

Determinants of Shariah Control Deficiencies: An Indonesian Shariah Banking Perspective

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Abstract. *This study aims to identify patterns of deficiency in the Shariah Internal Control System (SICS) and uncover determinant factors of Shariah Control Weakness (SCW) in Indonesian Islamic commercial banks. Using an embedded multiple-case study approach, the research combines analysis of financial and governance reports from Islamic banks for 2013–2024 period with interviews with ten Islamic banking practitioners. The findings reveal that Shariah Non-Compliance Events (SNCE) occur systemically across all observed banks, with deficiency patterns including non-halal income, Shariah audit findings, and fraud, and identified 12 determinant factors for SCW, which are the control weakness, poor employee understanding of Shariah, pressure from customers and business targets, complexity of akad, the number, quality & meeting frequency of Shariah Supervisory Board members, number of branch offices, employee training budget, bank's total assets, and the bank's age.*

Keywords: *shariah banking; shariah governance; shariah compliance; shariah internal control system; sharia control weakness*

Abstrak. *Penelitian ini bertujuan mengidentifikasi pola defisiensi dalam Sistem Pengendalian Internal Syariah dan faktor determinan kelemahan pengendalian syariah (SCW) pada bank umum syariah di Indonesia. Menggunakan pendekatan embedded multiple-case study, penelitian ini mengombinasikan analisis laporan keuangan dan tata kelola bank syariah periode 2013–2024 dengan wawancara terhadap sepuluh praktisi perbankan syariah. Penelitian menyimpulkan bahwa ketidakpatuhan syariah terjadi secara sistemik di seluruh bank yang diteliti, dengan pola defisiensi berupa pendapatan non-halal, temuan audit syariah, dan fraud, serta adanya 12 faktor determinan SCW, yaitu kelemahan pengendalian, pemahaman syariah pegawai yang minim, tekanan nasabah & capaian target, kompleksitas akad, jumlah, frekuensi pertemuan & kualitas DPS, jumlah kantor cabang, anggaran pelatihan pegawai, kuantitas aset bank, dan lamanya bank beroperasi.*

Kata kunci: *shariah compliance; shariah internal control system; sharia control weakness*

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Introduction

The philosophical distinction between conventional internal control and Shariah-based internal control lies in the foundational values, ultimate objectives, and moral orientation underpinning each system. Conventional internal control is grounded in principles of efficiency, operational effectiveness, financial reporting reliability, and compliance with regulations established by state authorities. This system is primarily oriented toward achieving business objectives and safeguarding corporate assets within the framework of positive law and professional standards.

In contrast, the foundational framework of the Islamic economic system emphasizes ethical, moral, social, and religious aspects aimed at ensuring justice, equity, and the well-being of society as a whole (N. Hidayah, 2023.p.4). This is also what should shape the Shariah internal control system, giving it a much deeper and more spiritual philosophical foundation. The system is not only intended to ensure operational effectiveness and compliance with regulations, but also to maintain adherence to Shariah principles derived from the Qur'an, Hadith, Ijma', and Qiyas (analogical reasoning) (Algabry et al., 2020; Almutairi & Quttainah, 2017; Ginena, 2014; Grais, W. and Pellegrini, 2006a; Grassa & Matoussi, 2014; Masruki et al., 2020; Safieddine, 2009).

The issue of internal control weakness has long been a global concern. Major corporate bankruptcies such as Enron and WorldCom in 2001 intensified debates on the importance of effective internal control systems (Kim et al., 2011), culminating in the enactment of the Sarbanes–Oxley Act (SOX) in 2002, which mandates CEOs and CFOs to evaluate and disclose internal control weaknesses (Sarbanes–Oxley Act, 2002; Zhang et al., 2007). Since then, extensive empirical evidence has documented the adverse financial and non-financial consequences of internal control weakness, including higher cost of capital (Ogneva et al., 2007; Ittonen, 2010), a decline in accrual quality ((Ashbaugh-skaife et al., 2008; Lu et al., 2011; Hu et al., 2021), inefficiencies in cash flow and inventory management (Feng et al., 2015; Kim et al., 2019; Shu-Miao Lai et al., 2020), and suboptimal investment performance (Cheng et al., 2013; Feng et al., 2015; Harp & Barnes, 2018; Sun, 2016), to an increased likelihood of earnings management (Doyle et al., 2007; Feng et al., 2009), credit rating downgrades (Ashbaugh-Skaife et al., 2006; Schneider & Church, 2008), and heightened risk of future stock price crashes (J. Chen et al., 2016).

Meanwhile, in the Islamic banking sector, this issue becomes more complex. Although Islamic banks have established a Shariah Internal Control System (SICS) and possess a Shariah Supervisory Board (DPS) to oversee Shariah compliance

(Almutairi & Quttainah, 2017; Nomran et al., 2018), Shariah violations still occur. Examples include repeated instances of non-halal income (Hanefah et al., 2020; Islamy, 2016; Johari, 2022; Mohamed & Ibrahim, 2023; Mohd & Sawari, 2020; Puneri et al., 2020; Rosman et al., 2017; Shafiai & Engku Ali, 2019), cases of fraud that constitute severe violations of Shariah principles such as fictitious credit worth IDR 59 billion at Bank Syariah Mandiri (Panggabean, 2013), a fictitious credit scandal worth IDR 1.1 trillion in 2018 (Fauzie & Agustiyanti, 2018), and problematic financing worth IDR 548 billion at BJB Syariah (Arief, 2019), all of which serve as evidence of systemic weaknesses stemming from Shariah non-compliance.

