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Strengthening Sharia Compliance in Indonesian Sharia Cooperatives: A Governance-Based Perspective from Islamic Economic Law

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Abstract

This study examines Sharia compliance in Indonesian Sharia cooperatives from the perspective of Sharia economic law, emphasizing the role of the Sharia Supervisory Board (DPS) in ensuring adherence to Islamic principles. While previous studies have focused on operational and financial aspects, limited attention has been given to Sharia economic law as a framework for evaluating compliance. This normative legal research employs statute and conceptual approaches through qualitative analysis of primary and secondary legal materials. The findings indicate that Indonesia has established a comprehensive regulatory framework for Sharia cooperatives. However, challenges persist, including inconsistent implementation of Sharia contracts (akad), limited effectiveness of the Sharia Supervisory Board, and inadequate understanding of Sharia economic law among cooperative managers. These weaknesses may undermine contract validity, institutional legitimacy, and member confidence. This study highlights the importance of strengthening Sharia governance by promoting substantive, rather than merely formal, compliance and provides practical recommendations for enhancing supervisory mechanisms and the sustainability of Sharia cooperatives in Indonesia..

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INTRODUCTION

Public awareness of conducting sharia transactions continues to increase, influenced by religious understanding regarding the prohibition of usury, increasing enthusiasm for Islam, and the desire to obtain halal investments (Syaepudin, 2024). Indonesia, as a country with a Muslim majority and a population of 280.73 million by the end of 2023, has great potential in the development of Islamic financial products and services, including banking, insurance, financing, and Islamic cooperatives (Syaepudin, 2024). Over the past two decades, the development of the Islamic economy in Indonesia has demonstrated increasingly significant progress, particularly marked by the expansion of Islamic financial institutions across both banking and non-banking sectors. Among these, Islamic cooperatives, specifically Sharia Savings and Financing Cooperatives (Koperasi Simpan Pinjam Syariah/KSPS), have emerged as important grassroots financial institutions. Sharia Savings and Financing Cooperatives (Koperasi Simpan Pinjam dan Pembiayaan Syariah/KSPPS) are Islamic financial institutions established to deliver financial services to the community by upholding sharia principles, including profit-sharing mechanisms, fairness, transparency, and the avoidance of riba (Pratiwi et al., 2024). Sharia cooperatives are cooperatives managed based on sharia principles. The use of sharia cooperatives is more focused on cooperatives engaged in savings and loans; thus, sharia-compliant savings and loans cooperatives are known as Sharia Financial Services Cooperatives (Iska et al., 2023; Susanto et al., 2023).

Data from the Ministry of Cooperatives and SMEs indicate that the number of KSPS increased from 3,905 units in 2019 to 4,011 units in 2023, as reported by Nashiha et al., (2025), This increase reflects the growing presence of sharia cooperatives and their potential contribution to financial inclusion, especially for micro and small communities underserved by conventional banking systems. However, this numerical growth should not be interpreted as proof that sharia compliance has been fully achieved in practice. As shown by Rohmah and Sakinah (2025) and Wijaya (2022), the expansion of sharia cooperatives needs to be accompanied by stronger operational quality, governance, and compliance mechanisms so that institutional growth is not only quantitative but also substantive. Therefore, the core issue is not merely how many cooperatives exist, but whether their operations truly reflect sharia principles.

Despite the rapid development of Islamic cooperatives in Indonesia, their growth has not always been accompanied by substantive Sharia compliance. Theoretically, compliance is shaped by the interplay between contractual correctness, governance effectiveness, and regulatory supervision. Existing literature shows that Islamic cooperatives continue to struggle with the proper implementation of *akad*, the limited use of profit-sharing arrangements, and inconsistent alignment with Sharia standards and cooperative regulations (Ali et al., 2023; Fauzi et al., 2023; Hidayat, 2016; Rohmah & Sakinah, 2025). The Sharia Supervisory Board (DPS) is therefore expected to serve as a key governance instrument to ensure that operations, products, and managerial decisions conform to Sharia principles. Nevertheless, weaknesses in supervision, recruitment, managerial competence, risk management, and human resource capacity remain significant barriers to effective compliance (Ali et al., 2023; Hidayat, 2016). Based on this theoretical foundation, the present study adopts an integrated framework combining Sharia compliance, *akad*, and governance perspectives to examine the extent to which Islamic cooperatives operationalize Sharia principles in practice.

