

SHARIA COMPLIANCE DISCLOSURE ON THE GULF COOPERATION COUNCIL COUNTRIES BASED ON AAOIFI STANDARDS



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Abstract

Sharia compliance is a concept referring to adherence or conformity to the principles of Islamic law in various aspects of life, including economics, finance, business, and social matters. This research aims to analyze the factors suspected to influence Sharia compliance based on AAOIFI standards, namely Sharia supervisory boards and risk management. The study adopts a quantitative approach with data sourced from the financial reports of seven companies located in GCC countries. The method employed in this research is multiple linear regression analysis using SPSS version 25 software. The findings indicate that, partially, the educational background of Sharia supervisory board members, the number of Sharia supervisory board members and liquidity risk have a positive impact on Sharia compliance while the educational background in fiqh muamalah (Islamic commercial jurisprudence) of Sharia supervisory board members and credit risk have a negative impact on Sharia compliance.

Keywords: Sharia Compliance, Risk Management, Sharia Supervisory Board

INTRODUCTION

Islamic banking and finance were introduced in the 1970s during the Foreign Ministers Conference of the Organization of Islamic Cooperation in Pakistan. At that time, Egypt proposed the establishment of the International Islamic Bank for Trade and Development to create Islamic banks. Essentially, the proposal suggested replacing interest-based financial systems with profit-sharing schemes, where risks and profits are shared. The conference approved the proposal and added recommendations to form the Association of Islamic Banks as a consultative body for Sharia-compliant economic and banking issues (Antonio 2015).

In 1975, the Islamic Development Bank (IsDB) was established by the Organization of Islamic Cooperation (OIC) as the first intergovernmental Islamic bank with an initial capital of 2 billion. The first international conference on Islamic economics was held in 1976, marking a significant event in the development of Islamic Banking and Finance (IBF) (Wani 2022). The primary foundation for the establishment of Islamic banks is based on the demand of Muslims to conduct transactions in accordance with Sharia principles. In Islam, the concept of *riba* (interest) is strictly prohibited and actively avoided. Therefore, transactions reflecting such practices are prohibited in the Sharia financial system. Additionally, the Sharia financial system aims to create justice and sustainability in the economy. Transactions in the Sharia financial system must adhere to the principles of fairness for all parties involved, fostering a balanced relationship between providers and recipients of funds in line with Islamic ethical and moral values. Legislation within the Sharia financial system is derived from the Quran and Sunnah, which serve as the main guidelines for Muslims.

It is mentioned in the words of Allah in Surah Al-Baqarah, verses 275 and 282 :

الَّذِينَ يَأْكُلُونَ الرِّبَا لَا يَقُومُونَ إِلَّا كَمَا يَقُومُ الَّذِي يَتَخَبَّطُهُ الشَّيْطَانُ مِنَ الْمَسِّ ذَلِكَ بِأَنَّهُمْ قَالُوا إِنَّمَا الْبَيْعُ مِثْلُ الرِّبَا وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا

The meaning is: *“Those who consume interest cannot stand (on the Day of Resurrection) except as one stands who is being beaten by Satan into insanity. That is because they say, 'Trade is (just) like interest.' But Allah has permitted trade and has forbidden interest.”*

ذَلِكُمْ أَقْسَطُ عِنْدَ اللَّهِ وَأَقْوَمٌ لِلشَّهَادَةِ وَأَدْنَىٰ أَلَّا تَرْتَابُوا إِلَّا أَنْ تَكُونَ تِجَارَةً حَاضِرَةً تُدِيرُونَهَا بَيْنَكُمْ فَلَيْسَ عَلَيْكُمْ جُنَاحٌ أَلَّا تَكْتُمُوهَا

The meaning is: *“And do not be (too) weary to write it, whether it is small or large, for its (specified) term. That is more just in the sight of Allah and stronger as evidence and more likely to prevent doubt between you, except when it is an immediate transaction which you conduct among yourselves.”*

These two verses explain the prohibition of usury (interest) in financial transactions and the principle of transparency and fairness in financial and business transactions, especially those related to debt. As a result, in the Sharia financial system, funds are managed and traded according to Islamic Sharia principles without imposing interest or engaging in speculation (making profits through gambling), and all activities are conducted with transparency between clients and financial institutions. The presence of the Sharia financial system provides a more sustainable alternative in line with Islamic ethical and moral principles. This has attracted the interest of many individuals and economic entities seeking to participate in a more just, transparent financial system aligned with Islamic values.