This phenomenon is not new; Grais, W. and Pellegrini, (2006) had documented similar weaknesses as early as the 1980s, such as the failure of Kuwait Finance House in the Souk al-Manakh crisis (1986) and the liquidation of the International Islamic Bank of Denmark (1986). These incidents demonstrate a misalignment between operational activities and the Shariah principles that should be upheld. Such actions pose a serious threat to the stability and sustainability of Islamic banks, as noted by Fielnanda et al., (2024) customers may lose trust in Islamic banks and choose to do business elsewhere if they discover that an Islamic bank is involved in dishonest or immoral practices. According to Ginena (2014) and Yusuf et al., (2016), Islamic banks are also vulnerable to non-compliance, much like conventional banks, which can have significant implications for their business. Another study on corporate governance indices in Indonesian Islamic banking found that internal control practices scored the lowest at only 38% (Darmadi, 2013). Previous research on risk management practices in Islamic Financial Institutions also confirmed that adequate internal controls, as a component of risk management, remain at a moderate level (Ahmed & Khan, 2007).

In principle, Shariah values should serve as a moral fortress preventing deviations such as data manipulation and abuse of authority. The fact that such violations still occur indicates gaps in the design or deficiencies in the implementation of the Shariah internal control system. The persistence of violations despite state regulations and Shariah principles underscores the importance of examining what this study refers to as Shariah Control Weakness (SCW). Unlike conventional Internal Control Weakness, SCW reflects a holistic, divinely rooted compliance paradigm. This paradigm is based on Shariah Enterprise Theory (Hallaq, 1984, 2014; Schacht, 1982; Triyuwono, 2001; Yusuf et al., 2016), which demands that every management policy and decision align with the Qur'an and the Sunnah of the Prophet Muhammad.

However, literature on Shariah internal control systems and their deficiencies remains very limited. Existing research on Shariah governance has largely focused on compliance and auditing issues (Abdul Rahim Abdul Rahman, 2011; Hanefah et al., 2012; Khalid et al., 2017; Nurazalia and Ariffin, 2019; Ayedh et al., 2019; Khalid, 2020; Hanefah et al., 2020; Algabry et al., 2020; Azam Abdelhakeem Khalid et al., 2021; Amayreh, 2021; Abdallah, 2021; Aimi et al., 2022; Bouheraoua & Djafri, 2022)). Meanwhile, the structural and operational dimensions of Shariah control deficiencies have not been widely discussed.

Based on this background, this study addresses the following research questions,

1. **RQ1:** What patterns of Shariah control deficiencies are observed in Islamic banks in Indonesia?
2. **RQ2:** What factors influence the emergence of Shariah control deficiencies in Indonesian Islamic banks?

The analysis of these Shariah Internal Control System deficiency patterns is expected to provide a more concrete understanding of the characteristics of recurring or systemic control weaknesses, enabling more targeted and applicable improvement recommendations. Thus, this study offers dual contributions: enriching academic literature on Shariah internal controls and their determining factors, while also providing practical benefits for regulators, bank management, and Shariah Supervisory Boards in strengthening Shariah internal control systems. The remainder of this paper is organized as follows. Section 2 reviews the relevant literature. Section 3 outlines the research methodology. Section 4 presents and discusses the findings. Section 5 concludes with key implications and directions for future research.

Literature Review

The Role of Shariah Internal Control System

The Shariah Internal Control System (SICS) plays a pivotal role in Shariah governance by ensuring that all organizational activities and transactions adhere to Shariah principles (Ginena, 2014; Hanoon et al., 2021; OJK, 2024; Shafii & Salleh, 2010). The existence of an effective SICS safeguards organizational integrity and builds trust in operational processes. Through comprehensive risk assessment, SICS functions to identify and manage risks arising from business activities, while preventing losses caused by non-compliance or managerial errors. Furthermore, the monitoring mechanisms embedded in SICS enable continuous observation and evaluation of the effectiveness of existing controls, thus supporting better and more responsive decision-making in the face of changing conditions. As a key element of Islamic Good

Corporate Governance, the Shariah internal control system must be meticulously designed to ensure effective compliance with Shariah principles. SICS also plays a vital role in ensuring that all contracts and transactions are executed properly and in accordance with Shariah rulings, thereby preventing practices that conflict with Islamic law, such as *gharar* (excessive uncertainty), *riba* (usury), and ambiguity in transactions (Archer et al., 1998; Md Zain & Shafii, 2018; Safieddine, 2009).

The development and adoption of effective Shariah control systems enable Islamic banks to better manage the risks of Shariah non-compliance. This must also be supported by adaptive regulations from regulators, which can enhance the market share of Islamic banking, strengthen trust, foster innovation, and create a more inclusive and healthy financial sector (N. Hidayah et al., 2024; p.32). The development and adoption of a robust Shariah control system enable Islamic financial institutions to better manage the risk of Shariah non-compliance. This not only contributes to minimizing the negative impact on the institution's reputation and operations but also enhances corporate social accountability (Ab Ghani et al., 2019; Amayreh, 2021; Ayedh et al., 2019; Darmadi, 2013; Ginena, 2014; Muhammad Iqmal Hisham Kamaruddin & Mustafa Mohd Hanefah, 2017; Rahman & Anwar, 2014; Shafii & Salleh, 2010). In addition, SICS provides a transparent framework for supervision and reporting activities, thereby offering legal certainty and a sense of justice for all stakeholders (Cheong, 2021; Safieddine, 2009). Accordingly, the Shariah internal control system serves not only as a key component in implementing sound Shariah governance, but also as a solid foundation for the sustainability, integrity, and public trust of Islamic banking within a value-based economic framework rooted in Islamic principles.

