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UNDERSTANDING SHARIA GOVERNANCE IN ISLAMIC FINANCIAL INSTITUTION: A SYSTEMATIC LITERATURE REVIEW AND CONCEPTUAL PERSPECTIVE

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ABSTRACT

Sharia governance constitutes a fundamental pillar in ensuring the legitimacy, credibility, and sustainability of Islamic financial institutions (IFIs). Unlike conventional governance frameworks, Sharia governance integrates corporate governance principles with Islamic jurisprudence, aiming to ensure that all financial activities comply with Sharia principles. As the global Islamic finance industry continues to expand, particularly in Muslim-majority countries such as Indonesia, Malaysia, and Gulf Cooperation Council (GCC) states, the effectiveness of Sharia governance practices has become a critical concern for regulators, practitioners, and scholars.

This study aims to systematically review and synthesize existing literature on Sharia governance practices in Islamic financial institutions using a qualitative systematic literature review and conceptual approach. The review draws on peer-reviewed international and national journal articles, regulatory documents, and institutional reports published over the last two decades. The analysis focuses on key components of Sharia governance, including the role of Sharia Supervisory Boards (SSBs), internal Sharia audit mechanisms, governance disclosure, and regulatory frameworks established by standard-setting bodies such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB).

The findings indicate that while formal Sharia governance structures have been widely adopted, their implementation varies significantly across jurisdictions due to differences in regulatory enforcement, institutional capacity, and scholarly interpretation of Sharia principles. Empirical evidence from Indonesia demonstrates rapid growth in Islamic financial assets exceeding IDR 1,028 trillion in 2025 yet highlights persistent challenges related to SSB independence, effectiveness, and governance transparency. This study contributes by offering a comprehensive conceptual understanding of Sharia governance practices and identifying key gaps between regulatory expectations and operational realities. The findings are expected to provide insights for policymakers, regulators, and Islamic finance practitioners seeking to strengthen Sharia governance frameworks and enhance institutional accountability.

INTRODUCTION

Islamic finance has increasingly positioned itself as an important and integral segment of the global financial architecture, offering an alternative framework that is fundamentally distinct from conventional financial systems. This form of finance is grounded in Islamic law (Sharia), which provides not only legal prescriptions but also ethical and moral guidelines governing economic behavior. Unlike conventional finance, which is largely driven by profit maximization and interest-based transactions, Islamic finance explicitly prohibits interest (riba), excessive uncertainty (gharar), and speculative or gambling-like activities (maisir). Instead, it emphasizes principles such as fairness, ethical responsibility, transparency, risk-sharing, and transactions backed by real economic activities and tangible assets (Iqbal & Mirakhor, 2011; Obaidullah, 2016). These distinguishing characteristics do not merely affect the structure of financial products but also shape the institutional environment within which Islamic financial institutions operate. Consequently, Islamic finance requires governance mechanisms that go beyond conventional corporate governance frameworks, as it must simultaneously comply with regulatory requirements and ensure adherence to Sharia principles.

The dual nature of accountability inherent in Islamic finance legal-regulatory accountability on one hand and religious-ethical accountability on the other creates a unique governance challenge. Islamic financial institutions are not only expected to meet prudential regulations, risk management standards, and market discipline similar to conventional institutions, but they are also obligated to ensure that all financial activities, contracts, and operational processes are fully compliant with Sharia. Failure to meet this expectation may lead not only to legal or financial consequences but also to reputational damage and erosion of public trust, which can ultimately threaten the legitimacy of Islamic finance as a faith-based financial system. In this context, Sharia governance emerges as a critical institutional mechanism designed to safeguard Sharia compliance and maintain stakeholder confidence.

Sharia governance can be broadly understood as a structured system comprising institutional arrangements, policies, procedures, and oversight mechanisms that ensure Islamic financial institutions conduct their operations in accordance with Sharia principles. This system encompasses both ex ante and ex post controls, including the approval of financial products before launch, continuous monitoring of operational activities, and periodic reviews or audits to assess ongoing compliance (AAOIFI, 2015; IFSB, 2009). The absence or weakness of effective Sharia governance mechanisms may result in Sharia non-compliance risk, which is widely recognized as one of the most critical risks faced by Islamic financial institutions. Such risk has the potential to undermine the credibility of Islamic finance, reduce customer confidence, and expose institutions to financial losses or regulatory sanctions (Hasan, 2011; Grassa, 2013).

The conceptual foundations of Sharia governance are deeply rooted in Islamic jurisprudence, particularly in the domain of fiqh muʿāmalāt, which regulates commercial and financial transactions. From a theoretical standpoint, Sharia governance extends and complements established governance theories such as agency theory and stakeholder theory by embedding a moral and religious dimension into organizational accountability. While agency theory traditionally focuses on mitigating conflicts of interest between principals and agents, and stakeholder theory emphasizes the responsibility of firms toward a broader group of stakeholders, Sharia governance introduces an additional layer of accountability that transcends worldly stakeholders. In Islamic finance, accountability ultimately extends to God (Allah), reflecting the belief that all economic actions are subject to divine judgment (Chapra, 2000; Hasan, 2009).

This concept of divine accountability fundamentally alters the objectives and expectations of governance in Islamic financial institutions. Profit generation remains an important goal, but it is not pursued in isolation; instead, it must be achieved within the boundaries of ethical conduct, social responsibility, and Sharia compliance. Scholars argue that this moral foundation distinguishes Islamic finance from conventional systems and justifies the need for a specialized governance framework that integrates legal, ethical, and religious considerations (Safieddine, 2009; Farook et al., 2011). Sharia governance thus serves not only as a compliance mechanism but also as a value-based system that reinforces the ethical identity of Islamic financial institutions.