According to S&P Global Ratings' research, the global Islamic finance industry is estimated to grow by around 10% in 2023-2024. By the end of 2022, the total assets of the global Islamic finance industry reached approximately \$3 trillion (excluding Iran), with Islamic banking dominating, accounting for about 62% of total assets as of December 31, 2022. This industry remains concentrated in GCC countries, contributing around 68% of the total assets by the end of 2022, followed by Malaysia (S&P Global Ratings 2023).

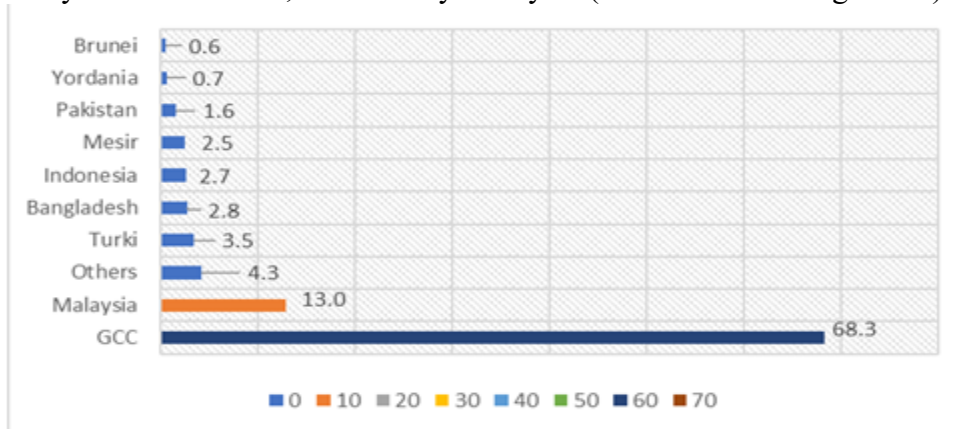


Figure 1.
Distribution Of Sharia Banking Assets

Given the robust growth of Islamic banking in Gulf Cooperation Council (GCC) countries, which also supports the global growth of the Islamic banking sector, it is clear that these countries are committed to establishing legal standards that serve as references for Sharia compliance, namely the Sharia Standards set by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). Saudi Arabia, Kuwait, the United Arab Emirates, Qatar, Bahrain, and Oman have adopted AAOIFI standards as mandatory regulations within their jurisdictions. Established in Bahrain in 1991, AAOIFI has issued over 100 standards covering various aspects, including 54 Sharia Standards, 31 Accounting Standards, 5 Audit Standards, and 13 Governance Standards. These AAOIFI standards provide comprehensive guidelines for Sharia-compliant financial institutions in terms of Sharia compliance, accounting, auditing, and governance. The aim is to ensure that the operations of Islamic banks remain in line with Sharia principles, thereby helping to maintain the trust of customers and shareholders while preserving the integrity of the Islamic finance industry.

Despite being a member of the Gulf Cooperation Council (GCC) and thus situated within the birthplace region of AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions) standards, Oman's Sharia compliance level with AAOIFI standards indicates a low achievement, approximately 50% of the standards set by AAOIFI. The low compliance level may be attributed to several factors, including insufficient infrastructure to support the implementation of Sharia principles, such as lack of education or training, as well as inadequate backgrounds and competencies, including proficiency in managing risk management and Sharia supervisory boards.

The research conducted by Albarrak & El-Halaby, (2019) has provided valuable insights into the impact of AAOIFI adoption on the level of Sharia compliance disclosure in

Islamic banking institutions. It was found that the Sharia Supervisory Board and the level of Sharia compliance disclosure are positively influenced by the independence level of the Sharia Supervisory Board in disclosing Sharia rulings that comply with Islamic law. Setiawan (2021) suggested in his research to conduct a more in-depth study regarding the risks associated with Sharia compliance, which is expected to provide considerations for banking practitioners and regulators in formulating policies related to Sharia compliance risks. This reason has prompted researchers to add risk management as a variable of study, distinguishing it from previous research that only focused on company value, the role of the Sharia Supervisory Board, and banking financial performance.