In this context, the development and implementation of the Shariah Internal Control System is an essential and inherent responsibility of Islamic banks. The SICS embodies the accountability of Islamic financial institutions by ensuring that every policy, procedure, and control mechanism applied in banking operations aligns with Shariah principles. Moreover, Shariah compliance and oversight embedded in the SICS reflect the Islamic concept of *amanah* (trust), which entails a multifaceted responsibility not only toward shareholders, but also toward Allah, society, and the environment.

The systematic implementation and supervision of SICS in line with Shariah principles corresponds to the concept of *mas'uliyah* (accountability to Allah and society) as defined in Shariah Enterprise Theory. Shariah compliance and oversight embedded in SICS reflect accountability not only to shareholders, but also to Allah, society, and the environment. Accordingly, a robust SICS is expected to reduce

Shariah control deficiencies and Shariah non-compliance events, as it operationalizes the principles of *amanah*, *maslahah*, and *mas'uliyah* in daily banking operations. Thus, SICS serves as a tangible manifestation of Islamic banks' commitment to achieving both organizational integrity and the objectives of Shariah (*Maqasid al-Shariah*), generating social and spiritual value alongside financial performance.

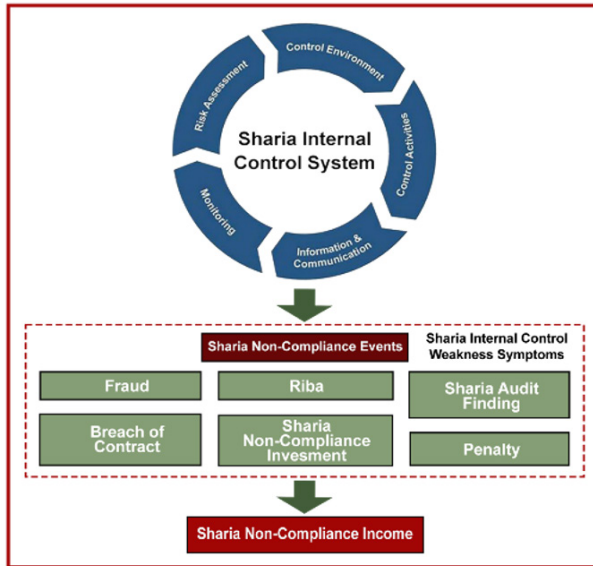
Shariah Internal Control System Deficiencies

However, the Shariah Internal Control System is also susceptible to control deficiencies, as indicated by the occurrence of Shariah Non-Compliance Events (SNCEs). The emergence of SNCEs signals weaknesses within the internal control system that is supposed to ensure all banking activities are conducted in line with Shariah principles (Lahsasna, 2014). While differing in focus, such weaknesses have impacts comparable to those in conventional banking, namely increased financial and reputational risks (Ginena, 2014; Rosman et al., 2017). If left unaddressed, these deficiencies may lead to financial losses, such as regulatory sanctions or a decline in customer trust ultimately reducing the institution's revenue (Farooq & AbdelBari, 2015). Furthermore, reputational damage can be significant (Rahman & Anwar, 2014), especially in the Islamic finance industry, which heavily relies on public confidence in Shariah compliance. Deficiencies in internal control and Shariah supervision may therefore result in serious consequences for the institution across financial, operational, and reputational dimensions (Farooq & AbdelBari, 2015; Ginena, 2014; Lahsasna, 2014; Rahman & Anwar, 2014; Rosman et al., 2017).

Nonetheless, it is essential to acknowledge that, as emphasized by COSO (2013)(Committee of Sponsoring Organizations of the Treadway Commission), Shafii & Salleh, (2010:p.34), IFSB, (2009), and R Anthony, V Govindarajan, Frank Hartmann, K Kraus, (2014)), internal control systems including those implemented in the context of Shariah are inherently limited. Using the COSO internal control framework, this study expects that Shariah Internal Control Systems can only provide reasonable, rather than absolute, assurance in preventing Shariah Non-Compliance Events (SNCEs). Accordingly, the occurrence of SNCEs reflects inherent limitations and deficiencies in control design, implementation, or monitoring, rather than the complete absence of control mechanisms. This limitation is reflected in the assertion that internal control systems can provide only *reasonable assurance*, not absolute guarantees, in preventing all forms of Shariah violations. In other words, the effectiveness of such systems is highly dependent on the fulfillment of good control prerequisites and the absence of efforts to weaken the system through collusion or systematic misconduct.

The following section illustrates a model of Shariah Internal Control System Deficiency.

Figure 1. Ilustrasi Defisiensi Sistem Pengendalian Internal Syariah



Source: Developed by the author, adapted from the COSO(Committee of Sponsoring Organizations of the Treadway Commission) Internal Control Framework

As illustrated, Shariah Control Weakness (SCW) may arise from deficiencies in one or more of the components of the Shariah Internal Control System namely policies, procedures, or mechanisms or from a simultaneous combination of weaknesses across these components. Such deficiencies result in the failure to prevent or timely detect Shariah Non-Compliance Events, thereby compromising the achievement of Shariah objectives. The occurrence of SNCE indicates that both internal preventive controls and internal detection controls are not functioning optimally, leading to the need for additional resource allocation to implement corrective actions for the Shariah non-compliance incident.

