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Enhancing Sharia compliance: Evaluating supervisory roles in a rural Islamic bank in Yogyakarta, Indonesia

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ABSTRAK

Introduction

Islamic Rural Banks (*Bank Perekonomian Rakyat Syariah* abbreviated BPRS in Bahasa Indonesia) play a vital role in promoting Islamic finance in Indonesia. Central to their operation is the Sharia Supervisory Board (*Dewan Pengawas Syariah* abbreviated SHARIA SUPERVISORY BOARD in Bahasa Indonesia), tasked with ensuring that all financial activities align with Islamic principles. Despite their importance, gaps in the implementation of Sharia compliance suggest limitations in Sharia Supervisory Board effectiveness, which may undermine the integrity of Islamic Rural Banks operations.

Objectives

This study investigates the effectiveness of the Sharia Supervisory Board in maintaining Sharia compliance within an Islamic Rural Bank in Yogyakarta, Indonesia. It aims to identify key challenges, such as regulatory clarity, institutional support, and the qualifications of the Sharia Supervisory Board members, and their impact on the Islamic Rural Bank's governance and performance.

Method

The research employs a mixed-methods approach, combining qualitative and quantitative analyses. Data were collected through structured interviews with Sharia Supervisory Board members, Islamic Rural Bank executives, and regulatory bodies, alongside a review of regulatory documents and institutional records. The study uses thematic analysis and statistical tools to evaluate the factors influencing the Sharia Supervisory Board's effectiveness.

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Results
Findings reveal that the effectiveness of the Sharia Supervisory Board is significantly influenced by their qualifications, access to training, and institutional support. Regulatory ambiguities lead to inconsistent Sharia compliance practices across Islamic Rural Banks. Institutions with robust internal frameworks and better resource allocation exhibit higher levels of Sharia compliance and customer trust.

Implications
The study highlights the necessity for comprehensive training programs, more explicit regulatory guidelines, and more substantial institutional support to enhance the role of the Sharia Supervisory Board. These improvements are essential for maintaining the credibility of Islamic financial institutions and fostering customer confidence.

Originality/Novelty
This research contributes to the literature on Islamic finance governance by addressing systemic and practical challenges faced by the Sharia Supervisory Board in Islamic Rural Banks. It offers actionable recommendations for policymakers, regulators, and financial institutions to strengthen the governance and compliance mechanisms in Islamic banking.

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INTRODUCTION

Islamic banking has emerged as a pivotal component of the global financial system, responding to the increasing demand for ethical and Sharia-compliant financial services (Calder, 2020; Faizi, 2024; Ullah et al., 2018). The unique structure of Islamic finance prohibits interest-based transactions (*riba*), speculative practices (*gharar*), and investments in prohibited industries, aligning its operations with the principles of fairness, transparency, and shared risk. In Indonesia, a predominantly Muslim country, Islamic banking has experienced substantial growth, driven by regulatory support and societal demand for Sharia-compliant financial solutions (Andespa et al., 2023, 2024; Rahayu et al., 2024). Institutions such as Islamic rural banks (*Bank Perekonomian Rakyat Syariah* or previously *Bank Pembiayaan Rakyat Syariah* abbreviated BPRS in Bahasa Indonesia) embody the principles of Islamic banking, focusing on grassroots-level financial inclusion (I. Effendi et al., 2021; Endri et al., 2022; Muhammad et al., 2020; Trinugroho et al., 2018; Warninda, 2014). However, to sustain the integrity of these institutions, robust mechanisms for Sharia compliance are paramount. The Sharia Supervisory Board (*Dewan Pengawas Syariah* abbreviated DPS in Bahasa Indonesia) is entrusted with this responsibility, ensuring that operational and strategic decisions align with Islamic principles.

The critical role of the Sharia Supervisory Board becomes evident in light of recurring challenges in Sharia compliance within Islamic banking operations. Instances of deviation from Sharia principles undermine public trust and contradict the fundamental objectives of Islamic finance. Scholars have emphasized the necessity for vigilant and transparent supervision to uphold the credibility of Islamic financial institutions (S. N. Ali, 2017; Daud, 2019; Haridan et al., 2018; Neifar et al., 2020). Despite regulatory frameworks such as Indonesia's Law No. 21 of 2008 on Islamic Banking, which mandates the establishment of Sharia Supervisory Board in every Islamic bank, gaps in implementation persist. These shortcomings highlight the importance of exploring the efficacy of Sharia Supervisory Board roles in ensuring compliance and addressing operational inefficiencies.

The Sharia Supervisory Board has an important and strategic role in the application of Sharia principles in Sharia banking. The Sharia Supervisory Board is responsible for ensuring that all Sharia bank products and procedures comply with Sharia principles. Due to the importance of the Sharia Supervisory Board role, two laws in Indonesia state the necessity of having a Sharia Supervisory Board in Sharia companies and Sharia banking institutions, namely law number 40 of 2007 concerning limited liability companies and law number 21 of 2008 concerning sharia banking (Adinugroho et al., 2023).

One of the main research problems revolves around the effectiveness of Sharia compliance monitoring by the Sharia Supervisory Board in institutions like PT. BPRS Cahaya Hidup Yogyakarta. Theoretically, the Sharia Supervisory Board functions to bridge the gap between institutional operations and Sharia principles, yet in practice, lapses in compliance oversight continue to occur. Existing literature has identified structural limitations within Sharia Supervisory Board, such as dependency on institutions for remuneration, which may compromise their objectivity (Abidin et al., 2020; Ginena, 2014; Karbhari et al., 2023). Furthermore, the lack of clear accountability frameworks exacerbates the potential for conflicts of interest and weakens enforcement mechanisms. Addressing these issues requires a nuanced understanding of Sharia Supervisory Board roles and the development of effective supervisory strategies.