REVIEW OF LITERATURE

Sharia Supervisory Board on Sharia Compliance.

The Sharia Supervisory Board (SSB) plays a crucial role in ensuring the compliance of a financial entity or corporation with Sharia principles (Mukhibad 2018). In this context, the Sharia supervisory board is responsible for formulating policies and procedures aimed at implementing Sharia principles in every operational aspect. By closely collaborating with the company management, the Sharia compliance board can play a critical oversight role in ensuring that financial transactions, investments, and other policies align with the Sharia norms established based on AAOIFI standards.

In this regard, the Sharia supervisory board is considered the main pillar in ensuring the compliance of a financial entity with Sharia principles, particularly in accordance with the standards emphasized by AAOIFI as a clear foundation for conducting financial activities in line with Islamic principles (Muhammad et al. 2021). The Sharia compliance board in this study is identified as a key element in the corporate governance structure, with responsibilities including the formulation of policies and procedures to ensure overall entity operations comply with applicable Sharia standards. Their involvement in strategic decision-making also indicates that Sharia compliance is not only focused at the operational level but is also integrated into the company's policies and strategic direction. The role of the Sharia compliance board in this context relates to the implementation of Sharia enterprise theory principles, highlighting efforts to not only comply with rules but also internalize Sharia values throughout the company's structure and policies (Albarrak and El-Halaby 2019). Based on previous research findings, it has been established that the educational background of the Sharia compliance board has a significant and positive influence on Sharia compliance. This implies that Sharia supervisory boards with educational backgrounds in finance and accounting are considered more compliant with Sharia regulations and standards. Based on the explanation above, the hypotheses to be proposed are:

- H1a : The Sharia Supervisory Board proxied by educational background has a positive effect on Sharia compliance.
- H1b : The Sharia Supervisory Board proxied by fiqh muamalah educational background has a positive effect on Sharia compliance.
- H1c : The Sharia Supervisory Board proxied by the number of Sharia Supervisory Board members has a positive effect on Sharia compliance.

Risk Management on Sharia Compliance

The AAOIFI standards emphasize the importance of proportional and fair risk measurement encompassing both financial and ethical aspects, thus enabling a comprehensive assessment of risk impact on Sharia compliance. Risk management, based on AAOIFI standards, also emphasizes managing risks while adhering to Sharia principles (Utami and Irawan 2022). In the context of risk management based on Sharia principles, special attention is given to liquidity risk and credit risk to ensure that activities of Sharia financial institutions remain in line with Islamic teachings. Management of liquidity risk and credit risk must adhere to Sharia principles to mitigate potential violations of these norms.

In addressing liquidity risk, companies are directed to develop mechanisms in accordance with Islamic principles, including cash management based on recognized Sharia contracts. Developing liquid financial instruments compliant with *mudharabah* or *musyarakah* principles can be part of the strategy to minimize liquidity risk while considering Sharia aspects. Meanwhile, credit risk in the Sharia context includes assessing and managing risks related to financing or investment transactions conducted by the company. Companies are directed to design clear rules and procedures for assessing creditors or business partners considering their compliance with Sharia principles (Alsyaahrin, Atahau, and . 2018).

In relation to Shariah enterprise theory, risk management is considered an integral element of corporate management that encompasses Sharia values. This theory asserts that financial growth should be achieved through business practices that not only benefit stakeholders but also adhere to Sharia principles. By incorporating Sharia-compliant risk management, Shariah enterprise theory emphasizes the importance of integrating Islamic values into all aspects of corporate operations and decision-making, thus creating alignment between economic objectives and Sharia principles. Based on previous research findings, it has been established that risk management has a positive influence on Sharia compliance. This means that the better the risk management in a company, the higher the level of Sharia compliance implemented by the company. Based on the explanation above, the hypotheses to be proposed in this study are:

H2a : Risk Management proxied by Credit Risk has a positive effect on Sharia Compliance

H2b : Risk Management proxied by Liquidity Risk has a positive effect on Sharia Compliance

Sharia Supervisory Board and Risk Management on Sharia Compliance

Within the scope of Islamic banking, the presence of the Sharia Supervisory Board and the implementation of risk management are considered two important interconnected factors in ensuring optimal Sharia compliance. The Sharia Supervisory Board serves as an overseeing entity actively involved in strategic decision-making and plays a crucial role in ensuring that every policy and practice of financial institutions align with Sharia principles (Albarrak and El-Halaby 2019). Meanwhile, risk management plays a role in identifying, measuring, and managing financial and operational risks that may affect compliance with Sharia principles. Careful implementation of risk management is expected to mitigate potential violations of Sharia norms, maintain the integrity of financial institutions, and ensure that their operational activities are in line with Islamic teachings.

