

Fraud in Islamic Banks: Recent Research Developments

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Abstract

The Islamic banking industry is growing rapidly, but faces the risk of fraud that can damage its reputation and integrity. Fraud in Islamic banks often occurs due to weak internal supervision, low Islamic financial literacy, and the complexity of financial products that open up opportunities for irregularities. This study uses the Systematic Literature Review (SLR) method to identify, evaluate, and synthesize research related to fraud in Islamic banking by collecting articles from accredited sources between 2020 and 2024. After a rigorous selection, 8 main articles were selected to be analyzed to identify the methodology, topics, and findings related to fraud in Islamic banks. The results of the study show that although Islamic banks have adopted good governance, fraud challenges remain, influenced by external factors such as corruption and political instability, as well as internal factors such as weak Islamic supervision. Several studies highlight the importance of stricter Islamic supervision and transparency to reduce the risk of fraud, although disclosure of corruption in Islamic banks is less than in conventional banks. This study shows the need to strengthen sharia supervisory mechanisms and increase transparency in Islamic banks to reduce the risk of fraud, as well as develop more comprehensive strategies in implementing more effective governance.

Keywords: Fraud, Cheating, Islamic Banks, Corruption, Transparency

INTRODUCTION

Islamic banking, a Sharia-based financial system, has grown rapidly in Indonesia (Handrisusanto, 2024). Islamic banks adhere to fairness, transparency, and the avoidance of riba (usury), gharar (uncertainty), and maysir (gambling), according to Ismail et al. (2021). Islamic banks' asset growth, client base, and product variety have improved

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recently. The Financial Services Authority of Indonesia (OJK) reported IDR 847.58 trillion in Islamic banking assets in 2023, 7.10% of the national banking business. BI also recorded a significant increase in Islamic banking accounts, surpassing 40 million in the same year.

Despite this optimistic trend, Islamic banks face financial dangers, including fraud. Karpoff (2021) defines fraud as deceit to achieve illegal advantages. Fraud occurs in banking, business, government, and non-profits (Ozili, 2020). Financial statement manipulation, asset theft, document fabrication, bribery, and corruption are included (Homer, 2020). The most popular fraud model is the Fraud Triangle, which includes pressure, opportunity, and justification. With a fourth component—capability—this model became the Fraud Diamond. The Fraud Pentagon adds hubris, whereas the Fraud Hexagon adds collusion (Sánchez-Aguayo et al., 2021).

Fraud may result in financial losses, brand harm, public distrust, and legal action, according to Christian and Ricardo (2022). Fraud in the banking business includes financial reporting fraud, misuse of money, and internal and external corruption (Hashim et al., 2020). Islamic bank fraud is especially troubling since Sharia values honesty and openness. Internal control system weaknesses and public Islamic financial illiteracy make fraud prevention difficult (Wibowo, 2023). The intricacy of Islamic financial instruments like murabahah (cost-plus financing), mudharabah (profit-sharing), and musyarakah (joint venture partnerships) might allow immoral people to misuse them. Islamic banking fraud may cause financial loss, client distrust, and reputational damage to the Islamic finance industry (Ginanjar & Syamsul, 2020). Forged credit paperwork, false financing disbursements, and bank employee-external cooperation to pilfer client cash are common frauds. Weak internal controls and regulatory gaps used for personal benefit enable these events (Mayndarto, 2023).

Islamic financial fraud has been studied using theoretical frameworks including the Fraud Triangle, Fraud Diamond, and Fraud Hexagon. Effective Islamic banking fraud prevention and mitigation measures are still lacking in the literature. Thus, this study will undertake a Systematic Literature Review (SLR) of previous academic research on Islamic banking fraud to detect recurring fraud tendencies.

METHODOLOGY

Systematic Literature Reviews (SLRs) are systematic, clear, and reproducible methods used to locate, analyze, and summarize prior research findings. This strategy aims to systematically acquire and integrate information from a variety of academic

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publications to better answer research problems (van Dinter et al., 2021). The SLR technique also critically reviews and evaluates pertinent existing studies to provide a comprehensive overview of Islamic banking fraud research.