These difficulties raise serious questions regarding **Sharia compliance theory** within the framework of Islamic economic law. The theory of Sharia compliance posits that the legitimacy of Islamic financial institutions depends on the extent to which their contracts, products, and governance structures adhere to Sharia principles. In particular, the prohibition of riba, gharar, and maysir serves as a substantive legal standard for assessing whether a transaction is valid under Islamic law; non-compliance with these principles may render a contract fasid or batil, thereby affecting both its legal enforceability and moral legitimacy (Ashraful & Chowdhury, 2015). For Islamic cooperatives, compliance is therefore not only a matter of regulatory conformity but also a determinant of institutional credibility, stakeholder confidence, and long-term sustainability (Ascarya, 2015; Wanto & Syafe, 2025). This perspective is consistent with Sharia governance literature, which highlights the role of supervisory mechanisms, particularly the Sharia Supervisory Board, in ensuring that operational practices remain aligned with Islamic legal and ethical standards (Akbar, 2023).

Although Indonesia has established a comprehensive regulatory framework to support Sharia compliance, including fatwas issued by the National Sharia Council of the Indonesian Ulema Council (DSN-MUI) and relevant cooperative regulations, the effectiveness of its implementation remains questionable. In practice, the supervisory role of the DPS is often constrained by limited expertise in Islamic finance, accounting, and banking, as well as broader human resource limitations among cooperative managers (Absor et al., 2019). This gap between regulatory frameworks and practical implementation highlights a critical issue that warrants further investigation.

Accordingly, a notable gap in the existing literature lies in the limited integration of Islamic economic law perspectives in assessing Sharia compliance within Islamic cooperatives. While prior studies have largely focused on operational, managerial, or financial aspects, there remains insufficient examination of how legal principles shape and evaluate compliance practices in this sector. Addressing this gap is essential to provide a more comprehensive understanding of the institutional challenges faced by Islamic cooperatives.

Thus, the purpose of this study is to investigate Sharia compliance in Indonesian Islamic cooperatives from the standpoint of Islamic economic law. Specifically, it seeks to analyze the conceptual foundations, regulatory frameworks, and practical implementation challenges. By doing so, this study is expected to contribute to the existing literature by offering a more integrative and legally grounded perspective on Sharia compliance, while also providing practical insights for strengthening governance and compliance mechanisms in Islamic cooperatives.

LITERATURE REVIEW

Sharia Compliance in Islamic Financial Institutions

Sharia compliance constitutes the defining characteristic that distinguishes Islamic financial institutions from their conventional counterparts. It refers not merely to compliance with regulatory requirements but also to adherence to Islamic legal principles derived from the Qur'an, Sunnah, ijma', qiyas, and contemporary fatwas issued by authorized Sharia institutions. According to the Islamic Financial Services Board (IFSB), Sharia compliance encompasses the implementation of governance mechanisms that ensure all financial products, contracts, and operational activities remain free from prohibited elements such as riba, gharar, and maysir, while simultaneously promoting justice (adl), transparency, and public welfare (maslahah) (IFSB, 2009).

Previous studies emphasize that Sharia compliance is multidimensional because it combines legal, ethical, managerial, and institutional dimensions. Ascarya (2015) argues that Sharia compliance is closely associated with institutional legitimacy, as stakeholders expect Islamic financial institutions to consistently implement Islamic principles rather than merely adopt Islamic terminology. Likewise, Ashraful and Chowdhury (2015) explain that the validity of Islamic financial contracts depends upon substantive compliance with Islamic legal requirements rather than formal contractual documentation alone. In the context of Islamic cooperatives, Sharia compliance becomes even more critical because these institutions serve grassroots communities whose trust largely depends upon the perceived Islamic legitimacy of financial transactions. Consequently, effective governance is indispensable to ensure that operational practices remain aligned with Sharia principles

Sharia Governance and the Role of the Sharia Supervisory Board

Sharia governance refers to the institutional framework designed to ensure that Islamic financial institutions consistently comply with Islamic legal principles throughout their operations. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI, 2021) defines Sharia governance as a system involving Sharia supervision, internal review, audit, and institutional accountability aimed at maintaining continuous Sharia compliance.