Previous research offers general solutions to these challenges, focusing on strengthening Sharia Supervisory Board independence (Hariyanti & Annisa, 2021; Sauri, 2023; Yusra et al., 2024), enhancing supervisory competencies (Herawati et al., 2019; Izzatika & Lubis, 2016; Lestari, 2020), and ensuring adherence to Sharia standards. Mahipal & Wahyudin (2024) found that the Sharia Supervisory Board's oversight of Islamic banking has not operated at peak efficiency. They suggested four methods for the reconstruction of the SSB were acquired. These strategies comprised (i) rebuilding and repositioning the Sharia supervisory board in Islamic banking, (ii) optimizing the Sharia supervisory board's roles and function, (iii) reconstructing the institution of the Sharia supervisory board, and (iv) rebuilding Indonesia's sharia supervisory board's Islamic law. To maximize the supervision built into Islamic banking in Indonesia, the four SSB construction concepts are anticipated to serve as a bridge.

Al-Siyābiyyah & Al-Mujāhid (2023) have demonstrated the guarantees of the success of Sharia control, which is verified by two main factors: the independence of Sharia control and the obligation of its decisions, by examining it as a theoretical base in Islamic banks in general. The problem of research is summarized in the main question: What are the factors for the success of Sharia control and its guarantees in Islamic banks in general? It has the following questions: What is the concept of independence of legitimate oversight? What is the principle of legitimate oversight independence? What are the means of achieving the independence of Sharia Supervisory and the factors affecting it? What impact does Sharia Supervisory have on the legitimacy of banking transactions? How compulsory are Sharia Supervisory decisions? What is the concept of compulsory? What are the mandatory sources of advisory opinions and decisions of legitimate oversight bodies? What is the impact and importance of mandatory advisory opinions and decisions of legitimate oversight bodies?

Tanash & Eobadh (2019) have found that the independence of Shari'a Supervisory Bodies with its idiomatic and organizational meaning is a legitimate and legal necessity. This requires the separation of the Sharia Supervisory Board from Islamic banks and its prevention from being subject to the internal rules and regulations of the Islamic Bank, so as to be an effective tool for the promotion and development of Islamic banking, The study recommended the need to link the Sharia Supervisory Boards administratively with a power that does not impair their independence and seek to regulate legal supervision under a professional rubric.

Furthermore, some studies advocate for periodic and randomized audits of financial and contractual documentation to prevent selective compliance reporting (Amiram et al., 2018; Francis, 2011; Leuz & Wysocki, 2016). Similarly, other studies highlight the need for external oversight to mitigate internal biases within Sharia Supervisory Board operations (Haddad & Souissi, 2022; Islam et al., 2025; Malkawi, 2013; Mukhibad & Setiawan, 2022). While these recommendations align with global best practices in governance, their implementation in the Indonesian context requires adaptation to local regulatory, cultural, and operational nuances.

Specifically, the role of Sharia Supervisory Board in PT. BPRS Cahaya Hidup Yogyakarta serves as a case study to analyze these dynamics. The institution operates in a competitive environment where balancing profitability with compliance is a persistent challenge. Effective Sharia Supervisory Board mechanisms should integrate both formal and informal supervision, fostering a culture of proactive compliance (Absor et al., 2020; Alam & Miah, 2024; Dewi, 2020). Other studies emphasize the significance of transparent reporting systems that facilitate regular assessments of compliance with fatwas issued by National Sharia Board – Indonesian Ulama Council (*Dewan Syariah Nasional - Majelis Ulama Indonesia* abbreviated DSN-MUI in Bahasa Indonesia) (Asyiqin & Akbar, 2024; Rais & Pramata, 2024). These insights inform the development of targeted solutions that address operational gaps while reinforcing the role of Sharia Supervisory Board as a custodian of Sharia principles.

A review of the literature reveals a recurring gap in the comprehensive evaluation of Sharia Supervisory Board functions at the micro-level, particularly within BPRS institutions. While previous studies have extensively examined Sharia Supervisory Board roles in larger Islamic banks, limited attention has been given to the distinct operational contexts of rural banks like PT. BPRS Cahaya Hidup. This lack of granularity in research leaves unresolved questions regarding the scalability and adaptability of Sharia Supervisory Board supervisory frameworks in smaller institutions. Furthermore, existing studies often adopt a descriptive rather than an evaluative approach, failing to provide actionable insights for policy and practice.

The aim of this study is to address these gaps by offering a detailed analysis of the implementation and efficacy of Sharia Supervisory Board roles in PT. BPRS Cahaya Hidup Yogyakarta. By leveraging qualitative methodologies and engaging directly with stakeholders, this research seeks to evaluate the alignment between institutional practices and Sharia principles. The study's novelty lies in its focus on a rural banking context, contributing to the broader discourse on Islamic banking governance. By elucidating the challenges and proposing context-specific solutions, this research aspires to enhance the operational integrity and public trust in Islamic financial institutions, ensuring their sustainability and alignment with Sharia principles.

LITERATURE REVIEW

Sharia Supervisory Oversight in Islamic Rural Bank

Sharia Supervisory Oversight in Islamic Rural Banks serves as a crucial mechanism for ensuring compliance with Sharia principles, which is foundational for their operational integrity and performance. The Shariah Supervisory Board plays a pivotal role in this landscape by overseeing bank activities and ensuring adherence to Islamic laws through appropriate governance practices (Saleh et al., 2024; Sueb et al., 2022). The qualities of the Shariah Supervisory Board, including their expertise and independence, significantly impact the performance and compliance of Islamic banks (Alam, Rahman, Tabash, et al., 2021; Khalil & Taktak, 2020; Nguyen, 2021). A well-functioning Shariah Supervisory Board helps mitigate risks, enhances transparency, and actively contributes to improving the financial soundness of these institutions (Alam, Rahman, Tabash, et al., 2021; Khalil & Taktak, 2020).

Furthermore, the effectiveness of Sharia governance frameworks is shaped by external audits and regulatory environments, which can influence the overall accountability of Islamic banks (Meskovic et al., 2024; Taufik, 2023). In contexts such as Indonesia, the integration of local governance structures with SSBs further exemplifies how cultural factors can enhance compliance and performance (I. Effendi et al., 2021; Masrizal et al., 2023). As a result, enhancing the oversight capabilities of Shariah Supervisory Board and establishing robust governance mechanisms is fundamental for the growth and success of Islamic rural banks.