The relationship between the Sharia Supervisory Board and risk management is indicated to have simultaneous influence because the Sharia Supervisory Board not only acts as an overseer but also contributes to directing strategies and policies that reflect Islamic

views (Albarrak and El-Halaby 2019), while risk management serves as an operational tool to identify and address risks that may hinder Sharia compliance. Based on this, the presence of the Sharia Supervisory Board and effective implementation of risk management are expected to create a positive influence that can enhance understanding, oversight, and risk management efforts to maintain and improve overall Sharia compliance. Based on this explanation, the hypothesis to be proposed in this study is:

H3 : The Sharia Supervisory Board and Risk Management influence Sharia Compliance.

Based on the background and introductions described above, this study seeks to determine whether the Sharia Supervisory Board (SSB) impacts Sharia Compliance in accordance with AAOIFI standards, whether Risk Management influences Sharia Compliance based on these standards, and whether the combined effects of the Sharia Supervisory Board (SSB) and Risk Management simultaneously influence Sharia Compliance. These questions are crucial because they provide valuable insights into the mechanisms that ensure adherence to Sharia principles in financial institutions, offering important implications for both practitioners and regulators within the field of Islamic finance.

RESEARCH METHOD

This type of research can be categorized as causal research. Causality is defined as the relationship of cause and effect between events that will lead to subsequent events or, in this research, can be interpreted as the cause and effect relationship between one variable and another variable, and/or the cause and effect relationship between independent variables and dependent variables. In this study, it means analyzing the influence of Sharia compliance boards, profitability, and risk management on Sharia compliance in Gulf Cooperation Council (GCC) countries based on AAOIFI standards from 2018 to 2024.

This research adopts a quantitative approach, where the data used consists of numbers with the aim of testing hypotheses with an emphasis on numerical data using specific statistical methods. According to Sugiyono (2018), quantitative research methods are grounded in positivist philosophy, aiming to examine a specific population and/or sample data, which will then be used to test pre-established hypotheses. In quantitative research, the focus and direction of the research tend to lean towards theory-building using existing data and facts, ensuring that the field conditions do not influence or change the focus of the research.

In this study, multiple linear regression analysis will be employed as the primary method for examining the research hypotheses. SPSS software will be utilized for data processing and analysis. This approach will enable a comprehensive evaluation of the relationships between the variables of interest, specifically focusing on how the Sharia Supervisory Board (SSB) and Risk Management influence Sharia Compliance according to AAOIFI standards. The use of multiple linear regression allows for the assessment of the individual and combined effects of these factors, providing a robust framework for testing the hypotheses and drawing meaningful conclusions from the data.

The sampling technique used in this research is the saturated sampling technique, where this type of sampling uses the entire population as part of the sample, so there are no

samples taken randomly. This technique is usually used when the population to be studied is relatively small and easily accessible, which is suitable for this research, which has a population of 7 Sharia banks in the Gulf Cooperation Council (GCC) countries from 2018 to 2024.

RESULTS AND DISCUSSION

Simultaneous Test

This test is conducted with the aim of determining whether there is a simultaneous influence between the independent variables of credit risk, liquidity risk, educational background of Sharia Supervisory Board (DPS), fiqh muamalah DPS background, and the number of DPS on Sharia compliance in banking companies in the Gulf Cooperation Council (GCC) countries during the period 2018-2024. The results of the simultaneous test can be seen in the significance value (sig) and the calculated F value, as shown in Table 1.