Within Indonesian Islamic cooperatives, the Sharia Supervisory Board (Dewan Pengawas Syariah/DPS) represents the principal governance mechanism responsible for monitoring the implementation of DSN-MUI fatwas. DPS evaluates contracts, reviews new financial products, advises management, and reports compliance issues to the National Sharia Council (Muhammad, 2011). However, previous empirical studies reveal that many DPS members perform supervisory functions only administratively because of limited institutional authority, insufficient technical expertise, and multiple professional responsibilities (Absor et al., 2019; Susanto et al., 2023). Akbar (2023) further argues that weaknesses in governance structures contribute directly to inconsistent implementation of Sharia principles. Therefore, strengthening governance institutions rather than merely expanding regulatory frameworks becomes essential for achieving substantive Sharia compliance.

Islamic Economic Law and Sharia Contracts (Akad)

Islamic economic law regulates economic transactions through contractual relationships (akad) based on justice, transparency, mutual consent, and accountability. Every Sharia contract must satisfy the essential legal pillars (rukun) and contractual conditions (shurut) established under Islamic jurisprudence. Contracts that contain uncertainty (gharar), interest (riba), gambling (maysir), or deception may be considered legally invalid (batil) or defective (fasid) (Antonio, 2011).

Islamic cooperatives generally employ several financing contracts, including murabahah, mudharabah, musyarakah, ijarah, qardhul hasan, and wakalah. Each contract possesses different legal consequences and governance requirements. Previous studies indicate that many Sharia compliance problems originate from improper implementation of these contracts, particularly murabahah financing conducted without prior ownership of the underlying asset or profit-sharing arrangements that resemble conventional interest-based financing (Ali et al., 2023; Fauzi et al., 2023). Therefore, effective contract supervision is fundamental to preserving both the legal validity and ethical legitimacy of Islamic cooperative transactions.

Previous Studies and Research Gap

Numerous studies have examined Islamic cooperatives from operational, managerial, and financial perspectives. Hidayat (2016) investigated alternative supervisory systems in Islamic cooperatives and concluded that institutional supervision remains insufficient to ensure comprehensive Sharia compliance. Similarly, Rohmah and Sakinah (2025) found that compliance risks primarily originate from weak governance structures, inadequate implementation of Sharia contracts, and limited institutional capacity. Other researchers have explored governance challenges in Indonesian Islamic cooperatives. Supar et al. (2025) demonstrated that governance quality and Sharia compliance significantly influence institutional sustainability by preventing mission drift. Atmajaya et al. (2024) further identified limited human resources, low Islamic financial literacy, and regulatory complexity as persistent barriers to effective implementation of Sharia principles.

Despite these important contributions, existing literature generally approaches Sharia compliance from operational, financial management, or governance perspectives. Very limited attention has been devoted to examining Sharia compliance through the analytical framework of Islamic economic law, particularly regarding how legal principles shape governance mechanisms and determine the substantive validity of Islamic cooperative operations. Accordingly, this study addresses the existing research gap by integrating Sharia governance theory with Islamic economic law to develop a governance-based framework for evaluating Sharia compliance in Indonesian Islamic cooperatives. This integrated perspective contributes theoretically by extending previous governance literature beyond administrative compliance toward substantive legal compliance grounded in Islamic jurisprudence.

RESEARCH METHODS

This study employs normative legal research to examine Sharia compliance in Indonesian Islamic cooperatives from the perspective of Islamic economic law. The research adopts a statute approach and a conceptual approach. The statute approach analyzes Indonesian laws, ministerial regulations, Financial Services Authority (OJK) regulations, and fatwas issued by the National Sharia Council of the Indonesian Ulema Council (DSN-MUI). The conceptual approach examines the legal concepts of Sharia compliance, Sharia governance, the Sharia Supervisory Board (DPS), and

Sharia contracts (*akad*) as the analytical framework for this study. The study relies on library research using secondary legal materials. The materials include primary legal sources, namely legislation, regulations, and DSN-MUI fatwas, as well as secondary legal sources, including books, *fiqh muamalah* literature, and peer-reviewed journal articles. The legal materials were selected purposively based on their relevance to the research objectives, particularly those addressing the legal framework of Islamic cooperatives, Sharia compliance, Sharia governance, and the implementation of Sharia contracts.