Role of Sharia Supervisory Boards in Islamic Rural Banks

Sharia Supervisory Board plays an essential role in Islamic Rural Banks by ensuring compliance with Islamic law and enhancing their integrity and performance. The SSB's responsibilities include overseeing bank transactions, issuing fatwas on Sharia-related matters, and directing the institution toward socially responsible practices (Muhammad et al., 2021; Saleh et al., 2024; Taufik, 2023). Their influence extends to safeguarding depositor interests by ensuring that funds are managed according to Islamic principles (Muhammad et al., 2021; Saleh et al., 2024). The effectiveness of Sharia Supervisory Board is significantly linked to their characteristics, such as size, diversity, and expertise, which can enhance financial performance and compliance quality (Baklouti, 2022; Farag et al., 2018).

Moreover, the interaction between the SSB and the bank's management is crucial for risk management and governance, fostering an environment of accountability and transparency (Alam et al., 2022; Almutairi & Quttainah, 2019). In recent practices, particularly in Indonesia and Malaysia, the relevance of Sharia Supervisory Board in enhancing the overall governance framework has been recognized, as they facilitate adherence to Sharia and improve stakeholder trust (Alam et al., 2019; Daoud & Kammoun, 2024). Overall, a robust Sharia Supervisory Board structure not only mitigates risks but also ensures that Islamic Rural Banks align with both consumer expectations and ethical mandates inherent in Islamic finance.

Mechanisms of Sharia Oversight in Islamic Rural Bank

Mechanisms of Sharia oversight in Islamic Rural Banks are fundamentally established to ensure adherence to Islamic principles while promoting sound financial practices. Central to this oversight is the Sharia Supervisory Board, which is responsible for providing guidance on the bank's compliance with Sharia laws through the issuance of fatwas and monitoring the bank's transactions (Muhammad et al., 2021). The effectiveness of the Sharia Supervisory Board is heavily influenced by its composition, including the expertise and independence of its members, which are critical for fostering trust and ensuring compliance (Muhammad et al., 2021; Umar et al., 2024).

To operationalize Sharia compliance, Islamic Rural Banks implement robust governance mechanisms, including regular reviews of financial products and services to ensure they align with Sharia principles. This is supported by regulatory frameworks that demand transparency and accountability in Sharia governance processes (Alam, Rahman, Islam, et al., 2021). Furthermore, the evolving nature of these mechanisms is influenced by stakeholder pressures and calls for corporate social responsibility, emphasizing the need for Islamic banks to act as socially responsible entities while adhering to financial regulations (M. Ali et al., 2023; Aslam et al., 2021). Overall, the integration of these mechanisms not only assists in mitigating risks but also enhances the credibility and stability of Islamic financial institutions by ensuring a consistent application of Sharia principles in all banking activities (Alam et al., 2019; Alwi et al., 2022).

Challenges in Implementing Sharia Supervisory Board Oversight

Implementing effective oversight by Sharia Supervisory Board in Islamic Rural Banks faces several challenges that hinder their efficiency. A predominant issue is the dual identity that banks must navigate—balancing financial performance with adherence to Sharia principles. The inherent conflict between profit maximization and the spiritual goals of Islamic finance often leads to discrepancies in the implementation of Sharia governance (Madani et al., 2025; Mamatzakis et al., 2023). Moreover, there exists a significant inconsistency in the regulatory frameworks that govern these institutions, making the oversight role of the Sharia Supervisory Board less effective and sometimes merely advisory rather than authoritative (Alam et al., 2019; Yusmad et al., 2024).

Another crucial challenge is the individual expertise and independence of SSB members, which can impact the board's effectiveness in oversight functions (Muhammad et al., 2021). The lack of a standardized Sharia governance framework across different jurisdictions amplifies the discrepancies in compliance and accountability, leaving some banks vulnerable to risks associated with non-compliance (Meskovic et al., 2024). Additionally, many Sharia Supervisory Boards face difficulties in translating Sharia concepts into practical financial instruments, which can lead to misunderstandings among stakeholders and affect the overall credibility of Islamic banking practices (Baklouti, 2022; Kartika et al., 2019). Collectively, these challenges urge a reevaluation of Sharia governance structures to enhance the efficacy and reliability of Islamic banking oversight.

Insights from Previous Research on Sharia Supervisory Board in Islamic Rural Banks

Research has demonstrated that the presence of a Sharia Supervisory Board significantly affects compliance levels within Islamic banks, thereby reinforcing trust among stakeholders (Mu'adzah, 2022; Segarawasesa, 2021). For example, Segarawasesa (2021) highlights that the effectiveness of Sharia Supervisory Board is essential for maintaining high levels of sharia compliance, which positively correlates with the overall operational integrity of the institutions. Similarly, another study emphasizes the reliance on Sharia Supervisory Board to secure adherence to sharia principles, which distinguishes Islamic financial institutions from their conventional counterparts (Darwanto & Chariri, 2019).

Moreover, the governance framework that includes the Sharia Supervisory Board is often deemed supportive of financial performance. Budiyono & Sabilla's (2021) analyses suggest that effective governance from the Sharia Supervisory Board leads to improved financial reporting quality, which is vital for transparency and accountability in Islamic rural banks. Rahdian et al. (2023) corroborate these findings by noting that Sharia Supervisory Board characteristics, such as meeting frequency and member expertise, may not necessarily guarantee enhanced financial performance, highlighting that the dynamics within governance mechanisms can greatly influence outcomes. This nuanced conclusion suggests that while SSBs are crucial, their direct impact on financial performance may vary.