The investigation started with finding relevant academic literature on Islamic bank fraud. This was done using Google Scholar and other academic resources. Search terms included “Fraud in Islamic Banking,” “Islamic Bank Corruption,” “Sharia Compliance Fraud,” and “Financial Fraud in Islamic Finance.” Only 2020–2024 journal articles indexed in Q1, Q2, and Q3 levels were reviewed to confirm source reliability.

The first search found 48 keyword-matched journal articles. The article's topic relevancy, research methods, and Islamic banking contribution were then assessed. Studies on Islamic bank fraud that were irrelevant, non-indexed, or deficient in analysis were eliminated. This review relied on eight main papers after careful selection. These publications were analysed to reveal the techniques, issues, and important conclusions of Islamic banking fraud.

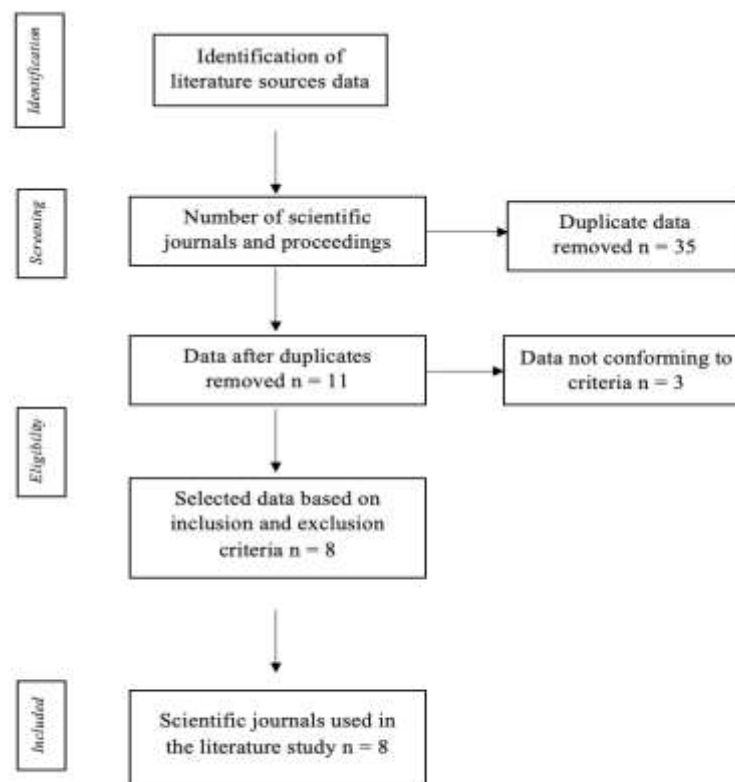


Figure 1. PRISMA Flow Diagram

RESULT

Research on fraud in Islamic Banks has become a serious concern, especially regarding its causes, impacts, and prevention strategies. Presented below is a table summarizing 10 research articles related to the development of studies on fraud in Islamic Banks.

Table 1. Descriptive Analysis of SLR

No.	Title	Author and Year	Journal	Ranking
1	Corruption Disclosure Practices of Islamic and Conventional Financial Firms in Bangladesh: The Moderating Role of Big 4	Md. Abdul Kaium Masud, M. Sharif Hossain, Mahfuzur Rahman, M. Ashraful Ferdous Chowdhury, M. Mizanur Rahman, 2023	Journal of Islamic Accounting and Business Research	Q2
2	Sharia Compliance, Islamic Corporate Governance, and Fraud: A study of Sharia Banks in Indonesia	Dedik Triyanto, 2022	Journal of Intelligence Studies in Business	Q3
3	The Risk of Political Instability and The Performance of Islamic Banks: Does Corruption Matter?	Zuhairan Yunmi Yunan, Majed Alharthi, Saeed Sazzad Jeris, 2023	Journal of Financial Crime	Q2
4	Combating Corruption Based on Al-Siyasah Al-Syar'iyah Perspective: A Literature Review	Kinza Aish, M. Kabir Hassan, Qamar Uz Zaman, Sadaf Ehsan, Khurram Abbas, Ijaz Hussain Shah, 2021	International Journal of Ethics and Systems.	Q1
5	Do Islamic Banks Gain from Corruption and Money Laundering (ML)?	Kinza Aish, M. Kabir Hassan, Qamar Uz Zaman, Sadaf Ehsan, Khurram Abbas, Ijaz Hussain Shah, 2021	Journal of Money Laundering Control	Q2
6	Does Corruption Affect Islamic Banking? Empirical Evidence from The OIC Countries	Zuhairan Yunmi Yunan, 2020	Journal of Financial Crime	Q2
7	Impact of Corruption on Bank Soundness: The Moderating Impact of Shari'ah Supervision	Mushtaq Hussain Khan, Ahmad Fraz, Arshad Hassan, Syed Zohaib Hassan Kazmi, 2021	Journal of Financial Crime	Q2
8	How Money Laundering (ML) Affects the Loan Portfolio Quality of Islamic Banks?	Ijaz Hussain Shah, Kinza Aish, Islam Kashif, 2022	Journal of Money Laundering Control	Q2