Shariah Internal Control System Deficiencies and SNCEs

A key indicator of the presence of Shariah Control Weakness is the occurrence of various SNCEs. These events signify shortcomings in the internal control system, which is expected to ensure that all operations of Islamic banks adhere strictly

to Shariah principles. From a theoretical standpoint, SNCEs are also linked to income-generating activities. The presence of SNCE can result in the generation of Shariah Non-Compliance Income (SNCI). Therefore, when an Islamic bank reports the existence of SNCI, it is a direct consequence of prior SNCEs (Johari, 2022; Mohamed & Ibrahim, 2023; Mohd & Sawari, 2020; Puneri et al., 2019).

Understanding the consequences of SNCE arising from deficiencies in Shariah internal control necessitates the further development of the Shariah Control Weakness construct. This construct must be contextualized within the broader framework of Shariah governance, as it is inherently linked to the fundamental values that differentiate Shariah-based internal control from conventional internal control systems. The definition of internal control weaknesses, as widely used in audit and internal control literature, particularly as articulated by PCAOB, (2004, 2007) and COSO (2013) serves as a foundational reference for shaping the SCW concept. The notion of *significant deficiency* describes a weakness in internal control that could result in a material misstatement in financial reporting going undetected (Ananzeh, 2024; Muhtar et al., 2023; PCAOB, 2007). However, within the context of Islamic Financial Institutions, an additional layer of risk must be considered: Shariah non-compliance risk. This type of risk emerges from failures to comply with Shariah rules and principles (Puneri et al., 2019:p.108). Accordingly, internal control systems in Islamic banks are not limited to financial and operational matters but also encompass strict adherence to Shariah principles (Rihab Grassa, 2015).

Thus, the definition of Shariah Control Weakness must be expanded to incorporate elements of Shariah compliance. In this light, internal control weaknesses are not only viewed as potential enablers of fraud or material misstatements in financial reports, but also as contributors to Shariah violations that could hinder the attainment of Maqasid al-Shariah (objectives of Shariah). Consequently, Shariah Control Weakness can be defined as: A deficiency, or a combination of deficiencies, in the policies, procedures, and mechanisms of the Shariah Internal Control System that results in the inability to prevent or timely detect violations, errors, or deviations from Shariah principles, thereby endangering the fulfillment of Shariah objectives.

Methods

An Embedded Multiple Case Study was employed to understand the patterns of deficiencies in the Shariah internal control systems within Indonesian Islamic banking. This method was chosen due to its flexibility in enabling data

triangulation across multiple observed phenomena (Dul & Hak, 2008; Hanock & Algozzine, 2006; Woodside, 2010; Yin, 2018). The process of gathering secondary data utilized content analysis techniques (Dumay & Cai, 2014). This method was applied in the study to comprehend the content within financial reports and good corporate governance (GCG) reports from 2013 to 2024 of Indonesian Islamic banks, specifically BSI, Muamalat, BJB Syariah, Bank Aceh Syariah, Mega Syariah, BCA Syariah, NTB Syariah, BPD Riau Kepri Syariah, and Bukopin Syariah. Additionally, primary data collection was conducted through structured interviews with 10 individuals involved (or previously involved) in identifying, investigating, and reporting Shariah non-compliance incidents. The respondents, comprising 9 males and 1 female aged between 37 and 49 years, possessed work experience ranging from 3 to 19 years. Their educational backgrounds spanned from Bachelor's (S1) to Doctoral (S3) degrees, holding various strategic positions such as Branch Managers, Compliance Unit members, Business Control, Financial Officers, and members of the Shariah Supervisory Board.

This approach aimed to capture empirical perspectives and patterns directly experienced by Islamic banking practitioners. The researchers performed content analysis on the interview results through a meaning-making process using coding methods. The coding process applied thematic/category coding to group codes related to Shariah Non-Compliance Events and their determinants. The findings were then subjected to pattern matching (Dul & Hak, 2008; Yin, 2018), a technique that involves comparing observed patterns in financial reports and interview data with theoretical patterns.

Results and Discussion

The cross-case analysis results from the embedded multiple case studies, covering nine Islamic commercial banks, reveal that nearly all sampled Islamic banking institutions experienced Shariah Non-Compliance Events. These SNCEs including audit findings, non-halal income, penalties, and fraud were widespread across almost all nine Islamic commercial banks in the sample. This recurring pattern indicates that the identified SNCEs were not isolated incidents limited to just one or a few banks. Instead, their repetitive nature suggests a common phenomenon in Indonesia's Islamic banking sector. The consistent observations across the sample point to potential Shariah control weaknesses within the Shariah Internal Control System of the nine Islamic commercial banks examined in this study. Below is the coding results table:

Table 1. Coding Results of Shariah Non-Compliance Events
in Indonesian Islamic Commercial Banks

Bank	Years Observed	Frequency of Code Appearance in Annual Reports		
		Fraud	Audit Findings	SNC Income
BSI	3	3	3	3
Muamalat	11	11	11	11
BJB Syariah	9	7	7	9
Bank Aceh Syariah	8	7	0	8
Mega Syariah	9	8	6	9
BCA Syariah	10	3	0	10
NTB Syariah	6	4	0	6
BPD Riau Kepri Syariah	2	2	0	2
Bukopin Syariah	11	3	0	11

Source: Annual reports of Islamic commercial banks (2013-2023)

In response to RQ1, the findings from Table 1 reveal a pattern of systemic and persistent Shariah control deficiencies across Indonesian Islamic banks. The universal reporting of Non-Halal Income (SNC Income) by all observed institutions indicates that control failures are not isolated incidents but rather chronic challenges in maintaining Shariah-compliant revenue streams. This deficiency is reinforced by the widespread recurrence of Fraud, which appears in the reports of all sampled banks often paralleling SNC income events suggesting that Shariah compliance failures are deeply intertwined with broader weaknesses in the internal control environment. Furthermore, a distinct pattern of inconsistency emerges in Audit Findings; while banks like BSI and Muamalat consistently disclose findings, five other banks report zero frequency for audit findings despite recording Fraud and SNC Income, revealing a critical transparency gap in how control deficiencies are formally identified and reported.