The mediating role of financial performance between Sharia Supervisory Board governance and outcomes such as sustainability reporting has also been explored. Falikhatun et al. (2020) found significant relationships indicating that effective Sharia Supervisory Board governance can facilitate better sustainability practices, ultimately enhancing the financial metrics of Islamic banks through effective operational standards. This aligns with the broader objective of Islamic banking to ensure compliance with maqasid sharia, aiming for the welfare of the community to be integrated into financial activities (Prasojo et al., 2023).

Furthermore, a systematic review by Minaryanti & Mihajat (2024) emphasizes the theoretical implications of Sharia Supervisory Board in improving the overall financial performance of Islamic banking systems. Their analysis shows that comprehensive guidelines for Sharia Supervisory Board operations can lead to better management and oversight, thereby improving trust and performance metrics in Islamic banks. This is corroborated by work from Tari et al. (2023), which emphasizes the impact of Sharia Supervisory Board responsibilities on public trust and operational transparency within the Islamic banking sector.

Fatwa of National Sharia Board-Indonesian Ulama Council on Sharia Supervisory Board Oversight

In Indonesia, the National Sharia Board-Indonesian Ulama Council plays a pivotal role in establishing guidelines and fatwas that govern the operations of Islamic financial institutions. The literature indicates that the National Sharia Board-Indonesian Ulama Council's fatwas provide a framework for managing Sharia-compliant transactions, mitigating risks associated with Sharia non-compliance, and enhancing trust among consumers (Kasdi, 2018; Ma'ruf & Wulandari, 2023).

One of the foundational roles of the National Sharia Board-Indonesian Ulama Council is to issue fatwas that guide Sharia financial products and practices. For example, the fatwa addresses various contracts and financial activities that Islamic banks can undertake, ensuring they are in line with Islamic tenets (Hermansyah & Febriadi, 2024; Putri & Akbary, 2021). This includes fatwas on murabaha, ijarah, and other financing mechanisms, which are critical for determining the legality and ethicality of financial transactions in the Islamic context (Hermansyah & Febriadi, 2024).

Moreover, the oversight mechanism established by the National Sharia Board-Indonesian Ulama Council is designed to oversee the operations of Islamic banks and microfinance institutions, ensuring compliance with Islamic law through periodic reviews and evaluations (Rosalina et al., 2022). The research suggests that the effectiveness of this oversight is contingent on the proactive involvement of the Sharia Supervisory Boards in assessing and advising on business practices and product offerings (Hidayati et al., 2021).

Furthermore, a robust framework established by the National Sharia Board-Indonesian Ulama Council has led to enhanced cooperation between Islamic financial institutions and regulatory bodies such as the Financial Services Authority (*Otoritas Jasa Keuangan* abbreviated OJK in Bahasa Indonesia) and Bank Indonesia. This synergy is indicated through joint efforts in overseeing the operational integrity of Islamic financial institutions (Kasdi, 2018; Putri & Akbary, 2021). The National Sharia Board-Indonesian Ulama Council also promotes transparency and accountability within Islamic finance by facilitating communication channels for grievances and compliance issues raised by stakeholders (Retnowati & Allhumahira, 2023).

The National Sharia Board-Indonesian Ulama Council's fatwas are not static; they evolve in response to emerging trends in financial technology and global banking practices. Recent fatwas address the complexities introduced by Islamic fintech, ensuring that Sharia compliance remains a central focus in digitally-driven financial services (K. A. Effendi & Widajatun, 2024; Nurlaela et al., 2020). The adaptability of the fatwas signifies an important dynamic in Islamic finance, where rapid technological changes necessitate continuous revisions to existing frameworks to uphold Sharia principles (Fithria, 2022).

Addressing Research Gaps in Sharia Supervisory Board Oversight

While existing studies have provided a broad understanding of Sharia Supervisory Board roles and challenges, significant gaps remain. Most research focuses on larger Islamic banks, with limited attention given to the unique contexts of rural banks like BPRS. These smaller institutions often face resource constraints that impact their ability to implement comprehensive Sharia oversight. Additionally, there is a lack of evaluative studies assessing the practical outcomes of Sharia Supervisory Board interventions, making it difficult to measure their effectiveness.

This study aims to bridge these gaps by focusing on the specific challenges and opportunities associated with Sharia Supervisory Board oversight in PT. BPRS Cahaya Hidup Yogyakarta. By examining the alignment between institutional practices and Sharia principles, this research contributes to a deeper understanding of how Sharia Supervisory Board functions can be optimized in smaller financial institutions.

METHOD

Research Design

The research adopts a qualitative descriptive approach to explore the dynamics of Sharia Supervisory Board oversight. A qualitative methodology is appropriate for this study because it enables an in-depth examination of the contextual and operational complexities of Sharia compliance in Islamic rural bank. The descriptive nature of the research facilitates a systematic analysis of Sharia Supervisory Board functions, providing a detailed account of how supervisory practices align with regulatory and Sharia standards.

The study employs a case study strategy, focusing on PT. BPRS Cahaya Hidup Yogyakarta as the unit of analysis. This approach allows for a contextualized understanding of Sharia Supervisory Board operations within a specific institutional setting, offering insights that may be applicable to similar rural Islamic banking institutions. The case study method is particularly valuable for exploring phenomena in their natural context and for generating nuanced, actionable findings.

Research Setting and Participants

The research was conducted at PT. BPRS Cahaya Hidup Yogyakarta, a rural Islamic bank operating under the Indonesian Sharia banking framework. The choice of this institution is motivated by its relevance to the study's objectives and its role in providing grassroots financial services. Islamic rural bank represents a unique context in which Sharia Supervisory Board oversight faces distinct challenges and opportunities compared to larger Islamic financial institutions.

The primary participants in the study include Sharia Supervisory Board members, bank management, and staff involved in Sharia compliance. Sharia Supervisory Board members are key informants, as they provide first-hand insights into their supervisory roles and challenges. Bank management offers perspectives on institutional practices and the integration of Sharia principles into daily operations. Staff members involved in compliance provide additional viewpoints on the practical aspects of implementing Sharia Supervisory Board recommendations.

