

UNIVERSITI TEKNOLOGI MARA

**FRAUD PREVENTION MECHANISM
AND THEIR INFLUENCE
ON PERFORMANCE OF
ISLAMIC FINANCIAL INSTITUTIONS**

RESKINO

Thesis submitted in partial fulfillment
of requirements for degree of
Doctor of Philosophy
(**Financial Criminology**)

Accounting Research Institute

May 2022

ABSTRACT

There are many challenges that Islamic finance industry players need to anticipate and overcome. Important industry risks, such as disruptive technology, reputational damage, fraud, and cybercrime, have not been explicitly or adequately addressed in most of these reports. Such industrial risks can afflict the global financial sector, and of course, Islamic financial institutions (IFIs) will not be spared. To overcome industrial risks, especially fraud that occurs in IFIs, prevention efforts are needed before the fraud occurs. Fraud prevention mechanisms (FPM) have become an interesting area of research. There is a lot of current literature, which shows that studies on FPM have gained popularity among researchers for a very long time. Various models have been made, for example, fraud prevention efforts by implementing effective good corporate governance (GCG), but the model that links between working Islamically in financial institutions has not been widely studied. This study aims (1) to examine the effect of Islamic work ethics, corporate culture, risk management, internal control, GCG on the performance of IFIs in Indonesia and (2) how the role of FPM mediates the relationship between Islamic work ethics, corporate culture, risk management, internal control, GCG, and performance. This research is applied research by distributing questionnaires to IFIs in Indonesian with respondents such as Top/CEO/President/Managing Director and Finance Staff who work in Islamic banking and sharia insurance throughout Indonesia. Sampling was carried out on 87 respondents using the purposive sampling method. The data analysis method used in this research is Partial Least Square (PLS) – SEM. This study shows that internal control and GCG have a significant effect on the performance of IFIs in Indonesia. Meanwhile, Islamic work ethic, corporate culture, and risk management have not been able to significantly contribute to the performance of IFIs in Indonesia. Internal control and GCG through FPMs play an important role in improving the performance of IFIs in Indonesia. Furthermore, to fill the gaps in the previous literature, this study proposes the concept of the Heptagon fraud theory. Heptagon fraud theory continues the triangle theory and pentagon theory. The practical implication of this research is that the strong role of internal control GCG indicates that division heads, managers, and accounting staff must better understand the importance of their supervisory function to fulfil fiduciary obligations and responsibilities to stakeholders. This study contributes to the literature on the role of GCG in preventing fraud in IFIs. This study can provide insight for academics and practitioners in Indonesia and their international partners.

Keywords: Islamic Work Ethic, Corporate Culture, Risk Management, Internal Control, Good Corporate Governance, Fraud Prevention Mechanism, Performance, and Islamic Financial Institutions

ACKNOWLEDGEMENT

First and foremost, I would like to thank Allah for allowing me to begin my Ph.D journey and successfully complete this long, winding, steep, and challenging journey. A Ph.D. journey is analogous to a path through a long, dark tunnel in search of a light path to the end of the tunnel. Many joys and sorrows while travelling through a dark tunnel. Moments of joy while travelling through a dark tunnel were also unforgettable. Holding hands, we search for light and discover it at the end of the tunnel.

I'd like to express my gratitude to Dr. Intan Salwani Mohamed, my main supervisor. I appreciate your help, the time you gave me in the midst of your busy schedule, your patience in guiding me, and the ideas you shared to help me with this thesis. My thanks also go to Dr. Norazida Mohamed, my co-supervisor, who took the time and thought to perfect this writing. With jokes and laughter, you can spread positive energy and motivation. Prof. Dr. Nunuy Nur Afiah, thank you for sharing your knowledge and motivating me to complete this Ph.D.

Thank you also to Prof. Normah Omar, who has broadened my thinking. A special thanks to Prof. Nafsiah Mohamed, who helped bring me to ARI. Prof. Nafsiah is like a mother of nations to us.