A central pillar of Sharia governance is the Sharia Supervisory Board (SSB), which plays a pivotal role in ensuring that Islamic financial products and operations conform to Sharia principles. The SSB typically consists of qualified Sharia scholars with expertise in Islamic jurisprudence and, increasingly, knowledge of modern finance and banking. This body is entrusted with a wide range of responsibilities, including reviewing and approving financial products, examining contractual structures, issuing Sharia opinions (fatwas), and overseeing the implementation of Sharia rulings within the institution (Grais & Pellegrini, 2006; Thoib & Bibi, 2024). The effectiveness of the SSB is therefore crucial to the credibility of Sharia governance as a whole.

Beyond the SSB, Sharia governance frameworks generally encompass additional supporting functions such as internal Sharia review units, Sharia compliance departments, and Sharia audit mechanisms. These units are responsible for translating SSB decisions into operational guidelines, monitoring day-to-day compliance, and conducting systematic evaluations of institutional practices. Disclosure and transparency mechanisms also form an essential component of Sharia governance, as stakeholders including depositors, investors, regulators, and the wider public rely on accurate and comprehensive information to assess the Sharia integrity of Islamic financial institutions (AAOIFI, 2015; Arrazi, 2023). Together, these elements form a multi-layered governance structure aimed at ensuring both procedural compliance and substantive adherence to Sharia principles.

At the international level, the development of Sharia governance has been supported by several standard-setting bodies that seek to promote harmonization and best practices across jurisdictions. Among the most prominent of these institutions is the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), which has issued a comprehensive set of governance, accounting, and auditing standards specifically tailored to Islamic financial institutions. AAOIFI standards place particular emphasis on the independence, competence, and accountability of Sharia Supervisory Boards, as well as on clear reporting and disclosure requirements related to Sharia compliance (AAOIFI, 2015).

These standards are widely regarded as a benchmark for good Sharia governance, although their adoption remains voluntary in many jurisdictions.

In parallel, the Islamic Financial Services Board (IFSB) has developed guiding principles on Sharia governance systems that focus on regulatory oversight, internal controls, and risk management. The IFSB framework emphasizes the need for a holistic governance system that integrates Sharia compliance into the broader risk management and governance architecture of Islamic financial institutions (IFSB, 2009). While AAOIFI and IFSB standards share common objectives, differences in their scope and emphasis reflect the diverse regulatory and institutional environments in which Islamic finance operates.

Despite the existence of these international standards, empirical evidence suggests that the implementation and enforcement of Sharia governance frameworks vary significantly across countries. Some jurisdictions, such as Malaysia and Bahrain, have adopted centralized or semi-centralized Sharia governance models supported by strong regulatory oversight and detailed guidelines. These countries are often cited as examples of relatively comprehensive and consistent Sharia governance systems. In contrast, other jurisdictions rely on decentralized or institution-based approaches, where individual Islamic financial institutions have greater autonomy in designing and implementing their Sharia governance structures (Grassa, 2015; Hidayat & Al-Khalifa, 2025). Such diversity raises important concerns regarding the consistency, comparability, and overall effectiveness of Sharia governance practices at the global level.

Indonesia offers a particularly compelling context for examining Sharia governance due to its unique combination of demographic, economic, and institutional characteristics. As the world's largest Muslim-majority country, Indonesia possesses significant potential for the development of Islamic finance. Over the past decade, the Indonesian Islamic finance sector has experienced steady growth, supported by increasing public awareness, regulatory initiatives, and government commitment to developing a comprehensive Sharia-based financial ecosystem. According to data from the Otoritas Jasa Keuangan (OJK), the total assets of Islamic banking institutions in Indonesia surpassed IDR 1,028 trillion in 2025, reflecting sustained expansion and growing demand for Sharia-compliant financial services (OJK, 2025). This rapid growth underscores the importance of robust Sharia governance mechanisms to ensure that expansion does not come at the expense of Sharia integrity.

Although Indonesia has established regulatory requirements mandating the presence of Sharia Supervisory Boards and Sharia compliance units within Islamic banks, several empirical studies indicate that challenges remain in the practical implementation of Sharia governance. Issues frequently highlighted in the literature include concerns over the independence of SSB members, overlapping roles between governance and management functions, limitations in human resource capacity, and relatively low levels of disclosure regarding Sharia governance practices (Hidayah et al., 2022; Muhfiatun, 2024). These challenges suggest that formal compliance with regulatory requirements does not always translate into effective or substantive governance outcomes.

The existence of such gaps between regulatory expectations and operational realities raises important questions about the effectiveness of Sharia governance in emerging Islamic finance markets. While regulatory frameworks provide a necessary foundation, the actual practice of governance depends heavily on institutional capacity, organizational culture, and the commitment of key stakeholders to uphold Sharia principles. In the Indonesian context, these issues are further complicated by the coexistence of conventional and Islamic financial systems within a dual banking framework, which may influence governance priorities and resource allocation.