The initial assessment and screening of journals resulted in the selection of 8 articles from Scopus-indexed publications. These articles consist of one article with a Q1 ranking, six articles with a Q2 ranking, and one article with a Q3 ranking. The selection of articles based on these criteria is expected to improve the accuracy and effectiveness of the analysis process, given that the selected articles meet high-quality standards.



Table 1. SLR Article Research Methods and Results

No.	Title	Method	Results
1	Corruption Disclosure Practices of Islamic and Conventional Financial Firms in Bangladesh: The Moderating Role of Big 4	Keyword-based content analysis of financial firms in Bangladesh (2012-2016), using hierarchical regression.	Islamic financial firms disclosed less corruption information than conventional firms. Big4 had a positive and significant influence on corruption disclosure.
2	Sharia Compliance, Islamic Corporate Governance, and Fraud: A study of Sharia Banks in Indonesia	Logistic regression analysis on Islamic bank data in Indonesia (2016-2020).	Sharia Corporate Governance and Sharia Compliance influence fraud indications in Islamic banks, but fraud is still found in most banks.
3	The Risk of Political Instability and The Performance of Islamic Banks: Does Corruption Matter?	Data analysis from 93 Islamic banks in 20 developing countries (2011-2016).	Government stability is positively correlated with the soundness of Islamic banks, while corruption and military involvement in politics create instability and increase business risk.
4	Combating Corruption Based on Al-Siyasah Al-Syar'iyah Perspective: A Literature Review	Thematic analysis-based literature review of 45 academic works.	Corruption should be considered a sin, and the Al-Siyasah Al-Syar'iyah approach with principles of piety, justice, and accountability can be a solution in combating corruption.
5	Do Islamic Banks Gain from Corruption and Money Laundering (ML)?	Data analysis of 53 conventional banks and 19 Islamic banks in Pakistan and Malaysia using fixed and random effects regression.	In less corrupt environments (Malaysia), corruption harms Islamic banks, while in more corrupt environments (Pakistan), money laundering increases the profitability of Islamic banks.
6	Does Corruption Affect Islamic Banking? Empirical Evidence from The OIC Countries	Dynamic panel with data from 61 Islamic banks in 12 OIC countries (2016-2018).	Corruption affects the profitability and stability of Islamic banks with empirical evidence showing the negative impact of corruption on the Islamic banking sector.
7	Impact of Corruption on Bank Soundness: The Moderating Impact of Shari'ah Supervision	Data analysis of 1,528 observations from 71 Islamic banks and 120 conventional banks in 11 countries (2010-2017), using ordinary least squares regression and Two-Stage Least Squares.	Corruption negatively impacts the soundness of conventional banks, but its impact is smaller on Islamic banks. Shari'ah supervision can moderate the negative impact of corruption on Islamic banks.
8	How Money Laundering (ML) Affects the Loan Portfolio Quality of Islamic Banks?	Data analysis of conventional and Islamic banks in Pakistan (2012-2018) using modified and dynamic least squares.	Corruption and money laundering increase non-performing loans in conventional banks, but negatively impact the loan portfolio quality of Islamic banks.