The collected legal materials were analyzed through qualitative legal analysis using legal interpretation and qualitative content analysis. The analysis involved classifying legal materials, interpreting relevant legal norms and concepts, comparing statutory provisions with DSN-MUI fatwas and previous studies, and synthesizing the findings to identify governance challenges and the gap between formal regulatory compliance and the substantive implementation of Sharia principles in Indonesian Islamic cooperatives.

RESULT AND DISCUSSION

Islamic Cooperatives from the Perspective of Islamic Economic Law

Islamic cooperatives represent one of the key microfinance institutions that play a strategic role in strengthening community economic resilience, particularly among low- and middle-income groups. As economic entities grounded in the principles of cooperation, justice, and solidarity, Islamic cooperatives are expected to provide alternative financing mechanisms that are aligned with Islamic principles while promoting member empowerment to achieve collective welfare (Antonio & Syafi'i, 2011). From a normative standpoint, an Islamic cooperative is a cooperative company that conducts all of its operations in compliance with Sharia law. According to fatwas issued by the National Sharia Council of the Indonesian Ulema Council (DSN-MUI), these concepts relate to Islamic legal laws governing economic activity. Accordingly, Islamic cooperatives that engage in productive business activities, savings, and financing services are required to ensure that all products and operational practices comply with DSN-MUI fatwas as well as the prevailing legal and regulatory framework in Indonesia (Sobarna, 2021).

Based on these provisions, all business activities of Islamic cooperatives must be consistent with Sharia principles and must not involve elements prohibited under Islamic law, such as *maysir* (gambling), *gharar* (uncertainty), and *riba* (usury). In addition, Islamic cooperatives are not permitted to engage in derivative transactions, similar to other Islamic financial institutions (Nashiha et al., 2025), as regulatory frameworks explicitly define and limit the scope of permissible business activities for each type of financial institution or business entity.

The findings indicate that Islamic cooperatives occupy a unique position because they operate under a dual legal framework consisting of national cooperative law and Islamic economic law. Consequently, Sharia compliance cannot be assessed solely by adherence to statutory regulations but must also reflect compliance with substantive Sharia principles. This dual legal framework creates greater governance complexity than that found in conventional cooperatives, requiring effective institutional mechanisms to ensure that operational practices remain consistent with both legal systems.

Regulatory Framework of Islamic Cooperatives in Indonesia

Positive law and Islamic law are integrated to provide Indonesia's regulatory framework for Islamic cooperatives. This dual foundation reflects the unique nature of Islamic cooperatives as institutions that must comply not only with national legal systems but also with Sharia principles.

Legal Foundation of Islamic Cooperatives

Base on Islamic perspective, the conceptual foundation of cooperatives is closely related to the principle of cooperation (*ta'āwun*), which emphasizes mutual assistance and collective welfare. The term "cooperation" itself implies working together or helping one another, reflecting the fundamental values embedded in cooperative institutions (Sitio & Tamba, 2001). In Islamic jurisprudence, cooperatives are often associated with the concept of *syirkah ta'āwuniyyah* (mutual partnership), which refers to an agreement between two or more parties to collaborate, where one party may contribute capital while another contributes effort, and profits are shared based on a mutually agreed arrangement.

This concept is strongly supported by Islamic legal sources. The Qur'an explicitly encourages cooperation in righteousness and prohibits collaboration in sinful or harmful activities. As stated in Surah Al-Ma'idah (5:2)

وَتَعَاوَنُوْا عَلَى الْبِرِّ وَالتَّقْوٰىۖ وَلَا تَعَاوَنُوْا عَلَى الْاِثْمِ وَالْعُدْوَانِۖ وَاتَّقُوا اللّٰهَ ۗاِنَّ اللّٰهَ شَدِيْدُ الْعِقَابِ

"And cooperate in acts of righteousness and piety, and do not cooperate in sin and transgression. And be mindful of Allah; indeed, Allah is severe in punishment".