Although scholarly interest in Sharia governance has increased significantly over the past two decades, much of the existing literature remains fragmented. Many studies focus on specific aspects of Sharia governance, such as the characteristics of Sharia Supervisory Boards, the extent of Sharia-related disclosure, or compliance with particular regulatory standards within a single jurisdiction. While these studies provide valuable insights, they often fail to capture the broader, integrative picture of how Sharia governance operates across different institutional and regulatory contexts. Moreover, relatively limited attention has been paid to systematically comparing formal governance frameworks with their actual implementation in practice, particularly in rapidly developing Islamic finance markets.

This gap in the literature highlights the need for more comprehensive and integrative research that synthesizes existing findings and examines Sharia governance as a holistic system rather than as a collection of isolated components. By developing a deeper conceptual understanding of Sharia governance practices and their practical challenges, such research can contribute to both academic discourse and policy development. In doing so, it can also provide valuable insights for regulators, practitioners, and stakeholders seeking to strengthen the governance and sustainability of Islamic financial institutions in diverse contexts.

METHOD RESEARCH

2.1 Research Design

This research employs a qualitative methodological framework grounded in a systematic literature review (SLR) combined with conceptual analysis. The choice of an SLR is driven by the objective of consolidating and critically evaluating existing scholarly knowledge, identifying unresolved issues, and constructing a coherent conceptual understanding of the research topic without the collection of primary empirical data. Systematic literature reviews are widely recognized as an appropriate method for studies that seek to organize fragmented literature, map intellectual structures, and advance theoretical discussions, particularly in fields where regulatory and normative considerations play a central role (Tranfield et al., 2003; Snyder, 2019). In the context of Sharia governance, which is inherently shaped by legal doctrines, ethical principles, and institutional regulations, the SLR approach provides a rigorous and transparent means of examining diverse perspectives and practices across Islamic financial institutions (IFIs).

The qualitative orientation of this study facilitates a nuanced and interpretative exploration of Sharia governance systems, allowing the analysis to go beyond surface-level descriptions. Through this approach, the study seeks to capture the underlying governance mechanisms, the roles and responsibilities of institutional actors, and the interaction between regulatory frameworks and organizational practices embedded within Sharia governance structures. Instead of testing hypotheses or establishing statistical causal relationships, the research emphasizes the identification of recurring patterns, dominant themes, and conceptual relationships that emerge from prior academic contributions. Such an interpretive focus is particularly relevant for understanding governance phenomena that are complex, context-dependent, and value-laden (Creswell & Poth, 2018; Saunders et al., 2019).

Moreover, this qualitative and literature-based design aligns with established methodological traditions in governance and Islamic finance research, where doctrinal analysis and conceptual synthesis are frequently employed to examine institutional arrangements and regulatory models. Previous studies have demonstrated that this approach is effective in generating theoretical insights and clarifying conceptual ambiguities surrounding Sharia governance practices (Grais & Pellegrini, 2006; Grassa, 2013). By adopting a similar research design, this study positions itself within the existing scholarly discourse while contributing a structured and integrative perspective on Sharia governance.

2.2 Systematic Literature Review Procedure

The systematic literature review was conducted following a structured and transparent procedure adapted from the frameworks proposed by Tranfield et al. (2003) and Kitchenham et al. (2009). The review process consisted of three main stages: planning the review, conducting the review, and reporting and synthesizing findings.

In the planning stage, the scope of the review was clearly defined to focus on Sharia governance practices in Islamic financial institutions, including Islamic banks, takaful operators, and other Sharia-compliant financial entities. Key research questions guiding the review included:
(1) What are the core components of Sharia governance in IFIs?
(2) How are Sharia governance practices implemented across different jurisdictions?
(3) What challenges and best practices are identified in the existing literature?

During the review stage, a systematic search strategy was employed to identify relevant academic and institutional sources. The reporting stage involved thematic analysis and conceptual synthesis to integrate findings across studies and develop a coherent framework of Sharia governance practices.

2.3 Data Sources and Search Strategy

The literature search was conducted using multiple reputable academic databases to ensure comprehensive coverage and academic rigor. The primary databases included

Scopus, Web of Science, ScienceDirect, Emerald Insight, SpringerLink, and Google Scholar. To capture national perspectives, particularly from Indonesia and other Muslim-majority countries, additional sources were drawn from SINTA-indexed journals, institutional repositories, and publications indexed in Garuda (Garba Rujukan Digital).

Search keywords were developed based on the research objectives and refined through iterative testing. The main search terms included combinations of: *"Sharia governance," "Islamic corporate governance," "Sharia supervisory board," "Islamic financial institutions," "Islamic banking governance,"* and *"Sharia compliance."* Boolean operators (AND/OR) were used to enhance search precision and relevance (Boell & Cecez-Kecmanovic, 2015).

In addition to academic journal articles, the review incorporated regulatory documents and institutional reports published by standard-setting bodies and regulators such as AAOIFI, IFSB, Bank Indonesia, and Otoritas Jasa Keuangan (OJK). These sources were included to contextualize governance practices within prevailing regulatory frameworks and industry standards (AAOIFI, 2015; IFSB, 2009).

2.4 Inclusion and Exclusion Criteria

To ensure the quality and relevance of the reviewed literature, explicit inclusion and exclusion criteria were applied. Studies were included if they:
1) were published in peer-reviewed journals or official institutional reports;
2) focused on Sharia governance, Sharia compliance, or governance mechanisms in IFIs;
3) were written in English or Bahasa Indonesia; and
4) were published between 2000 and 2025 to capture both foundational and contemporary developments in Islamic finance governance.