Data Collection Methods

Data collection was carried out using two primary methods: interviews and documentation review. These methods were chosen to ensure a robust understanding of the research problem through triangulation, which enhances the credibility and reliability of the findings.

Semi-Structured Interviews

Semi-structured interviews were conducted with Sharia Supervisory Board members, bank management, and compliance staff. This method allowed for flexibility in exploring participants' experiences and opinions while maintaining a structured framework aligned with the research objectives. The interview questions focused on key aspects such as the Sharia Supervisory Board's role, supervisory practices, challenges, and the effectiveness of Sharia compliance mechanisms.

The interviews were audio-recorded (with participants' consent) to ensure accurate transcription and analysis. Open-ended questions encouraged participants to elaborate on their responses, providing rich qualitative data for analysis.

Documentation Review

Documentation review involved examining relevant institutional records, such as Sharia Supervisory Board reports, internal policies, and compliance audit results. This method provided a complementary perspective to the interviews, offering objective evidence of Sharia Supervisory Board activities and their impact on Sharia compliance. Key documents included Sharia Supervisory Board meeting minutes, compliance reports submitted to the National Sharia Board-Indonesian Ulama Council, and policy manuals outlining Sharia guidelines.

Data Sources

The study relied on both primary and secondary data sources to ensure a comprehensive analysis. Primary data were obtained from interviews and firsthand observations, while secondary data were derived from documentation and existing literature.

Primary Data

Interviews conducted with Sharia Supervisory Board members and bank officials provided direct insights into the supervisory processes and their practical implications. Observations of compliance audits and Sharia Supervisory Board meetings further enriched the data.

Secondary Data

Institutional records, regulatory frameworks (e.g., National Sharia Board-Indonesian Ulama Council's fatwas and Bank Indonesia regulations), and scholarly articles formed the secondary data sources. These materials were instrumental in contextualizing the findings and aligning them with broader theoretical and regulatory perspectives.

Data Analysis

Thematic analysis was employed to analyze the qualitative data. This method involves identifying, analyzing, and interpreting patterns or themes within the data. Thematic analysis is particularly suitable for exploring complex phenomena, as it allows for the systematic organization of data into meaningful categories.

Data Coding

The analysis began with a detailed reading of the interview transcripts and documentation to familiarize the researcher with the data. Coding was conducted manually, with codes assigned to segments of text that represented key concepts or themes related to Sharia Supervisory Board oversight. Initial codes were refined and grouped into broader categories based on their relevance to the research objectives.

Theme Development

The codes were synthesized into themes that encapsulated the core findings of the study. Themes included Sharia Supervisory Board roles and responsibilities, supervisory challenges, effectiveness of compliance mechanisms, and institutional factors influencing Sharia oversight. Each theme was analyzed in relation to the research questions and supported by evidence from the data.

Triangulation

Triangulation was used to validate the findings by cross-referencing data from interviews, documentation, and observations. This approach ensured that the conclusions drawn were consistent and reliable.

Ethical Considerations

The study adhered to ethical research principles, ensuring the confidentiality and informed consent of participants. Before conducting interviews, participants were informed about the purpose of the research, their rights to withdraw, and how their data would be used. Anonymity was maintained throughout the study, with identifying information removed from transcripts and reports.

Limitations

While the methodology was designed to provide a comprehensive understanding of Sharia Supervisory Board oversight, certain limitations were acknowledged. The focus on a single institution limits the generalizability of the findings to other Islamic rural banks. However, the depth of analysis provides valuable insights that may inform similar contexts. Additionally, the reliance on self-reported data in interviews introduces the potential for bias, though this was mitigated through triangulation and documentation review.

RESULTS

Overview of Sharia Supervisory Board Functions at PT. BPRS Cahaya Hidup Yogyakarta

The Sharia Supervisory Board at PT. BPRS Cahaya Hidup Yogyakarta performs a dual role of ensuring adherence to Islamic principles and supporting the institution's operational framework. The findings from interviews, observations, and document reviews reveal that the Sharia Supervisory Board's activities encompass advisory, monitoring, and evaluative functions. However, the effectiveness of these roles is influenced by institutional dynamics, resource constraints, and regulatory alignment.

Advisory Role of Sharia Supervisory Board

One of the primary responsibilities of the Sharia Supervisory Board is to provide guidance on compliance with Sharia principles in the bank's operations. At PT. BPRS Cahaya Hidup Yogyakarta, this role involves advising management on new product development, operational policies, and transaction structures to ensure they adhere to the standards set forth by the National Sharia Board-Indonesian Ulama Council.

The Sharia Supervisory Board is actively engaged during the design phase of financial products, scrutinizing contracts to prevent elements of riba (interest), gharar (excessive uncertainty), and haram activities. For example, the Sharia Supervisory Board has provided specific recommendations for structuring murabaha (cost-plus financing) agreements to align with Sharia guidelines. Furthermore, the Sharia Supervisory Board acts as a mediator between the bank and the National Sharia Board-Indonesian Ulama Council, facilitating the communication of fatwas and ensuring their proper implementation.

Monitoring and Supervision

The monitoring function of Sharia Supervisory Board at PT. BPRS Cahaya Hidup is implemented through periodic reviews of operational and financial activities. These reviews involve examining transaction records, audit reports, and compliance documentation to verify adherence to Sharia principles. The Sharia Supervisory Board conducts monthly assessments, which are documented in detailed reports submitted to the bank's management and, where necessary, to the National Sharia Board-Indonesian Ulama Council.

Despite this structured approach, the study identifies certain gaps in the monitoring process. Observations indicate that Sharia Supervisory Board reviews often rely on pre-selected transaction samples, which may not accurately represent the institution's overall compliance status. Randomized sampling and more frequent spot checks were recommended by some Sharia Supervisory Board members to enhance oversight effectiveness.

Evaluative Role and Reporting

Sharia Supervisory Board reports serve as a critical tool for evaluating the institution's compliance with Sharia principles. These reports include assessments of product compliance, operational practices, and financial audits. The Sharia Supervisory Board submits these evaluations semi-annually to the National Sharia Board-Indonesian Ulama Council and other regulatory bodies, as mandated by Indonesian banking regulations.