I am grateful to the Accounting Research Institute (ARI) and the team, especially Prof. Jamaliah Said, PM Dr. Norhayati Mohamed, and Dr. Eley Suzana Kasim, for providing the facilities and escorting us so that this dissertation could be completed properly. I'd also like to thank the ARI staff, Ms. Azizah, and the team for their help and support in completing this dissertation.

I also want to thank UIN Syarif Hidayatullah Jakarta, Indonesia, for helping me continue my doctoral studies. I would also like to express my gratitude to the Accounting Research Institute, Universiti Teknologi MARA, Malaysia, for providing me with the necessary space and time to complete this research.

Special thanks to my colleagues, GOT 1 (Mr. Moh. Mahsun, Ms. Rafrini, Mr. Halim, Mr. Triyanto, Mr. Rudy Suryanto, Mr. Atqkan, Mr. Yusmansah, Mr. Mursal, and Mr. Solichin), especially Darussalam, who faithfully listens to my complaints, a friend who is easy to talk to, confide in, share both joys and Renato, who is always encouraging and willing to assist me at any time.

Finally, I dedicate this thesis to my late father and mother, whom I admired for their vision and determination to educate me. This triumphant piece is dedicated to both of you. My beloved, my soul mate, my husband, Afrizon, is on the front lines to protect me and has always been by my side through ups and downs. God has been so good to me, sending the most patient husband into my life, as well as my sweet children (Nada Shafira Frisky, Sulthan Faris, Nadine Calista, and Cinta Kayla); I appreciate your prayers, support, and unconditional love. Thank you for your self-sacrifice.

TABLE OF CONTENTS

	Page
CONFIRMATION BY PANEL OF EXAMINERS	ii
AUTHOR'S DECLARATION	iii
ABSTRACT	iv
ACKNOWLEDGEMENT	v
TABLE OF CONTENTS	vi
LIST OF TABLES	xiii
LIST OF FIGURES	xv
CHAPTER ONE: INTRODUCTION	1
1.1 Preamble	1
1.2 Background Information and Motivation for the Study	3
1.3 Problem Statement	9
1.3.1 The application of sharia principles in Islamic Financial Institutions	11
1.3.2 Ineffective Use of Fraud Prevention Mechanisms	11
1.3.3 Poor Implementation of Good Corporate Governance	12
1.3.4 Fraud Prevention Mechanisms and the Performance of Islamic Financial Institutions	12
1.3.5 The Existing Theory(s) is Not Sufficient to Support the Research Variables Specifically for Studying Research in Islamic Financial Studies.	13
1.4 Research Questions and Research Objectives	13
1.4.1 Research Questions	13
1.4.2 Research Objectives	14
1.5 Definitions of Key Terms	15
1.5.1 Islamic Financial Institutions	16
1.5.2 Performance of Islamic Financial Institutions	16

1.5.3	Islamic Work Ethics (IWE)	18
1.5.4	Corporate Culture	19
1.5.5	Risk Management	20
1.5.6	Internal Control	20
1.5.7	Good Corporate Governance	21
1.5.8	Fraud Prevention Mechanisms	22
1.6	Scope of Research	22
1.7	Contributions of the Study	23
1.7.1	Contribution to Practice	24
1.7.2	Contribution to Theory	24
1.7.3	Contribution to Methodology	25
1.7.4	Contribution to Body of Knowledge	26
1.8	Organization of the Chapters	26
1.9	Chapter Summary and Its Link to the Next Chapter	28
CHAPTER TWO: ISLAMIC FINANCIAL INSTITUTIONS IN INDONESIA		29
2.1	Introduction	29
2.2	Characteristics, Development, and Evolution of Islamic Finance Industry in Indonesia	29
2.3	The Performances of the Islamic Financial Institutions during the Last Ten Years (2010-2020)	34
2.3.1	Islamic bank	38
2.3.2	Islamic Insurance	43
2.3.3	Islamic Capital Market	46
2.3.4	Zakat	47
2.4	Shariah Compliance	47
2.5	Conventional and Shariah Laws, as well as Standards that Islamic Financial Institutions Will Have to Comply With	49
2.6	Previous Fraud Cases in Indonesian Financial Institutions	51