Table 1.
Stimultaneous Test

ANOVA ^a						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.046	5	.009	15.378	.000 ^b
	Residual	.017	29	.001		
	Total	.063	34			

a. Dependent Variable: SC

b. Predictors: (Constant), DPS3, LR, CR, DPS1, DPS2

The result of the F-test shows a significance value (sig) of 0.000, which is less than 0.05. Based on this, it can be concluded that all independent variables, namely credit risk, liquidity risk, educational background of the Sharia Supervisory Board (DPS), fiqh muamalah DPS background, and the number of DPS, have a simultaneous or combined effect on Sharia compliance. Therefore, hypothesis 3 (H3) is accepted, and the research model is deemed fit to estimate the results of hypothesis testing.

To enhance Sharia compliance optimally, the Sharia Supervisory Board must have a profound understanding of Islamic principles related to business operations. The Sharia Supervisory Board needs to be actively involved in designing and reviewing policies and guidelines that adhere to Sharia principles. Additionally, the Sharia Supervisory Board also needs to ensure that all company activities are in accordance with Islamic law. Apart from the role of the Sharia Supervisory Board, effective risk management implementation is also necessary to support Sharia compliance. Effective risk management can help identify potential Sharia non-compliance early on and take necessary corrective actions. The Sharia Supervisory Board needs to collaborate with parties involved in risk management functions to identify Sharia compliance-related risks and develop appropriate mitigation strategies. With good cooperation between the Sharia Supervisory Board and risk management, companies can ensure that their business activities not only comply with Islamic law but also effectively manage risks. Ultimately, the optimal combination of the Sharia Supervisory

Board's role and good risk management implementation can enhance Sharia compliance in companies overall.

t-test

This test is conducted with the aim of determining whether there is a partial influence of each independent variable, namely credit risk, liquidity risk, educational background of the Sharia Supervisory Board (DPS), fiqh muamalah DPS background, and the number of DPS, on the dependent variable Sharia compliance. The results of the partial testing can be seen in the significance values (sig) attached in Table 2.

Table 2.
t-Test Result

Coefficients^a		Unstandardized		Standardized		
		Coefficients		Coefficients		
Model		B	Std. Error	Beta	t	Sig.
1	(Constant)	.466	.028		16.470	.000
	DPS1	.124	.020	1.194	5.171	.000
	DPS2	-.076	.029	-.627	-2.599	.015
	DPS3	.014	.006	.555	2.308	.028
	CR	-.052	.011	-.711	-4.594	.000
	LR	.160	.030	1.011	5.318	.000

a. Dependent Variable: SC

Based on the results of hypothesis testing calculations presented in Table 2, the following conclusions can be drawn:

Based on the results of the calculations in Table 2, the variable of Sharia Supervisory Board's educational background has a significance value of 0.000. This means that there is a relationship between the Sharia Supervisory Board's educational background and Sharia compliance, where the significance value obtained is less than 0.05 ($0.000 < 0.05$). With a beta value of 0.102, it can be concluded that the educational background of the Sharia Supervisory Board has a positive and significant influence on Sharia compliance. Therefore, it can be concluded that the proposed hypothesis (H1a) is accepted.

Based on the calculation results in Table 2, the variable of the Sharia Supervisory Board's background in fiqh muamalah has a significance value of 0.015. This means that there is a relationship between the background of fiqh muamalah of the Sharia Supervisory Board (DPS) and Sharia compliance, where the significance value obtained is less than 0.05 ($0.015 < 0.05$). With a beta value of -0.076, it can be concluded that the background of fiqh muamalah of the Sharia Supervisory Board (DPS) has a negative and significant influence on Sharia compliance. Therefore, it can be concluded that the proposed hypothesis (H1b) is accepted.

Based on the calculation results in Table 2, the variable of the number of Sharia Supervisory Board members (DPS) has a significance value of 0.028. This means that there is a relationship between the number of DPS and Sharia compliance, where the significance value obtained is less than 0.05 ($0.028 < 0.05$). With a beta value of 0.014, it can be concluded

that the number of DPS has a positive and significant influence on Sharia compliance. Therefore, it can be concluded that the proposed hypothesis (H1c) is accepted.

Based on the calculation results in Table 2, the variable credit risk has a significance value of 0.000. This means that there is a relationship between the credit risk variable and Sharia compliance, where the significance value obtained is less than 0.05 ($0.000 < 0.05$). With a beta value of -0.052, it can be concluded that credit risk has a negative and significant influence on Sharia compliance. Therefore, it can be concluded that the proposed hypothesis (H2a) is accepted.