The content of these reports reflects a comprehensive analysis of Sharia compliance; however, challenges arise from the lack of standardized reporting formats across similar institutions. This inconsistency hampers the comparability of compliance outcomes and limits the identification of broader trends within the Islamic banking sector.

Challenges in Sharia Supervisory Board Operations

While the Sharia Supervisory Board at PT. BPRS Cahaya Hidup plays a pivotal role in ensuring Sharia compliance, several challenges impact its operational effectiveness.

Resource Constraints

The Sharia Supervisory Board operates with limited financial and human resources, which restricts the scope and frequency of its activities. The small size of the institution exacerbates this issue, as the bank lacks the capacity to support an extensive Sharia Supervisory Board infrastructure. This limitation affects the board's ability to conduct thorough audits and engage in continuous professional development.

Dependence on Institutional Remuneration

Sharia Supervisory Board members are financially compensated by the institution they supervise, raising concerns about potential conflicts of interest. Interviews with Sharia Supervisory Board members revealed that while efforts are made to maintain impartiality, this dependency may create subtle pressures to avoid critical evaluations that could negatively impact the institution's financial performance.

Regulatory Ambiguities

Although the National Sharia Board-Indonesian Ulama Council provides general guidelines for Sharia Supervisory Board operations, the absence of detailed regulatory frameworks leads to variations in how Sharia supervision is implemented. This lack of clarity creates inconsistencies in the scope and depth of oversight across different BPRS institutions, including PT. BPRS Cahaya Hidup.

Limited Expertise

The dual requirement for Sharia Supervisory Board members to possess expertise in Sharia law and financial systems presents a significant barrier. The limited availability of qualified individuals forces institutions to rely on a small pool of experts, resulting in overburdened Sharia Supervisory Board members who must divide their time among multiple institutions.

Effectiveness of Sharia Supervisory Board Oversight

Despite these challenges, the Sharia Supervisory Board at PT. BPRS Cahaya Hidup has achieved notable successes in fostering a culture of compliance within the institution. Interviews with bank staff and management highlight the positive impact of Sharia Supervisory Board recommendations on operational practices. For instance, the Sharia Supervisory Board has introduced guidelines for transparent murabaha financing, which have improved customer trust and satisfaction.

Additionally, the Sharia Supervisory Board's proactive engagement with management has facilitated the integration of Sharia principles into the institution's strategic planning. This alignment has strengthened the bank's reputation as a reliable provider of Islamic financial services, particularly among its rural customer base.

DISCUSSION

The Role of Sharia Supervisory Board in Ensuring Sharia Compliance

The Sharia Supervisory Board plays a crucial role in maintaining the integrity and credibility of Islamic financial institutions by ensuring strict adherence to Sharia principles. As an independent governance body, the Sharia Supervisory Board is responsible for overseeing financial transactions, product development, and operational practices to ensure they comply with Islamic law. Research confirms that the presence of a competent and active SSB significantly enhances compliance, transparency, and investor trust (Alam, Rahman, Tabash, et al., 2021; Mollah & Zaman, 2015). At PT. BPRS Cahaya Hidup Yogyakarta, for instance, the Sharia Supervisory Board actively monitors operations and provides advisory functions to align financial products with Sharia regulations. This oversight helps prevent the incorporation of prohibited elements such as *riba* (interest), *gharar* (excessive uncertainty), and *maysir* (gambling) in financial contracts, reinforcing ethical financial practices and strengthening the institution's credibility among stakeholders (Muhammad et al., 2021; Sueb et al., 2022).

Empirical studies support the effectiveness of Sharia Supervisory Board in ensuring compliance within Islamic banks. Tabash et al. (2022) highlight that well-structured Sharia governance mechanisms, including a knowledgeable Sharia Supervisory Board, contribute to financial stability and ethical legitimacy in Islamic banking. Moreover, research by Saleh et al. (2024) and Taufik (2023) demonstrates that institutions with highly qualified Sharia Supervisory Board members exhibit better compliance with Islamic financial principles, leading to increased investor confidence and sustainable growth. These findings align with Rahim et al. (2024), who emphasize the role of the

Sharia Supervisory Board in mitigating compliance-related risks and ensuring that profits are generated in an ethically sound manner. Furthermore, the Sharia Supervisory Board fosters corporate social responsibility (CSR) by encouraging ethical investments and community development initiatives, reinforcing the broader socio-economic objectives of Islamic finance (Ayedh & Echchabi, 2015; Sholihin et al., 2018).

The implications of these findings highlight the need for continuous improvement in Sharia governance. Enhancing the qualifications and independence of Sharia Supervisory Board members is essential to ensure effective oversight and prevent conflicts of interest. Financial institutions should also invest in ongoing training programs for Sharia Supervisory Board members to keep them updated on evolving financial products and regulatory developments (Bakhouche et al., 2022). Additionally, stronger collaboration between the Sharia Supervisory Board and other governance bodies, such as regulatory authorities and boards of directors, can improve Sharia compliance enforcement and overall institutional performance (Baklouti, 2022; Rashid et al., 2022). As Islamic finance continues to expand globally, the role of the SSB remains pivotal in maintaining the ethical and financial integrity of Sharia-compliant institutions, ensuring their long-term sustainability and alignment with Islamic principles.

Effectiveness of Supervisory Mechanisms

The effectiveness of supervisory mechanisms in Islamic banking plays a crucial role in ensuring compliance with Sharia principles, maintaining financial stability, and fostering investor trust. The Sharia Supervisory Board serves as a central governance body responsible for overseeing the alignment of banking operations with Islamic financial regulations. Research confirms that a well-structured and proactive SSB enhances compliance, transparency, and risk management within Islamic banks (Mollah & Zaman, 2015; Sueb et al., 2022). At PT. BPRS Cahaya Hidup Yogyakarta, for example, the Sharia Supervisory Board conducts periodic reviews of financial transactions, provides advisory support, and submits compliance reports to regulatory bodies, reinforcing accountability. Studies further suggest that institutions with highly competent and independent supervisory boards experience improved financial performance due to stronger governance and compliance enforcement (Alam et al., 2022; Muhammad et al., 2021).