However, the data shows marked variations in Fraud occurrences and Audit Findings among banks. Bank Muamalat emerged with the highest incidence of both Fraud cases and Audit Findings, recording 11 instances each over the 11-year study period. In contrast, several banks including Bank Aceh Syariah, BCA Syariah, NTB Syariah, and Bukopin Syariah reported no Audit Findings despite documenting SNC Income, suggesting either divergent reporting practices or differing audit outcomes rather than an absence of audit-related issues. Interview data corroborated these findings, with most respondents confirming direct experience with various SNCEs

including Shariah audit findings, non-halal income incidents, compliance penalties, and fraud cases. A strong consensus emerged among practitioners that SNCEs reliably indicate weaknesses in internal control systems, though with varying degrees of conviction while Respondents C, E, F, M, O, and Z viewed them as clear evidence of systemic flaws requiring investigation, others like Respondents B, D, and L agreed with reservations, and Respondent W remained hesitant.

This perspective aligns with (Dusuki, 2011) and (AAOIFI, 2019), who assert that audit findings revealing violations whether intentional or not demonstrate weaknesses in Shariah internal controls. This view is further supported by (Bedard & Graham, 2011), who emphasize auditors' critical role in identifying such deficiencies. The fact that Shariah Non-Compliance Income (SNCI) is accepted and reported indicates suboptimal implementation of Shariah principles in banks, encompassing operational compliance, product oversight, and stakeholder education (Hanefah et al., 2020a; Islamy, 2016; Johari, 2022; Mohamed & Ibrahim, 2023; Mohd & Sawari, 2020; Puneri et al., 2019; Rosman et al., 2017; Shafai & Engku Ali, 2019). These scholars regard SNCI disclosure as essential to Islamic value transparency, a mandatory requirement for Islamic banks. However, not all SNCI can serve as proxies for Shariah Control Weakness (SCW). Relevant SNCI arises from SNCEs caused by deficiencies in the Shariah internal control system—for example, income from transactions violating Shariah principles or failing to meet their pillars and conditions (DSN-MUI Fatwa No. 123/DSN-MUI/XI/2018). Conversely, SNCI stemming from external factors beyond a bank's control (e.g., penalties due to natural disasters) cannot proxy SCW.

Additionally, empirical findings on persistent fraud cases in some Islamic banks align with theory. Mohamed & Ibrahim, (2023) classify fraud as SNCE due to its contradiction with Shariah principles like honesty (amanah). Donelson et al., (2017) further establish a link between internal control weaknesses and heightened financial reporting fraud risk, corroborating the annual report findings. After identifying deficiency patterns in Indonesian Islamic banks' control systems, in-depth interviews were conducted with respondents. Demographic analysis revealed significant diversity: most respondents were male (aged 37–49), held bachelor's to doctoral degrees, and had 3–19 years of work experience. Their positions spanned various organizational levels, ensuring comprehensive perspectives on SCW indicators. Below is the frequency mapping of factors contributing to Shariah Control Weakness as manifestations of Shariah internal control deficiencies:

Identified Factors Contributing to Shariah Control Weakness Based on Respondent Interviews:

No.	Identified Factors	Number of Respondents Who Mentioned the Factor	Mention Frequency
1	Control Weaknesses	9	24
2	Low Shariah Literacy Among Employees	7	22
3	Customer Pressure	7	11
4	Target Achievement Pressure	6	9
5	Complexity of Akad	4	6
6	Number of Shariah Supervisory Board (SSB) Members	3	4
7	Number of Branch Offices	3	3
8	Frequency of SSB Meetings	2	2
9	Quality Characteristics of SSB Members	1	2
10	Employee Training Budget	1	1
11	Bank Asset Size	1	1
12	Length of Bank Operation (Bank Age)	1	1

Source: Processed by the researcher based on interview data with respondents

To address RQ2 regarding the factors influencing the emergence of Shariah control deficiencies, the study's reveal twelve distinct factors contributing to Shariah Control Weakness (SCW), with internal control deficiencies emerging as the most prominent issue. Control Weakness itself was cited 24 times by all nine respondents, highlighting systemic vulnerabilities in Shariah internal control mechanisms. Closely following in significance were human resource factors, particularly Weak Employee Shariah Understanding, which was mentioned 22 times by seven respondents, underscoring critical gaps in staff competency regarding Islamic finance principles. External pressures also proved substantial, with Customer Pressure (11 mentions from 7 respondents) and Target Achievement Pressure (9 mentions from 6 respondents) demonstrating how commercial realities can compromise Shariah compliance. The research additionally identified several other influential factors including Contract Complexity, the Number of Shariah Supervisory Board (DPS) Members, Branch Network Size, and various governance/operational elements such as DPS Meeting Frequency, DPS Member Quality, Employee Training Budget, Bank Asset Size, and Bank Operating Duration. These multifaceted findings collectively establish SCW as a complex phenomenon stemming from both internal organizational shortcomings and external environmental pressures. To deepen these

quantitative insights, the study employed NVivo-assisted qualitative analysis, with the synthesized results visually represented through a comprehensive project map included in the figure's lower section, providing a holistic understanding of the interconnected nature of these contributing factors.

Figure 2. Illustration of Project Mapping: Determinants of Shariah Control Weakness (SCW) According to Respondents



Data source: NVivo-processed qualitative analysis of interview responses.