The legal foundation of Islamic cooperatives is also supported by Hadith literature. A narration reported by Muslim (No. 2699) states:

مَنْ نَفَّسَ عَنْ مُؤْمِنٍ كُرْبَةً مِنْ كُرَبِ الدُّنْيَا نَفَّسَ اللهُ عَنْهُ كُرْبَةً مِنْ كُرَبِ يَوْمِ الْقِيَامَةِ

"Whoever relieves a believer's distress in this world, Allah will relieve his distress on the Day of Resurrection."

This hadith emphasizes the importance of mutual assistance and social responsibility, which form the ethical basis of cooperative practices in Islamic economic activities.

Positive Legal Framework

The legal basis of Islamic cooperatives in Indonesia is also grounded in the national legal system. Several key regulations provide the formal framework governing the establishment, operation, and supervision of Islamic cooperatives:

1) Law No. 25 of 1992 on Cooperatives, particularly Article 3, which states that cooperatives aim to promote the welfare of their members in particular and society in general.
2) Regulation of the Minister of Cooperatives and Small and Medium Enterprises No. 10/Per/M.KUKM/IX/2015 concerning Cooperative Institutional Framework.
3) Regulation of the Minister of Cooperatives and Small and Medium Enterprises No. 17/Per/M.KUKM/IX/2015 concerning Cooperative Supervision.
4) Regulation of the Minister of Cooperatives and Small and Medium Enterprises of the Republic of Indonesia No. 11/Per/M.KUKM/XII/2017 concerning the Implementation of Savings and Financing Business Activities Based on Sharia Principles by Cooperatives.
5) Regulation of the Minister of Cooperatives and SMEs of the Republic of Indonesia No. 8 of 2023 concerning Savings and Loan Business Activities by Cooperatives (Arief & Azmi, 2023).

These regulations collectively establish the legal foundation for Islamic cooperatives, ensuring that their institutional structure, operational activities, and supervisory mechanisms are aligned with national legal standards while accommodating Sharia-based financial practices. The implementation of Sharia principles in Islamic cooperatives in Indonesia is guided by the Regulation of the Deputy of the Ministry of Cooperatives and SMEs No. 02/Per/Dep.6/IV/2017. This regulation outlines several core principles that must be embedded in the governance and operational practices of Islamic cooperatives:

1) Principle of Balance (Tawāzun)
   This principle emphasizes that the vision and mission of Islamic cooperatives should not be solely profit-oriented but must also be directed toward *falah* (holistic success in both worldly life and the hereafter). A *falah*-oriented approach implies that economic activities are not limited to material gain but also encompass spiritual well-being and the pursuit of divine blessings (*barakah*). Accordingly, all economic activities must align with the ethical and moral guidance provided in the Qur'an as the primary reference for Muslim life.
2) Principle of Public Benefit (Maslahah)
   According to the National Sharia Council of the Indonesian Ulema Council's (DSN-MUI) fatwas, cooperative products and company operations must be developed in compliance with Sharia law. Cooperatives have a duty to make sure that all financial services and products adhere to these authoritative Sharia laws as they are Islamic organizations.
3) Principle of Justice ('Adl)
   Justice in Islamic cooperatives encompasses both social and economic dimensions. From a social perspective, all members must have equal rights and obligations within the cooperative. From an economic perspective, transactions must be free from prohibited elements such as *riba* (usury), *zulm* (injustice), and *maysir* (gambling or speculative activities). This principle ensures fairness, transparency, and ethical conduct in all cooperative operations.
4) Principle of Brotherhood (Ukhuwwah)
   This principle highlights the importance of solidarity and mutual care among members. In practice, it is reflected in the cooperative's approach to resolving financing issues, particularly through the provision of flexibility or leniency in debt repayment for members facing financial difficulties. This approach reinforces the social function of Islamic cooperatives as institutions that prioritize collective welfare over purely contractual enforcement.