Studies were excluded if they:
1) focused solely on conventional corporate governance without Sharia relevance;
2) addressed Islamic finance only tangentially without governance analysis;
3) were opinion pieces, news articles, or non-academic commentaries; or
4) lacked methodological transparency or academic rigor.

Applying these criteria helped ensure that the review captured high-quality and contextually relevant studies while minimizing bias and redundancy (Petticrew & Roberts, 2006).

2.5 Data Analysis Technique

The selected literature was analyzed using thematic content analysis, a widely used qualitative method for identifying, analyzing, and reporting patterns within textual data (Braun & Clarke, 2006). Each article was carefully reviewed and coded based on recurring themes related to Sharia governance, such as: 1) governance structure and institutional arrangements; 2) role and characteristics of Sharia Supervisory Boards (SSBs); 3) internal Sharia audit and compliance mechanisms; 4) governance disclosure and transparency; and 5) regulatory and supervisory frameworks.

Through an iterative coding process, similar themes were grouped into broader analytical categories to facilitate conceptual synthesis. This approach allowed the study to compare governance practices across jurisdictions and institutional contexts while preserving the richness and nuance of qualitative insights (Miles et al., 2014).

2.6 Conceptual Synthesis and Framework Development

Beyond thematic aggregation, this study employed conceptual synthesis to integrate findings into a coherent analytical framework. Conceptual synthesis involves moving beyond descriptive summaries to establish theoretical linkages and explanatory constructs derived from the literature (Jaakkola, 2020). In this study, insights from governance theory, Islamic jurisprudence, and regulatory analysis were combined to conceptualize Sharia governance as a multidimensional system encompassing institutional actors, governance processes, and regulatory environments.

This synthesis provides the foundation for the Results and Discussion section, where Sharia governance practices are analyzed comparatively and organized into a conceptual framework highlighting key determinants, challenges, and best practices. Such an approach aligns with prior conceptual studies in Islamic finance and corporate governance literature (Safieddine, 2009; Hasan, 2011).

2.7 Research Rigor and Validity

To enhance methodological rigor and trustworthiness, several strategies were employed. First, transparency was maintained through explicit documentation of search strategies, inclusion criteria, and analytical procedures. Second, triangulation was achieved by incorporating multiple data sources, including academic literature and regulatory documents (Denzin, 2012). Third, reflexivity was applied by critically assessing potential biases in interpreting normative and doctrinal texts, particularly those rooted in diverse schools of Islamic jurisprudence.

Although this study does not involve empirical data collection, the systematic and transparent review process strengthens the credibility and reproducibility of its findings. The qualitative SLR approach is therefore deemed appropriate for achieving the research objectives and contributing meaningful insights to the discourse on Sharia governance practices in Islamic financial institutions.

RESULT AND DISCUSSION

Based on the systematic review of the selected literature, this section synthesizes and discusses the key findings related to Sharia governance practices in Islamic financial institutions (IFIs). The discussion is organized thematically to reflect dominant issues identified across studies, namely: (1) institutional structure of Sharia governance, (2) role and effectiveness of Sharia Supervisory Boards (SSBs), (3) internal Sharia control and audit mechanisms, (4) governance disclosure and transparency, and (5) regulatory diversity and cross-country practices. These themes collectively provide a comprehensive understanding of how Sharia governance is conceptualized and implemented in practice.

3.1 Institutional Structure of Sharia Governance

The existing body of literature consistently conceptualizes Sharia governance as a complex and layered institutional arrangement aimed at safeguarding Sharia compliance across all stages of operations within Islamic financial institutions. Rather than functioning as a single control mechanism, Sharia governance is understood as an integrated system composed of multiple organizational components that collectively ensure adherence to Islamic legal and ethical principles. At the institutional level, these governance structures commonly include Sharia Supervisory Boards (SSBs), dedicated internal Sharia compliance or review units, Sharia audit functions, and formalized reporting and disclosure mechanisms related to Sharia matters (Grais & Pellegrini, 2006; AAOIFI, 2015; Hasan, 2011). These specialized structures do not operate in isolation but are embedded within broader corporate governance systems, interacting with conventional bodies such as boards of directors, management committees, and audit committees. As a result, Islamic financial institutions operate under a dual governance framework that combines conventional corporate governance with Sharia-based oversight.

Empirical evidence suggests that the institutionalization of Sharia governance structures has increasingly become a mandatory regulatory requirement in jurisdictions where Islamic finance has developed as part of the formal financial system. Regulatory authorities often prescribe minimum governance arrangements to ensure that Islamic financial institutions maintain Sharia integrity and protect stakeholders' interests. In the Indonesian context, for example, regulations issued by the Otoritas Jasa Keuangan require all Islamic banks and Islamic business units to establish Sharia Supervisory Boards as a core element of their governance structure. This regulatory mandate reflects a relatively centralized approach to Sharia oversight, where compliance is closely monitored by supervisory authorities (OJK, 2025; Muhfiatun, 2024). The formal requirement for SSBs is intended to provide an institutional safeguard against Sharia non-compliance and to enhance public confidence in Islamic financial products and services.

A similar emphasis on structured Sharia governance can be observed in other jurisdictions with well-developed Islamic finance sectors. Malaysia, for instance, has adopted a more centralized and hierarchical model of Sharia governance by establishing a Sharia Advisory Council at the central bank level. This body serves as the highest authority on Sharia matters in Islamic finance, ensuring consistency and uniformity in the interpretation and application of Sharia principles across the financial system (Grassa, 2015; Rahman & Bukair, 2013). Through this centralized mechanism, Malaysian regulators seek to reduce divergence in Sharia rulings among individual institutions and to strengthen the overall credibility of Sharia governance at the national level.