The following section presents a detailed discussion of each identified factor:

Control deficiency

The coding of interview data revealed that Shariah Non-Compliance Events, as manifestations of Shariah Control Weaknesses, are primarily triggered by deficiencies in internal control mechanisms. One of the main factors identified was the ineffectiveness of supervisory processes. Several respondents highlighted inadequate oversight of financing transactions (Respondent B), where many deals were not properly monitored. Moreover, the imposition of overly ambitious business targets without adequate supervisory follow-up also increased the risk of non-compliance with Shariah principles. These findings are consistent with previous studies that emphasized the limitations of internal control systems in addressing business target pressures (Agwa-Ejon & Vermeulen, 2015; Esen, 2022; K. Hu et al., 2021; Polidoro et al., 2022; Shafiai & Engku Ali, 2019; Surmačs & Surmača, 2024).

Weak supervision and oversight also create opportunities for violations. When management fails to evaluate the implementation of Shariah-compliant transactions, the risk of non-compliance escalates. Despite ongoing system improvements (Respondents C, L, Z), gaps remain that can be exploited for non-Shariah-compliant actions (Respondent Z). Lax monitoring, particularly under urgent circumstances (Respondent D), further contributes to SNCE. These perspectives are supported by several researcher (Brehm & Gates, 1994; J. Hu et al., 2021; Ishwardat et al., 2024; Mearns, 2020). Furthermore, suboptimal implementation of Standard Operating Procedures (SOPs) emerged as a compliance issue. Failure to adhere to SOPs opens the door to violations (Respondent F). This is reinforced by Ginena (2014) and Shafii & Salleh (2010), who noted that non-compliance often stems from unclear processes, policies, or responsibilities. Internal negligence, whether intentional or unintentional, was also cited as a driver of SNCE (Respondent Z). Ginena, (2014) emphasized that even with adequate human resources and training, negligence can still expose Islamic banks to Shariah risk.

Overall, the interview findings suggest that SNCE is closely linked to weaknesses in the internal Shariah control system. These findings align with prior research by Zhang et al., (2007) and Krishnan (2005), which highlighted the connection between corporate governance and internal controls. Weak internal controls in Islamic banks not only undermine compliance but also impact

operational efficiency and institutional reputation. Addressing these issues requires strengthening Shariah audits, enhancing staff training, and implementing stricter control mechanisms (Hanefah et al., 2020a). These findings are consistent with earlier research indicating that many Islamic financial institutions continue to struggle with weak internal control practices (Ahmed & Khan, 2007; Darmadi, 2013; Ghani et al., 2019; Rahman & Anwar, 2014; Rosman et al., 2017).

Low Shariah Literacy Among Employees

The second most frequently cited factor by respondents was the lack of Shariah understanding among Islamic bank employees. This factor was identified by seven respondents and mentioned 22 times, indicating that violations of Shariah principles often stem from insufficient employee knowledge. The gap between job demands and employee competencies increases the likelihood of non-compliance in day-to-day operations, negatively affecting both the integrity and Shariah compliance of the bank. The coding analysis suggests that SNCE is largely driven by a weak foundational understanding of Shariah. According to Respondent B, not all employees are able to adequately explain basic Shariah principles, while Respondent D emphasized that actual implementation heavily depends on individual awareness and discipline.

Respondents E, F, and L also acknowledged the lack of Shariah literacy and understanding of fundamental principles as root causes of non-compliance. These findings are consistent with several studies (Ginena, 2014; Hanefah et al., 2020b; Malim, 2015; Muhammad Iqmal Hisham Kamaruddin & Mustafa Mohd Hanefah, 2017), who argued that internal control weaknesses often arise from employees' inability to fulfil their Shariah-related responsibilities. As the primary executors of Islamic contracts, bank staff must possess a strong understanding of Shariah-compliant products and services and be able to clearly communicate contractual terms to customers. Employees with sound Shariah knowledge and awareness enhance institutional credibility and foster customer loyalty. Employee non-compliance can lead to financial losses, as income generated from SNCE is considered non-halal (Shariah Non-Compliance Income/SNCI). Lahasna, (2014) identified several contributing factors to non-compliance, including lack of knowledge, inadequate skills, insufficient training and supervision, human error, and moral hazard. The absence of regular training was also cited as a major contributor to low employee Shariah literacy. Respondent C emphasized the importance of continuous training, aligning with Ginena, (2014) and Lailiya & Kusumaningtias, (2024), who noted that inadequate training may worsen compliance issues.

Additionally, a lack of willingness or commitment among employees to implement Shariah principles also emerged as a key factor in non-compliance (Respondent Z). As Ginena, (2014;93) noted, even with sufficient resources and training, negligence can still expose banks to undesirable Shariah risks. This discussion highlights clear pattern matching between empirical data and theory, supporting the conclusion that weak employee understanding of Shariah principles is a major driver of SNCE. This in turn elevates the risk of non-compliance and reflects broader weaknesses in the Shariah internal control system.

Customer Pressure

The third factor identified by respondents as a cause of Shariah Non-Compliance Events is external pressure from customers. In practice, employees of Islamic banks often face dilemmas between maintaining Shariah compliance and fulfilling customer demands. These pressures may take the form of requests to expedite processes, relax requirements, or even overlook Shariah stipulations. This factor was cited by seven respondents, with a total of eleven mentions. Coding results indicate that customer pressure serves as a significant trigger for SNCE, highlighting a vulnerability in the Shariah control system (Ginena, 2014; Muhammad Iqmal Hisham Kamaruddin & Mustafa Mohd Hanefah, 2017; Shafii & Salleh, 2010).