Studies on fraud, corruption, Islamic corporate governance, and Islamic banking have used various methods, as shown in Table 2. Logistic, fixed-effects, random-effects, and OLS regression are used in most of these investigations. These methodologies are popular because they may examine how corruption, governance, and Sharia oversight affect Islamic bank performance. Thematic analysis has been used in literature reviews to examine perspectives rooted in **Al-Siyasah Al-Syar'iyah** (Islamic political jurisprudence), and dynamic panel analysis has been used to compare variables across countries with different corruption levels.

DISCUSSION

Banking fraud is a major issue, especially for Islamic institutions that value honesty and justice. Recent research on Islamic financial institution fraud have provided more detailed insights as academic interest has expanded. Triyanto (2022) discovered that Indonesian Islamic banks commit fraud despite adopting good corporate governance measures. Governance frameworks and Sharia compliance reduce fraud, but they cannot eradicate it, highlighting Islamic banks' fraud prevention challenges. Yunan et al. (2023) showed that political instability and corruption hurt Islamic banks. These external variables may not directly create fraud, but they enhance operational uncertainty and fraud risk, especially in corrupt situations. Loopholes may be used by those who misuse institutional structures for personal advantage.

Masud et al. (2023) stressed corporate transparency in corruption. Their results show that Islamic financial institutions provide less corruption information than conventional ones. Although not fraudulent, low transparency may increase fraud risk by hindering Islamic bank internal control. Khan et al. (2021) showed that Islamic banks are more robust to corruption than regular banks. Corruption may still erode financial stability, allowing fraud. The research highlighted Sharia supervision's ability to mitigate corruption's negative consequences on Islamic banks. Aish et al. (2021) explored how corruption and money laundering affect Islamic bank profitability. They found that money laundering may enhance Islamic bank profitability in highly corrupt countries like Pakistan. Corruption hurt Islamic banks in Malaysia, a country with higher institutional integrity. Corruption hurts Islamic banks' profitability and finances, according to Yunan (2020). Money laundering may provide short-term profits, but it compromises institutional integrity and increases fraud risks.

Internal variables also increase fraud. Insufficient or inconsistent Sharia oversight might enable power abuse and operational system manipulation. Khan et al. (2021)

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claimed that greater Sharia monitoring may reduce fraud by boosting public and investor trust in an institution's Islamic practices. Based on **Al-Siyasah Al-Syar'iyah** (Islamic political jurisprudence), Din et al. (2023) recommended seeing corruption as a moral offense. This approach emphasizes education's role in promoting piety, justice, and accountability to fight corruption and fraud from a religious and ethical standpoint. Educational activities might create integrity-promoting workplace cultures that prohibit fraud. Further investigation into money laundering has uncovered further vulnerabilities to Islamic banking portfolios. Shah et al. (2021) found that corruption and money laundering lower Islamic banks' credit portfolio quality, increasing their financial risk and fraud exposure. These data show that Islamic banks are susceptible to money laundering despite its tougher rules. These investigations demonstrate that fraud persists in Islamic banking despite its stricter regulation and ethical standards. Governance issues or poor supervision may cause this risk. Future study should enhance Sharia-based oversight and increase openness and accountability in Islamic financial organizations to prevent fraud.

CONCLUSION

The data above show that Islamic banks still struggle to combat fraud despite their better control and monitoring. External variables like corruption and political instability and internal elements like insufficient Sharia oversight increase Islamic banking fraud risk. Islamic banks may be more resilient to corruption than conventional banks, but corruption and money laundering still threaten their financial stability and institutional integrity. Thus, Islamic banking fraud risks must be reduced by strengthening Sharia regulatory procedures and increasing openness and accountability. This research has limitations. Most of the studied literature focuses on external and internal variables affecting Islamic bank fraud, although Sharia supervision's practical implementation is not explored. Additionally, many studies exclude data from nations with varying economic and political contexts. Researchers should compare Sharia supervisory procedures in high- and low-corruption nations to determine their efficacy. Broader case study methodologies are also advised to better understand Islamic financial organizations' fraud prevention strategies.



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