These principles indicate that Islamic cooperatives are not merely financial institutions but also socio-religious entities that integrate economic objectives with ethical and spiritual values. However, the extent to which these principles are effectively implemented in practice remains a critical issue, particularly in relation to governance quality and Sharia compliance. The practice of dual compliance, which calls for conformity to both statutory laws and Sharia fatwas, reflects the link between positive law and Sharia law. From the perspective of Islamic economic law, fatwas issued by the National Sharia Council of the Indonesian Ulema Council (DSN-MUI) hold a crucial position as a source of substantive law that complements positive law, particularly in determining the validity of contracts (akad) and Sharia-based economic transactions.

Despite the existence of a comprehensive regulatory framework, empirical evidence suggests that the implementation of Sharia supervision remains suboptimal. In practice, the role of the Sharia Supervisory Board (Dewan Pengawas Syariah/DPS) has not been fully effective. A report by the National Committee for Islamic Economy and Finance indicates that more than 60% of Islamic cooperatives in Indonesia do not yet have a systematic internal Sharia audit mechanism. Furthermore, many DPS members tend to perform administrative roles only, with limited active involvement in transaction supervision and compliance evaluation processes (Supar et al., 2025). This condition highlights a significant gap between regulatory expectations and practical implementation, raising concerns regarding the effectiveness of sharia governance in ensuring compliance within Islamic cooperatives. Although Indonesia has established a relatively comprehensive legal framework governing Islamic cooperatives, the findings suggest that the existence of regulations alone does not guarantee effective Sharia compliance. The main challenge lies in the implementation of these legal provisions at the cooperative level. Differences in institutional capacity, managerial competence, and supervisory quality result in varying interpretations of Sharia principles. Consequently, compliance is often limited to fulfilling administrative requirements rather than ensuring substantive adherence to Islamic economic law.

This finding indicates that the primary issue is not the absence of regulation but the gap between legal norms and institutional implementation. From the perspective of Islamic economic law, the effectiveness of Sharia compliance depends on governance quality rather than the number of regulations issued.

The role of the Sharia Supervisory Board (DPS)

The regulatory framework in Indonesia mandates the presence of a Sharia Supervisory Board (Dewan Pengawas Syariah/DPS) in Islamic cooperatives. Regulation of the Minister of Cooperatives and SMEs No. 11 of 2017, as well as Financial Services Authority Regulation No. 11/POJK.05/2019 stipulate that every Sharia Savings and Financing Cooperative (KSPPS) and Sharia Savings and Financing Unit (USPPS) must appoint a DPS. At least half of its members are required to hold certification from the National Sharia Council of the Indonesian Ulema Council (DSN-MUI). The DPS functions as an independent body responsible for directing, reviewing, and supervising institutional activities to ensure compliance with Islamic principles (Harahap, 2002). Institutionally, the National Sharia Council (DSN) operates as an autonomous body under the Indonesian Ulema Council (MUI), with its chairperson serving *ex officio* as the head of MUI.

The duties, authorities, and responsibilities of the DPS encompass several key aspects. First, the DPS is responsible for ensuring and supervising the conformity of cooperative operations with fatwas issued by the DSN-MUI. Second, it evaluates the Sharia aspects of operational guidelines and financial products. Third, it provides Sharia opinions regarding overall operational practices, particularly in official reports and disclosures. Fourth, the DPS reviews new products or services that have not yet been addressed by existing fatwas and submits them to the DSN-MUI for further determination. Fifth, the management and the DSN-MUI must be informed of the outcomes of Sharia supervision regularly, at least twice throughout a fiscal year (Muhammad, 2011). In addition, based on Regulation of the Minister of Cooperatives and SMEs No. 11/Per/M.KUKM/XII/2017, the DPS plays a strategic role in strengthening Sharia governance within Islamic cooperatives. This role includes providing advice and recommendations to supervisory and management boards, ensuring Sharia compliance in operational guidelines and products, monitoring the development of new financial products, requesting fatwas from the DSN-MUI when necessary, conducting periodic evaluations of savings and financing products, and submitting supervisory reports to the DSN-MUI at least annually (2017) (Menteri Kopreasi Dan UKM, 2017).