Customers often prioritize convenience and transaction speed over Shariah compliance (Colvin, 2016). For example, Respondent B noted requests for cash financing based on pre-owned assets. Respondents C and F pointed out that customers' limited understanding of Shariah contracts leads them to compare Islamic financial products to conventional loans. Respondents D, E, L, and Z mentioned customer demands for immediate disbursement and transaction completion with little regard for Shariah requirements. This pressure is exacerbated by low levels of Shariah financial literacy among the public. According to Albaity & Rahman, (2019), average Shariah literacy stands at only 62%, and in Indonesia, this figure drops to 39.11% (Fajarihza, 2024). This knowledge gap renders employees vulnerable to compromising Shariah principles to meet customer expectations. The alignment between empirical observations and theoretical frameworks is evident, indicating that customer pressure is a significant external factor contributing to Shariah non-compliance. This supports Colvin, (2016) assertion that external demands can cause employees to overlook regulations in favor of meeting job-related expectations.

Business Target Pressure

Business target pressure was cited by six respondents and mentioned nine times, indicating its significance as a contributing factor to SNCE and its reflection of weaknesses within the Shariah internal control system. Coding analysis revealed that Islamic bank employees are often caught in a dilemma between achieving business targets and adhering to Shariah principles. Respondents B and F identified business target pressure as a dominant factor leading to Shariah principles violations, while Respondents D, E, and L highlighted excessive workloads and financial pressures as drivers of procedural compromises. Respondent Z added that pressure from superiors and difficulty in acquiring clients prompted marketing staff to seek their own solutions, even if this involved violating standard operating procedures (SOPs).

Previous studies by K. Hu et al., (2021), Agwa-Ejon & Vermeulen, (2015), and Esen, (2022) have shown that business target pressure can obscure ethical judgment and encourage non-compliant behavior. Moreover, such pressure creates room for misconduct if internal oversight is insufficient. Research by Shafiai & Engku Ali (2019) and Hanefah et al. (2020b) emphasizes that Islamic financial institutions may prioritize financial performance over Shariah adherence under such conditions. Losiewicz-Dniestrzanska & Nosowski (2017) similarly found that excessive target pressure could disrupt the balance between business performance and compliance.

Therefore, business target pressure not only triggers SNCE but also serves as an indicator of systemic weaknesses in Shariah control. This discussion highlights clear pattern matching between empirical data and theoretical perspectives, reinforcing the notion that performance pressure drives employees to compromise Shariah compliance in pursuit of personal or institutional targets (Agwa-Ejon & Vermeulen, 2015; Esen, 2022; Ginena, 2014; Hanefah et al., 2020b; J. Hu et al., 2021; Shafiai & Engku Ali, 2019).

Akad Complexity

Akad complexity has been identified as one of the contributing factors to Shariah Non-Compliance Events in Islamic banking. Unlike conventional banking contracts, Shariah-compliant contracts require the fulfillment of numerous conditions to ensure their validity and alignment with Islamic principles. This process often demands additional time and resources, which may prompt efforts to simplify procedures—at times at the cost of Shariah compliance. If left unchecked, such practices can increase the likelihood of SNCEs, thereby indicating weaknesses

in the Shariah internal control system. This factor was cited by four respondents, with a total of six mentions.

The coding results reveal that employees often resort to shortcuts to expedite transactions, especially when under pressure from customers who demand quick and seamless service. Respondent B highlighted difficulties in applying *murabahah* contracts for multi-item transactions, while Respondent F noted inconsistencies in supporting documentation and the lack of involvement from branch heads in contract signing procedures. These findings align with those of Naim (2014) and Sharifah (2004), who pointed out procedural violations in contract execution, such as incorrect sequencing of *ijab* and *qabul* and inadequate attention to contract validity. Respondents M and W also emphasized that diverse customer needs often lead to procedural deviations, such as merging multiple contracts for convenience. The study reveals persistent risk-averse tendencies even among Islamic Commercial Banks, with many institutions favoring safer, more predictable financing models like cost-plus Murabahah over higher-risk profit-sharing arrangements such as Mudarabah or Musharakah. Notably, the mark-up structures in Murabahah contracts are frequently designed to generate returns comparable to conventional banking products (N. Hidayah et al., 2023.p.11), raising questions about the industry's adherence to Islamic finance principles. Through careful analysis, a clear pattern emerges that aligns empirical observations with theoretical expectations: the inherent complexity of Shariah-compliant contracts, when combined with customer demands for faster and simplified services, creates significant vulnerabilities that often lead to Shariah Non-Compliance Events (SNCEs) during contract implementation. This situation presents a paradox, while the avoidance of excessive risk (*gharar*) technically complies with Shariah principles, the over-reliance on debt-like instruments like Murabahah may fundamentally undermine the distinctive value proposition of Islamic banking. Furthermore, the operational tension between maintaining strict Shariah compliance and meeting commercial efficiency targets highlights the urgent need for innovative solutions across multiple fronts, including standardized contract frameworks, enhanced staff training programs, and comprehensive customer education initiatives to bridge the gap between Islamic banking theory and practice.

Characteristics and Frequency of Shariah Supervisory Board (SSB) Meetings

Another factor identified by respondents as contributing to SNCEs is the characteristics and effectiveness of the Shariah Supervisory Board (SSB). Although this factor was mentioned less frequently (2–4 times), it remains critical given the

SSB's central role in ensuring Shariah compliance. According to agency theory, the SSB is primarily responsible for overseeing management's adherence to Shariah principles (Chalmers et al., 2018; Y. Chen et al., 2017; Zhang et al., 2007). The SSB plays a key role in identifying and preventing SNCEs as part of the broader Shariah corporate governance mechanism. Characteristics such as age, experience, educational background, and depth of Shariah knowledge directly affect the effectiveness of Shariah oversight (Amayreh, 2021; Naiker & Sharma, 2009; Srinivasan & Richardson, 2005; Yang & Krishnan, 2005). Respondent Z emphasized that the reputation and expertise of SSB members, particularly those recognized as public figures or religious scholars, can significantly enhance the credibility of the bank.