Based on the calculation results in Table 2, the liquidity risk variable has a significance value of 0.000. This means that there is a relationship between the liquidity risk variable and Sharia compliance, where the significance value obtained is less than 0.05 ($0.000 < 0.05$). With a beta value of 0.160, it can be concluded that liquidity risk has a positive and significant influence on Sharia compliance. Therefore, it can be concluded that the proposed hypothesis (H2b) is accepted.

Coefficient Determination Test

The Coefficient of Determination Test is used to measure how well the model explains the variation in the dependent variable. If the adjusted R-squared value is small, then the independent variables have limitations in explaining the variation in the dependent variable. The results of the coefficient of determination test (adjusted R-squared) can be seen in the following table:

Table 3.
Coefficient Determination Test Result

Model Summary				
Model	R	R Square	Adjusted Square	R Std. Error of the Estimate
1	.852 ^a	.726	.679	.02437

a. Predictors: (Constant), DPS3, LR, CR, DPS1, DPS2

Based on Table 3, it can be observed that the coefficient of determination, indicated by the Adjusted R Square value, is 0.679. This means that the variables credit risk, liquidity risk, educational background of DPS, fiqh muamalah DPS background, and the number of DPS are able to explain 67.9% of the variation in sharia compliance. The remaining 32.1% is explained by other variables outside of those used in this study.

Results of Testing the Influence of Sharia Supervisory Board's Educational Background on Sharia Compliance

Based on the results above, it can be concluded that the educational background of the Sharia Supervisory Board has a positive and significant influence on Sharia compliance. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) plays a crucial role in developing accounting, auditing, and ethical standards for Sharia-based financial institutions, including those related to the Sharia Supervisory Board (DPS). The Sharia Supervisory Board (DPS) in Islamic banking companies aims to ensure that the company conducts its operational activities based on applicable Sharia principles. In this case, the Sharia Supervisory Board (DPS) is required to have a background that aligns with the operational activities of Islamic banking, including law and finance. The legal department owned by the Sharia Supervisory Board (DPS) is useful for a deep understanding of the

legality aspects of products and financial transactions to comply with Sharia principles (Albarrak and El-Halaby 2019). The Sharia Supervisory Board (DPS) can ensure that decisions and policies taken by banking companies comply with AAOIFI standards and do not violate Islamic legal principles. Legal understanding can also assist in monitoring and enforcing compliance with applicable Sharia regulations. Furthermore, the educational background of the Sharia Supervisory Board (DPS) in the financial field can provide expertise in financial and accounting aspects in the context of Islamic banking. DPS with a financial background can deeply understand Sharia-based financial instruments, principles of risk management, and other relevant financial aspects in accordance with AAOIFI standards. The combination of educational backgrounds in accordance with AAOIFI standards can help the Sharia Supervisory Board (DPS) to have effective supervision and assessment capabilities regarding the company's compliance with established Sharia principles (Albarrak and El-Halaby 2019). This can create an environment where company policies, products, and operations are more likely to comply with AAOIFI standards, strengthening the integrity and reputation of the company in the eyes of the Islamic financial community.

These research findings are consistent with Albarrak & El-Halaby (2019) and Oktafiani et al., (2022), which state that the educational background of the Sharia Supervisory Board (DPS) in the fields of law, finance, and accounting is considered more compliant with Sharia regulations and standards.

The Results of Testing the Influence of the Background in Fiqh Muamalah of Sharia Supervisory Board (DPS) Members on Sharia Compliance

Based on the results above, it can be concluded that the background of fiqh muamalah of the Sharia Supervisory Board (DPS) has a negative and significant influence on Sharia compliance. The Sharia Supervisory Board (DPS) in this study was found to have a negative influence on Sharia compliance, where the background of fiqh muamalah held by the Sharia Supervisory Board (DPS) tends to decrease the level of Sharia compliance of the company based on AAOIFI standards. The Sharia Supervisory Board (DPS) in this case may have limitations in practical expertise, where DPS with a background in fiqh muamalah may have a strong theoretical understanding but experience difficulties in effectively applying Sharia principles, especially those related to AAOIFI standards. The Sharia Supervisory Board (DPS) may also face challenges in aligning Sharia principles with developments and innovations in contemporary finance, resulting in a decrease in Sharia compliance. Additionally, low involvement in strategic decision-making of the company and lack of coordination with related departments such as finance, legal, and audit may also be factors affecting the role of the Sharia Supervisory Board (DPS) in Sharia compliance.