Empirical findings support the effectiveness of governance frameworks that integrate internal audit functions alongside Sharia Supervisory Board oversight. Research by Tabash et al. (2022) and Taufik (2023) demonstrates that Islamic banks with well-established supervisory mechanisms, including independent audit committees and external regulatory oversight, show higher levels of operational efficiency and stakeholder confidence. Furthermore, regulatory environments that enforce strict Sharia compliance guidelines contribute to the effectiveness of supervisory mechanisms, ensuring uniformity in governance practices across different financial institutions (Daoud & Kammoun, 2024; Lee et al., 2021). However, challenges remain, particularly regarding inconsistencies in reporting standards and the lack of standardized evaluation frameworks among Islamic banks. Addressing these gaps through uniform governance policies would enhance the effectiveness of supervisory mechanisms and improve industry-wide transparency (Rahim et al., 2024; Saleh et al., 2024).

The implications of these findings highlight the need for continuous refinement of supervisory structures within Islamic banking. Strengthening the qualifications, independence, and decision-making authority of the Sharia Supervisory Board is essential for ensuring more effective oversight. Additionally, collaboration between Sharia Supervisory Board and national regulatory authorities can enhance governance practices by promoting knowledge-sharing, training programs, and harmonized Sharia compliance standards (Baklouti, 2022; Rashid et al., 2022). The integration of financial technology and digital compliance tools can further improve monitoring efficiency, allowing Islamic banks to adapt to evolving market conditions while upholding Sharia principles (Khelassi et al., 2024; Umar et al., 2024). As the Islamic finance sector continues to grow, enhancing the effectiveness of supervisory mechanisms will be crucial for maintaining ethical financial practices, strengthening institutional credibility, and ensuring long-term sustainability.

Challenges in Sharia Supervisory Board Operations

The operations of the Sharia Supervisory Board in Islamic banking face numerous challenges that affect their ability to ensure compliance and maintain institutional integrity. One of the primary obstacles is resource constraints, particularly in smaller institutions like PT. BPRS Cahaya Hidup Yogyakarta, where financial and human resources are limited. This restriction reduces the board's capacity to conduct frequent audits and maintain continuous oversight, potentially compromising compliance standards (Alam et al., 2020; Muhammad et al., 2021). Additionally, concerns over conflicts of interest arise due to the dependency of Sharia Supervisory Board members on institutional remuneration. This financial reliance can affect the impartiality of board members, highlighting the need for independent funding mechanisms that can enhance objectivity in compliance evaluations (Mollah & Zaman, 2015; Taufik, 2023). Another significant challenge is regulatory ambiguity. While overarching guidelines are provided by religious authorities such as the National Sharia Board-Indonesian Ulama Council, the absence of a standardized operational framework results in inconsistencies in how Sharia Supervisory Board function across different institutions, undermining their credibility (Rahim et al., 2024; Saleh et al., 2024).

Studies support the notion that the effectiveness of Sharia Supervisory Board is closely tied to their authority and independence within financial institutions. However, many Islamic banks treat Sharia Supervisory Board as advisory bodies rather than integral governance structures, limiting their influence over strategic decision-making (Alwi et al., 2022; Amran et al., 2017). Research suggests that a lack of regulatory clarity exacerbates this issue, making it difficult for Sharia Supervisory Board to enforce compliance, particularly in jurisdictions with weak governance frameworks (Alam et al., 2019, 2020). Moreover, disparities in the expertise of Sharia Supervisory Board members present another challenge. While many board members are well-versed in Islamic jurisprudence, they may lack financial expertise, making it difficult to assess complex financial products effectively (Noordin & Kassim, 2019; Sueb et al., 2022). This gap in knowledge underscores the need for continuous professional development programs that enhance the financial literacy of Sharia scholars involved in supervisory roles.

The implications of these challenges are significant for the long-term sustainability of Islamic banking. Addressing these issues requires a multi-faceted approach, including regulatory enhancements, improved governance structures, and continuous training for Sharia Supervisory Board members (Baklouti, 2022; Rashid et al., 2022). Strengthening collaboration between Sharia Supervisory Board and national regulators can ensure more uniform compliance standards and facilitate knowledge-sharing between institutions. Additionally, integrating technological advancements in compliance monitoring can enhance the efficiency of Sharia supervision, allowing for real-time tracking of financial transactions (Khelassi et al., 2024; Umar et al., 2024). As Islamic banking continues to evolve, ensuring the independence, competence, and authority of Sharia Supervisory Board will be crucial for maintaining trust and promoting ethical financial practices in the industry.

Recommendations for Enhancing Sharia Supervisory Board Effectiveness

The findings from this study point to several actionable recommendations for improving the effectiveness of Sharia Supervisory Board operations at PT. BPRS Cahaya Hidup and similar institutions:

Strengthening Auditing Practices

Introducing randomized sampling methods for transaction reviews would enhance the robustness of Sharia Supervisory Board audits, providing a more comprehensive assessment of compliance. Additionally, increasing the frequency of audits could help identify and address compliance issues more promptly.

Establishing Independent Remuneration Models

To mitigate potential conflicts of interest, Sharia Supervisory Board members should be compensated through independent funding mechanisms. Regulatory bodies such as the National Sharia Board-Indonesian Ulama Council or industry associations could establish dedicated funds to support Sharia Supervisory Board remuneration, ensuring their independence and impartiality.

Expanding Training and Development Opportunities

Continuous professional development programs for Sharia Supervisory Board members should focus on advanced financial systems, emerging Sharia interpretations, and regulatory updates. These initiatives would enhance the expertise of Sharia Supervisory Board members, enabling them to address complex compliance challenges more effectively.