Despite the widespread formal adoption of Sharia governance structures, a growing number of studies highlight that the mere presence of these institutional arrangements does not automatically guarantee effective governance outcomes. The actual functioning and impact of Sharia governance mechanisms are influenced by a range of contextual and organizational factors, including the commitment of senior management, the quality and independence of Sharia Supervisory Board members, the availability of qualified human resources, and the rigor of regulatory enforcement. In several cases, Sharia governance has been found to operate primarily as a procedural or symbolic mechanism, fulfilling regulatory and disclosure requirements without exerting meaningful influence on strategic decisions or operational practices within Islamic financial institutions (Safieddine, 2009; Arrazi, 2023).

This tendency toward procedural compliance underscores a persistent gap between structural conformity and substantive governance effectiveness. While institutions may formally comply with governance requirements by establishing the necessary boards and units, the extent to which these structures are empowered to shape policies, products, and risk management practices varies considerably. In environments where governance culture is weak or regulatory oversight is limited, Sharia governance may be marginalized within organizational hierarchies, reducing its capacity to ensure genuine Sharia compliance. Consequently, the effectiveness of Sharia governance should not be assessed solely on the basis of institutional design but also on how governance mechanisms are integrated into decision-making processes and supported by organizational culture and regulatory discipline.

Overall, the literature suggests that strengthening Sharia governance requires more than regulatory mandates and formal institutional arrangements. It also necessitates sustained institutional commitment, enhanced governance culture, and effective enforcement mechanisms that enable Sharia governance structures to function as substantive oversight bodies rather than symbolic compliance tools.

3.2 Role and Effectiveness of Sharia Supervisory Boards (SSBs)

Within the broader architecture of Sharia governance, the Sharia Supervisory Board (SSB) is consistently highlighted in the literature as the most pivotal and widely examined governance component. The prominence of the SSB stems from its central responsibility to safeguard Sharia compliance by overseeing the conformity of financial products, contractual arrangements, and operational practices with Islamic legal principles. This oversight is exercised through both ex-ante mechanisms, such as the approval of products and contracts prior to implementation, and ex-post mechanisms, including ongoing review and evaluation of institutional activities (Grais & Pellegrini, 2006; Thoib & Bibi, 2024). As such, the effectiveness of the SSB is directly linked to the preservation of the religious legitimacy of Islamic financial institutions (IFIs) and the maintenance of trust among stakeholders, including depositors, investors, and regulators.

Despite its central role, a substantial body of literature points to persistent challenges that constrain the effectiveness of SSBs in practice. Among the most frequently cited issues are concerns related to the independence, expertise, and workload of SSB members. Several studies observe that Sharia scholars often serve on multiple SSBs simultaneously across different Islamic financial institutions. While this practice may reflect a limited pool of qualified scholars, it raises concerns about potential conflicts of interest and the ability of SSB members to dedicate sufficient time and attention to each institution they oversee (Farook et al., 2011; Grassa, 2013). This issue has been documented not only in Gulf Cooperation Council (GCC) countries but also in emerging Islamic finance jurisdictions, including Indonesia.

In the Indonesian setting, regulatory frameworks provide formal criteria for the appointment of SSB members, aiming to ensure minimum standards of qualification and compliance. However, empirical studies suggest that the practical influence of SSBs on organizational decision-making remains constrained. In many cases, SSBs function primarily in an advisory capacity, with limited authority to shape or challenge managerial and strategic decisions dominated by executive management (Muhfiatun, 2024; Hidayah et al., 2022). This subordinate positioning may weaken the ability of SSBs to enforce Sharia rulings effectively, particularly when commercial objectives conflict with Sharia considerations.

Comparable concerns have been identified in other jurisdictions. Research on Islamic banks in Bahrain and Pakistan indicates that SSBs are sometimes perceived as symbolic governance structures established to satisfy regulatory expectations rather than as authoritative bodies with substantial decision-making power (Hidayat & Al-Khalifa, 2025; Khan et al., 2020). Such perceptions further reinforce the notion that formal institutional arrangements alone are insufficient to ensure effective Sharia governance if SSBs lack genuine independence and influence within organizational hierarchies.

Collectively, these findings underscore the need for reforms aimed at enhancing the effectiveness of Sharia Supervisory Boards. Scholars widely argue that strengthening SSB independence, clearly delineating their authority relative to management, and improving their professional capacity are critical steps toward more robust Sharia governance. Proposed measures include the provision of continuous professional development and training, the establishment of standardized qualification and competency frameworks, and the introduction of regulatory limits on multiple board memberships to reduce overextension and potential conflicts of interest (AAOIFI, 2015; Hasan, 2011). By addressing these structural and capacity-related challenges, Islamic financial institutions may enhance the substantive role of SSBs and improve overall Sharia governance outcomes.