The Results of Testing the Influence of the Number of Sharia Supervisory Board (DPS) Members on Sharia Compliance

Based on the results above, it can be concluded that the number of DPS has a positive and significant influence on Sharia compliance. The presence of an adequate number of Sharia Supervisory Board (DPS) members in a company can contribute positively to the level of Sharia compliance. Having a relatively large number of Sharia Supervisory Board (DPS) members can benefit from the diversification of expertise and experience among DPS members. This is because DPS members with diverse educational backgrounds and experiences can provide a more comprehensive perspective on Sharia compliance aspects in

various business dimensions. Additionally, the presence of an adequate number of Sharia Supervisory Board (DPS) members can enhance the effectiveness of oversight over the implementation of Sharia principles. Each DPS member can focus on specific areas according to their expertise and experience, ensuring that all business aspects related to Sharia receive sufficient attention. Thus, an adequate number of Sharia Supervisory Board (DPS) members can create a stronger internal supervision system, enhance accountability, and ensure better compliance with Sharia principles.

The Results of Testing the Influence of Credit Risk on Sharia Compliance

Based on the results above, it can be concluded that credit risk has a negative and significant influence on Sharia compliance. When credit risk increases in Islamic banking institutions, there is a possibility that the level of Sharia compliance may decrease. An increase in credit risk often creates significant pressure and drives institutions to seek additional funding sources. In such situations, there is a potential for institutions to engage in financial transactions or instruments that are not in line with Sharia principles to meet urgent funding needs. Additionally, as credit risk increases, banking institutions may face a higher number of non-performing transactions. To manage this risk, institutions may tend to take steps that contradict Sharia principles, such as restructuring financing with mechanisms that may not fully comply with Sharia principles.

The Results of Testing the Influence of Liquidity Risk on Sharia Compliance

Based on the results above, it can be concluded that liquidity risk has a positive and significant influence on Sharia compliance. Islamic banking institutions facing liquidity risk tend to urge management to take proactive steps in line with Sharia principles, some of which include adopting the concepts of mudarabah (business partnership) and musyarakah (investment partnership) to seek additional funding. Mudarabah, in this case, can help institutions form partnerships with parties who have the potential to provide profits based on Sharia principles. Mudarabah involves the capital provider (shahibul mal) providing funds and the party in need of funds managing the capital (mudarib) and being responsible for operations and management. Mudarabah involves sharing risks and profits as determined in the initial agreement to create solutions that can mitigate liquidity risk without involving practices contrary to Islamic teachings. Meanwhile, through musyarakah, institutions can engage in investment partnerships with other parties, where capital and risks are shared proportionally according to the agreement, adopting principles of Islamic economics. Based on these explanations, it can be concluded that banks experiencing liquidity risk tend to have several proactive options that are not contrary to Sharia principles, allowing them to pursue projects or businesses that are not only financially profitable but also in line with Islamic values.

CONCLUSION

Based on the hypothesis testing results, this research has found several important findings related to the factors influencing Sharia compliance based on AAOIFI standards. First, the educational background of Sharia Supervisory Board (DPS) members has been proven to have a positive influence on the level of Sharia compliance. This indicates that a deep understanding of Sharia principles, supported by relevant educational backgrounds, can enhance compliance with AAOIFI standards. Second, the findings suggest that the fiqh muamalah background of DPS members has a significant negative impact on Sharia

compliance. Meanwhile, the research also found that the number of DPS members has a positive impact on Sharia compliance, highlighting the importance of having a sufficiently large team to ensure effective oversight of financial activities in accordance with Sharia principles. Furthermore, risk factors such as credit risk and liquidity risk have also been found to have a significant influence on Sharia compliance, with credit risk having a negative impact and liquidity risk having a positive impact. The most prominent result is that the relationship between the Sharia Supervisory Board and risk management simultaneously has a positive impact on the level of Sharia compliance, indicating the importance of close collaboration between these two entities in ensuring compliance with Sharia principles based on AAOIFI standards. Thus, these findings provide valuable insights for practitioners and regulators in enhancing Sharia compliance in Sharia-based financial institutions.

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