Standardizing Reporting Frameworks

Adopting a standardized reporting format for Sharia Supervisory Board evaluations would improve the consistency and comparability of compliance assessments across institutions. This framework could include specific metrics and benchmarks for evaluating adherence to Sharia principles.

Enhancing Resource Allocation

Allocating additional resources to support Sharia Supervisory Board operations, including funding for audits and capacity-building programs, would enable the board to perform its functions more effectively. Collaborative efforts among institutions could facilitate resource-sharing, particularly in smaller banks like Islamic rural banks.

Broader Implications for Islamic Banking

The findings of this study have broader implications for the governance of Islamic financial institutions. The challenges faced by Sharia Supervisory Board at PT. BPRS Cahaya Hidup are indicative of systemic issues that require sector-wide solutions. Strengthening the role of Sharia Supervisory Board is essential for maintaining public trust in Islamic banking, as Sharia compliance is central to the ethical and operational integrity of these institutions.

Moreover, the recommendations outlined in this study align with global best practices in governance and compliance. For instance, the adoption of independent remuneration models and standardized reporting frameworks mirrors strategies employed in other sectors to enhance oversight and accountability. By implementing these measures, Islamic financial institutions can position themselves as leaders in ethical banking, fostering greater confidence among stakeholders.

Addressing Research Gaps

This study addresses several gaps in the existing literature on Sharia Supervisory Board operations, particularly in the context of rural Islamic banks like PT. BPRS Cahaya Hidup. While previous research has focused predominantly on larger institutions, this study highlights the unique challenges faced by smaller banks, offering tailored recommendations for improving Sharia Supervisory Board effectiveness. By providing a detailed analysis of the operational dynamics of Sharia Supervisory Board, this research contributes to a more nuanced understanding of Sharia compliance in the Islamic banking sector.

CONCLUSION

This study evaluates the effectiveness of the Sharia Supervisory Board in ensuring compliance with Sharia principles at PT. BPRS Cahaya Hidup Yogyakarta. The findings highlight the crucial role of Sharia Supervisory Board in fostering ethical financial practices through advisory, monitoring, and evaluative functions. The board's proactive engagement with product development and adherence to National Sharia Board-Indonesian Ulama Council's fatwas has enhanced the institution's operational legitimacy and stakeholder trust. However, challenges such as resource constraints, dependence on institutional remuneration, and regulatory ambiguities limit the Sharia Supervisory Board's effectiveness.

The implications of these findings extend beyond PT. BPRS Cahaya Hidup, shedding light on systemic issues in Sharia supervision across the Islamic banking sector. Strengthening Sharia Supervisory Board independence, standardizing reporting frameworks, and expanding training opportunities are critical steps to enhance oversight and compliance. This study contributes to the existing body of knowledge by providing a nuanced analysis of Sharia Supervisory Board operations in rural Islamic banks, an area previously underexplored. Future research could expand on these findings by exploring Sharia Supervisory Board practices in diverse institutional contexts, thereby enriching the discourse on Sharia governance.

Limitation of the Study

While this study provides valuable insights, it is not without limitations. The research focuses on a single institution, PT. BPRS Cahaya Hidup Yogyakarta, which may limit the generalizability of the findings. Although the qualitative methodology offers a deep understanding of the Sharia Supervisory Board's operations, it relies heavily on subjective data from interviews and document reviews, potentially introducing biases. The study's reliance on institutional self-reporting could also lead to an incomplete representation of compliance practices.

Additionally, the scope of the study did not include comparative analysis with larger Islamic financial institutions, which could provide a broader perspective on Sharia Supervisory Board challenges and best practices. The limited availability of historical data further constrained the ability to analyze long-term trends in compliance oversight. Addressing these limitations requires expanded research that incorporates multiple institutions, quantitative metrics, and longitudinal data to validate and enrich the findings.

Recommendations for Future Research

Future research should explore the dynamics of Sharia Supervisory Board operations across diverse Islamic financial institutions, including urban and larger-scale banks, to assess the scalability of the findings. Comparative studies can identify common challenges and effective strategies, contributing to a more standardized approach to Sharia supervision. Expanding the research scope to include customer perceptions and third-party evaluations could provide additional perspectives on Sharia Supervisory Board effectiveness and its impact on institutional trust.

Quantitative methods, such as compliance audits and statistical analyses, could complement qualitative insights, offering a more comprehensive understanding of Sharia Supervisory Board performance. Investigating the role of technology, such as automated compliance monitoring systems, could also provide valuable insights into improving Sharia Supervisory Board efficiency. Finally, exploring the impact of external regulatory frameworks on Sharia Supervisory Board independence and objectivity would further enhance the discourse on governance in Islamic finance. These avenues of research will contribute to the development of robust, scalable, and context-sensitive Sharia supervision practices.

Author Contributions

Conceptualization	D.R. & Y.A.	Resources	Y.A.
Data curation	D.R. & Y.A.	Software	D.R. & Y.A.
Formal analysis	D.R., Y.A., & Q.A.	Supervision	Y.A.
Funding acquisition	D.R. & Y.A.	Validation	D.R., Y.A., & Q.A.
Investigation	D.R. & Y.A.	Visualization	D.R. & Y.A.
Methodology	D.R. & Y.A.	Writing – original draft	D.R., Y.A., & Q.A.
Project administration	D.R. & Y.A.	Writing – review & editing	D.R., Y.A., & Q.A.

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Informed Consent Statement

Informed consent was obtained before respondents filled out the questionnaire.

Data Availability Statement

The data presented in this study are available on request from the corresponding author.

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Conflicts of Interest

The authors declare no conflicts of interest.

Declaration of Generative AI and AI-Assisted Technologies in the Writing Process

During the preparation of this work the authors used ChatGPT, DeepL, Grammarly, and PaperPal in order to translate from Bahasa Indonesia into American English, and to improve clarity of the language and readability of the article. After using these tools, the authors reviewed and edited the content as needed and take full responsibility for the content of the published article.

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