14 working days after the Board of Directors meeting or such longer period as may be permitted by the Authority.

- (e) Internal Syariah audit opinion should be expressed in the report whether the internal control system for Syariah compliant is effective, reliable, adequate and efficient, or otherwise. Internal Syariah audit opinion should also be expressed on the financial statements, compliance on organizational structure, people, process, information technology applications system and Syariah governance process.
- (f) Timelines of internal Syariah audit report is essential.

(4) REVISION OF GUIDELINES

- (a) These Guidelines are subject to amendment and revision from time to time as deemed necessary by the SFSB.

**MANAGING DIRECTOR
AUTORITI MONETARI BRUNEI DARUSSALAM**

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