3.3 Internal Sharia Control and Audit Mechanisms

In addition to the central role of the Sharia Supervisory Board (SSB), the effectiveness of Sharia governance relies heavily on the establishment and operation of comprehensive internal control and audit mechanisms that ensure Sharia compliance is maintained throughout daily institutional activities. While SSBs provide strategic oversight and advisory functions, internal Sharia review units and Sharia audit functions constitute the operational backbone of Sharia governance systems, translating high-level rulings into actionable procedures and continuously monitoring adherence to Sharia principles (IFSB, 2009; Rahman, 2018). These mechanisms are responsible for detecting non-compliant practices, assessing the adequacy of internal processes, and recommending corrective measures where deviations occur. By providing a structured framework for internal monitoring, these units help bridge the gap between formal governance structures and substantive compliance in practice.

The literature reveals considerable variation in the maturity and effectiveness of internal Sharia control mechanisms across different jurisdictions. In well-established Islamic finance markets, such as Malaysia, internal Sharia audit functions are typically well-integrated into broader institutional risk management systems and operate under the scrutiny of regulatory authorities. In these contexts, internal audit units are not only tasked with evaluating compliance but also contribute to institutional risk assessment, product development, and policy formulation, thereby ensuring that Sharia considerations are embedded throughout the organizational decision-making process (Grassa, 2015; Rahman & Bukair, 2013). This level of integration demonstrates a high degree of institutionalization and reflects a mature governance culture in which Sharia compliance is systematically operationalized rather than treated as an ancillary function.

By contrast, emerging Islamic finance markets often face significant challenges in establishing and sustaining effective internal Sharia control mechanisms. Empirical studies from such contexts, including Indonesia, indicate that internal Sharia audit units frequently encounter limitations in institutional capacity, insufficiently trained personnel, and ambiguous role definitions. In some institutions, responsibilities for monitoring Sharia compliance overlap with conventional internal audit functions, leading to potential inefficiencies and confusion regarding accountability (Arrazi, 2023; Muhfiatun, 2024). These structural and resource constraints can hinder the ability of internal audit units to conduct rigorous assessments, limiting their capacity to detect and address non-compliant activities comprehensively.

Another challenge highlighted in the literature concerns the absence of standardized methodologies for conducting Sharia audits. While international standard-setting bodies such as AAOIFI have issued detailed guidelines for Sharia review and audit processes, the degree of adoption varies widely across institutions and jurisdictions (AAOIFI, 2015; Khan et al., 2020). In practice, internal Sharia control systems often rely on the discretion and interpretation of individual institutions rather than adhering to uniform best practices. This lack of standardization can result in inconsistent evaluations, varying levels of audit rigor, and difficulties in comparing compliance outcomes across organizations or markets. Consequently, even where internal mechanisms exist, their effectiveness may be contingent upon institutional commitment, resource allocation, and the extent to which audit findings are integrated into governance and operational decision-making.

Despite these challenges, internal Sharia control and audit mechanisms remain indispensable to the overall integrity of Sharia governance systems. By providing continuous oversight, facilitating timely corrective actions, and reinforcing accountability within operational processes, these functions help to ensure that Islamic financial institutions not only comply with regulatory requirements but also uphold the ethical and religious principles underpinning their operations. The literature consistently underscores the importance of strengthening these internal mechanisms, including through capacity building, clear role delineation, adoption of standardized methodologies, and alignment with broader risk management and governance frameworks. Such improvements are essential for enhancing both the credibility and effectiveness of Sharia governance in Islamic financial institutions across diverse market contexts.

3.4 Governance Disclosure and Transparency

Transparency and disclosure are widely acknowledged in the literature as fundamental components of effective corporate governance, and their importance extends equally to Sharia governance within Islamic financial institutions (IFIs). In the context of Sharia governance, disclosure encompasses a variety of information intended to demonstrate the institution's commitment to Sharia compliance and to maintain stakeholder confidence. Typical disclosures include details regarding the composition and qualifications of Sharia Supervisory Boards (SSBs), the processes employed to ensure Sharia compliance, summaries of fatwas issued, and procedures for handling non-compliant income (Farook et al., 2011; Hasan, 2009). By making such information publicly available, Islamic financial institutions aim to provide transparency about their governance structures, operational practices, and ethical commitments, thereby enhancing accountability to depositors, investors, regulators, and the wider public.

Despite the acknowledged importance of governance disclosure, empirical studies reveal that the practice of Sharia governance reporting remains relatively limited and inconsistent across institutions and jurisdictions. Analyses of annual reports from Islamic banks indicate that disclosures often focus primarily on demonstrating formal compliance with regulatory requirements rather than providing detailed explanations of governance processes or the rationale behind Sharia supervisory decisions (Rahman, 2018; Muhfiatun, 2024). This tendency suggests that disclosures are sometimes treated as a procedural obligation, fulfilling minimum regulatory expectations without offering substantive insights into the effectiveness, challenges, or strategic integration of Sharia governance mechanisms. Such patterns have been documented in both single-country studies and cross-country analyses, indicating that the issue of limited and uneven disclosure is systemic rather than confined to particular contexts.

Several factors contribute to the observed limitations in Sharia governance transparency. Weak regulatory enforcement is one significant factor, as some jurisdictions lack stringent requirements or oversight mechanisms to ensure consistent reporting standards. In addition, the absence of standardized disclosure frameworks creates variability in both the content and quality of governance reporting, making it difficult for stakeholders to compare practices across institutions or markets. Concerns over reputational risk may also play a role, as institutions might be reluctant to disclose operational weaknesses, non-compliance incidents, or contentious Sharia rulings for fear of undermining stakeholder confidence. Collectively, these factors result in a disclosure environment that is often fragmented, selective, and insufficiently informative to external stakeholders.