The number of SSB members also matters. Respondents F, L, and Z indicated that larger SSBs are generally more effective in performing oversight functions. Prior studies confirm that SSB size positively influences bank performance and the effectiveness of internal controls (Almutairi & Quttainah, 2017; Farag et al., 2018; Hakimi et al., 2018). In addition, the frequency of SSB meetings was highlighted as crucial. Respondents F and Z stated that regular meetings improve the SSB's ability to detect and address SNCEs. This is supported by findings that suggest frequent supervisory committee meetings enhance internal control effectiveness (Hoitash et al., 2009; Naiker & Sharma, 2009). These insights confirm a strong pattern matching between empirical findings and theoretical expectations: the characteristics, size, and meeting frequency of SSBs significantly contribute to the effectiveness of Shariah governance and internal control, ultimately helping to prevent SNCEs as manifestations of Shariah Control Weaknesses (SCW).

Other Contributing Factors

Beyond the major themes discussed, several additional factors were identified by respondents as potentially influencing the occurrence of SNCEs. These include the number of branch offices, total assets, institutional age, and training budget allocations. Although mentioned with lower frequency, these factors remain important in developing a comprehensive understanding of the drivers behind Shariah Control Weaknesses (SCW). Respondents F, L, and Z noted that as the number of branches increases, so too does the complexity of supervision. A wider span of control may reduce the effectiveness of monitoring and elevate the risk of Shariah violations. This aligns with prior findings by Ashbaugh-Skaife et al., (2007) and Doyle et al., (2007), who reported a positive correlation between organizational complexity and internal control weaknesses. Additionally, Respondent Z highlighted

that banks with larger asset bases are better equipped to develop robust Shariah control systems, including the adoption of advanced technologies such as artificial intelligence. The age of the bank was also considered influential; more established banks tend to have more mature control systems due to accumulated operational experience.

Another critical factor is the training budget. Respondent Z stressed that training is a vital investment for enhancing employee competence and Shariah awareness. This is supported by studies demonstrating that training has a positive impact on performance, compliance, and internal control effectiveness (Botelho, 2012; Elnaga & Imran, 2013; Guo et al., 2016; Imran & Tanveer, 2015; Shafii & Salleh, 2010). Overall, the empirical data and theoretical perspectives converge to indicate that branch network size, total assets, bank age, and staff training budgets all play meaningful roles in shaping the strength or weakness of Shariah internal control systems. While not dominant, these variables are nonetheless relevant to the broader framework of SCW in Islamic financial institutions.

The study reveals that Shariah Non-Compliance Events (SNCEs) including non-halal income, audit findings, and fraud occur systematically across Indonesian Islamic banks, indicating persistent weaknesses in the Shariah Internal Control System (SICS). These deficiencies are not isolated but reflect a recurring pattern of control failures, with significant variations in audit transparency among banks. Further analysis identifies twelve determinant factors contributing to Shariah Control Weakness (SCW), dominated by internal issues such as ineffective control mechanisms and low employee Shariah literacy, alongside external pressures from customers and business targets. Additional factors include akad complexity, governance characteristics of the Shariah Supervisory Board, branch network size, and resource constraints. Collectively, these findings underscore that SCW is a multifactorial phenomenon shaped by both organizational and environmental dynamics, requiring integrated strategies to strengthen Shariah governance and compliance.

Conclusion

Shariah Non-Compliance Events represent a widespread and consistent phenomenon across Islamic commercial banks in Indonesia, serving as a primary indicator of Shariah Control Weakness within the Shariah Internal Control System. These incidents including Non-Halal Income, fraud, and audit findings occur in nearly all observed banks, reflecting systemic weaknesses rather than isolated

cases. The study concludes that SCW is driven by twelve interrelated factors, encompassing both internal and external dimensions. The most dominant factor is Control Weakness, followed by Weak Employee Shariah Understanding, while external pressures such as Customer Pressure and Target Achievement Pressure also play significant roles. Additional contributors include Akad Complexity, Shariah Supervisory Board characteristics, branch network size, and resource limitations. Collectively, these findings confirm that SCW is a multifactorial issue requiring a holistic and integrated approach to strengthen Shariah governance and compliance.

The findings of this study have significant practical implications for Islamic banks. Banks should prioritize improvements to the Shariah Internal Control System by reviewing monitoring processes and standard operating procedures. Enhancing human resource competency is also crucial and can be achieved through regular training to address Weak Employee Shariah Understanding. Management needs to develop strategies to manage external pressures from customers and business targets to avoid compromising Shariah compliance.

Although this study has successfully identified various causes of SCW in depth through a qualitative approach, there are several limitations to consider. First, the data used comes from interviews with a limited number of respondents, making the findings contextual and potentially not reflective of the entire Islamic banking industry in Indonesia. To enhance the validity and generalizability of the results, follow-up studies are recommended to employ quantitative or mixed methods approaches to develop proxies for the identified factors, such as surveys with larger and more representative samples from various Islamic banks. Additionally, longitudinal studies are needed to examine the dynamics of SCW over the long term and evaluate the impact of regulatory changes and internal policies on compliance with Shariah principles.

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