Nevertheless, the literature emphasizes that enhanced Sharia governance disclosure is crucial for addressing information asymmetries between Islamic financial institutions and their stakeholders. By providing comprehensive and transparent reporting, IFIs can reinforce the credibility of their governance systems, signal institutional integrity, and foster greater trust among depositors, investors, and regulatory bodies (Farook et al., 2011; Hasan, 2011). Effective disclosure is also viewed as a mechanism for accountability, enabling stakeholders to assess the competence, independence, and performance of Sharia governance components, including SSBs, internal audit units, and compliance departments. Furthermore, transparency in governance processes can encourage best practices, stimulate institutional learning, and promote alignment between regulatory expectations and operational realities.

In conclusion, while Sharia governance disclosure is recognized as a critical element of effective governance, existing evidence indicates that its implementation remains suboptimal in many Islamic financial institutions. Limitations in regulatory enforcement, the absence of standardized reporting frameworks, and institutional reluctance to reveal operational challenges contribute to a persistent gap between the ideal of transparent governance and its actual practice. Addressing these challenges requires coordinated efforts from regulators, standard-setting bodies, and institutions themselves to develop clear, consistent, and comprehensive disclosure practices that genuinely reflect the effectiveness and integrity of Sharia governance systems. Strengthening transparency is therefore essential not only for enhancing stakeholder confidence but also for supporting the broader objectives of Sharia-compliant financial intermediation.

3.5 Regulatory Diversity and Cross-Country Practices

One of the most prominent findings from the literature review is the significant diversity in Sharia governance practices across jurisdictions. Regulatory approaches range from centralized models, where Sharia authority is concentrated at the national level, to decentralized models, where individual institutions bear primary responsibility for Sharia compliance (Grais & Pellegrini, 2006; Grassa, 2015).

Malaysia’s centralized Sharia governance framework is often cited as a best practice due to its consistency and regulatory clarity (Rahman & Bukair, 2013). Conversely, countries such as Indonesia adopt a hybrid model, combining national-level Sharia councils with institution-level SSBs. While this approach allows flexibility, it may also result in coordination challenges and divergent interpretations (Muhfiatun, 2024; Arrazi, 2023).

These regulatory variations underscore the absence of a universally accepted Sharia governance model. While international standards provide guidance, local legal systems, institutional capacity, and socio-cultural contexts significantly influence governance outcomes. This finding supports the argument that Sharia governance should be understood as a contextualized system rather than a one-size-fits-all framework (Safieddine, 2009; Hasan, 2011).

3.6 Toward a Conceptual Framework of Sharia Governance Practices

Based on the synthesis of the reviewed literature, Sharia governance can be conceptualized as a comprehensive and integrated system that encompasses multiple, interrelated dimensions. At the core of this system are the institutional actors, which include the Sharia Supervisory Boards (SSBs), management teams, and internal auditors responsible for ensuring that organizational operations conform to Sharia principles. These actors carry distinct but complementary responsibilities: SSBs provide strategic oversight and religious guidance, management implements policies and operational procedures, and internal audit or Sharia compliance units monitor adherence and report deviations (Grais & Pellegrini, 2006; Hasan, 2011; IFSB, 2009). The interplay between these actors is fundamental to the effective functioning of Sharia governance, as it ensures that both strategic decisions and operational practices align with Islamic legal and ethical standards.

The second dimension consists of governance processes, which encompass the mechanisms and activities through which Sharia compliance is operationalized within the institution. Key processes include the review and approval of financial products, regular Sharia audits, internal monitoring, and the disclosure of governance practices and compliance information to stakeholders (Farook et al., 2011; Rahman, 2018; AAOIFI, 2015). These processes are not isolated functions but are mutually reinforcing, forming a continuous loop in which guidance, implementation, monitoring, and reporting interact to sustain institutional integrity. Effective processes help to ensure that potential non-compliance is identified and corrected promptly, and that stakeholders are adequately informed about the institution's Sharia adherence, thereby enhancing transparency, accountability, and trust.

The third dimension involves the regulatory environment, which encompasses both national regulations and international standards set by bodies such as AAOIFI and IFSB (AAOIFI, 2015; IFSB, 2009). The regulatory context establishes the formal requirements for Sharia governance, including the establishment and composition of SSBs, the adoption of internal control mechanisms, and the reporting and disclosure obligations of institutions. Regulatory frameworks serve as an external anchor that shapes governance practices, provides guidance on best practices, and ensures a minimum standard of Sharia compliance across institutions. The alignment between institutional actors, governance processes, and regulatory requirements is therefore essential for the credibility and effectiveness of Sharia governance systems.

The literature indicates that weaknesses in any one of these dimensions can significantly undermine the overall effectiveness of Sharia governance. For instance, limited independence or competence of SSB members, inadequately implemented internal control mechanisms, or inconsistent enforcement of regulatory standards can compromise Sharia compliance and reduce stakeholder confidence (Farook et al., 2011; Arrazi, 2023; Muhfiatun, 2024). Conversely, when institutional commitment, robust governance processes, and supportive regulatory frameworks are aligned, they create a synergistic effect that strengthens compliance, reinforces institutional credibility, and ensures that Islamic financial operations adhere not only to formal regulatory standards but also to ethical and religious imperatives.

This conceptual framework therefore provides a holistic perspective on Sharia governance, emphasizing the interdependence between actors, processes, and regulatory structures. It offers a foundation for future empirical studies by highlighting critical variables and relationships that can be investigated to assess governance effectiveness in practice. Additionally, the framework has practical implications for policy-making and institutional development, suggesting that efforts to improve Sharia governance should focus on enhancing the independence and capacity of SSBs, strengthening internal monitoring and audit processes, ensuring transparent disclosure practices, and fostering regulatory consistency and enforcement. By integrating these dimensions, the conceptualization offers a comprehensive lens through which the performance and impact of Sharia governance can be evaluated, ultimately contributing to the sustainability, credibility, and growth of Islamic financial institutions in diverse markets.

CONCLUSION AND IMPLICATION

This study provides a systematic review and conceptual analysis of Sharia governance practices in Islamic financial institutions (IFIs). Drawing from a broad range of international and national studies, as well as regulatory documents from standard-setting bodies such as AAOIFI and IFSB, the study highlights the multi-dimensional nature of Sharia governance and its critical role in ensuring the legitimacy, credibility, and sustainability of Islamic finance operations.

4.1 Summary of Key Findings

The findings indicate that Sharia governance in IFIs is characterized by three core dimensions: (1) institutional actors, including Sharia Supervisory Boards (SSBs), management, and internal auditors; (2) governance processes, comprising Sharia compliance review, internal audit mechanisms, and disclosure; and (3) regulatory environments, encompassing national laws, international standards, and supervisory frameworks. Each of these dimensions plays a mutually reinforcing role in shaping effective governance outcomes.

Sharia Supervisory Boards emerge as the cornerstone of governance structures, responsible for monitoring, approving, and guiding Sharia-compliant operations. However, challenges related to independence, competence, workload, and influence over management persist, particularly in emerging markets such as Indonesia (Muhfiatun, 2024; Hidayah et al., 2022). Internal Sharia audit functions, while crucial for operational compliance, are often underdeveloped or inconsistently applied due to resource constraints and lack of standardized methodologies (AAOIFI, 2015; Arrazi, 2023). Moreover, disclosure and transparency remain limited across jurisdictions, with institutions primarily reporting formal compliance rather than substantive governance practices (Farook et al., 2011; Hasan, 2011).

Cross-country comparisons reveal significant regulatory diversity. Countries like Malaysia demonstrate centralized, standardized governance systems, whereas Indonesia and other emerging markets implement hybrid models combining national oversight with institution-level boards. This variation underscores the importance of context-specific governance frameworks that reconcile international standards with local legal, institutional, and cultural conditions (Grassa, 2015; Safieddine, 2009).

4.2 Theoretical Contributions

The study contributes theoretically by proposing an integrated conceptual framework of Sharia governance that links institutional actors, governance processes, and regulatory environments. This framework advances the understanding of Sharia governance beyond procedural compliance, emphasizing its strategic and ethical dimensions. By synthesizing prior literature, the study bridges gaps between doctrinal Sharia principles, corporate governance theory, and practical implementation in diverse institutional contexts. This framework can serve as a foundation for future empirical studies examining governance effectiveness, risk management, and performance outcomes in IFIs.

4.3 Practical and Policy Implications

The study offers several practical implications for regulators, financial practitioners, and institutional policymakers:

1) Enhancing SSB Independence and Capacity: Regulators should enforce limits on multiple board memberships and provide standardized qualification requirements and continuous training programs for Sharia scholars to strengthen governance credibility.

2) Strengthening Internal Sharia Controls: Institutions should establish dedicated internal Sharia audit units integrated with risk management and compliance systems to ensure daily operational adherence to Sharia principles.

3) Improving Governance Disclosure: Regulatory authorities should require comprehensive Sharia governance reporting in annual reports, including board composition, audit results, and fatwa compliance, to enhance transparency and stakeholder trust.

4) Contextualizing Regulatory Frameworks: Policymakers should balance international governance standards with local institutional and cultural contexts, promoting consistency while allowing flexibility in operational implementation.

5) Promoting Best Practices Sharing: Cross-country collaboration and knowledge sharing between regulators and institutions can help disseminate successful governance practices and mitigate inconsistencies in implementation.

4.4 Limitations and Future Research Directions

While this study provides a comprehensive review and conceptual framework, several limitations exist. First, the study relies solely on secondary data and literature; thus, empirical validation of the proposed framework is necessary. Second, the review focuses on published literature and official documents, potentially overlooking unpublished industry reports or practitioner insights. Third, the diversity of legal systems and governance structures across jurisdictions limits the generalizability of certain findings.

Future research should consider mixed-method empirical studies to assess the practical effectiveness of Sharia governance mechanisms, particularly SSB performance, audit quality, and disclosure impact on stakeholder trust. Comparative studies across emerging and developed Islamic finance markets would provide further insights into how regulatory, institutional, and cultural factors shape governance outcomes. Additionally, research could explore the interaction between Sharia governance and organizational performance, risk management, and innovation in Islamic finance products.

4.5 Conclusion

In conclusion, Sharia governance represents a strategically significant and ethically grounded governance framework that integrates Islamic jurisprudence into corporate and financial management. Effective governance requires the alignment of institutional actors, operational processes, and regulatory frameworks to ensure Sharia compliance, transparency, and accountability. While significant progress has been made in establishing formal governance structures, challenges remain in SSB independence, internal control effectiveness, and disclosure practices. By addressing these gaps, policymakers and practitioners can strengthen Sharia governance, enhance institutional credibility, and support the sustainable growth of Islamic finance globally.

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