Despite this clearly defined regulatory mandate, the effectiveness of the DPS in practice remains a critical concern, particularly in relation to its capacity, independence, and active involvement in ensuring substantive Sharia compliance. The findings suggest that the limited effectiveness of the DPS is primarily an institutional issue rather than merely an individual competency problem. In many Islamic cooperatives, DPS members perform supervisory duties on a part-time basis while simultaneously holding other professional responsibilities. As a result, supervision tends to focus on reviewing documents and contracts instead of continuously monitoring operational practices. This condition weakens Sharia governance and increases the risk that formal compliance may not be accompanied by substantive implementation. Furthermore, limited authority and inadequate institutional support reduce the ability of the DPS to influence managerial decision-making. Consequently, the supervisory function often becomes reactive instead of preventive.

Implementation of Sharia Compliance in Islamic Cooperatives

Sharia compliance constitutes a fundamental pillar that determines the legitimacy of operations within Islamic cooperatives (Supar et al., 2025). The use of Sharia-based contracts (akad) in fund mobilization and finance operations is the main way that Sharia compliance is implemented. The *akad* serves as a core element in Islamic cooperative operations, as each contract must fulfill specific pillars (*rukun*) and conditions (*shurut*) to be considered valid under Islamic jurisprudence (*fiqh muamalah*). Any deviation from these requirements may result in the invalidity of the transaction. In practice, several types of Sharia contracts are commonly employed in Islamic cooperatives. These include: (1) *mudharabah*, a profit-sharing agreement between a capital provider (*rabb al-mal*) and an entrepreneur (*mudharib*); (2) *musyarakah*, a partnership contract in which two or more parties jointly contribute capital and share profits and risks; (3) *murabahah*, a cost-plus sale agreement between the cooperative and its members or clients; (4) *ijarah*, a leasing agreement; (5) *qardhul hasan*, an interest-free benevolent loan; and (6) *wakalah*, an agency contract in which the cooperative acts on behalf of a member or client.

The implementation of Sharia compliance is fundamentally guided by fatwas issued by the National Sharia Council of the Indonesian Ulema Council (DSN-MUI), which serves as the highest authority in determining the Sharia legitimacy of financial practices. Accordingly, compliance is assessed based on the extent to which cooperative operations align with these fatwas. In this regard, the Sharia Supervisory Board (Dewan Pengawas Syariah/DPS) is crucial in making sure that all agreements and transactions are devoid of forbidden components like maysir (gambling), gharar (uncertainty), and riba (usury). In the case of *murabahah*, the DPS supervises the entire financing process, starting from the application stage to the execution of the contract. It ensures that the traded goods are lawful (*halal*) and permissible (*tayyib*), and that the cooperative has obtained full ownership of the asset before selling it to the member. Furthermore, the DPS verifies that the sale price, including the profit margin, is determined through mutual agreement at the outset of the contract.

Similarly, in *mudharabah* contracts, the DPS monitors the determination and implementation of the profit-sharing ratio (*nisbah*), ensuring that it is agreed upon voluntarily by both parties at the beginning of the contract without coercion. The DPS also ensures that the financed business activities are lawful and do not cause harm (*madharat*). In some cases, supervisory activities include field visits to verify that the business operations are conducted in accordance with Sharia principles. For *ijarah* contracts, the DPS oversees the determination of rental fees to ensure fairness and mutual agreement. It also ensures that the leased asset is fully owned by the cooperative prior to the leasing transaction. If the cooperative does not initially own the asset requested by the member, it is required to acquire ownership before entering into the lease agreement. Among these contracts, *murabahah*, *mudharabah*, and *ijarah* are the most frequently utilized in Islamic cooperatives. Consequently, the DPS allocates greater supervisory attention to these contracts. Supervision is conducted throughout the entire lifecycle of the contract, from initiation to completion. In addition to reviewing written reports and contract drafts, the DPS may also conduct interviews with management and members as part of its monitoring process.

Overall, the implementation of Sharia compliance reflects a collaborative effort between the DPS and cooperative management. While the DPS undertakes supervisory responsibilities, cooperative managers are expected to act cooperatively in ensuring adherence to Sharia principles.

Nevertheless, the effectiveness of this implementation may vary depending on the capacity, commitment, and governance quality within each cooperative. The analysis indicates that implementation challenges are mainly caused by organizational and managerial factors rather than deficiencies in the legal framework. Limited understanding of Sharia contracts, inadequate human resource capacity, and weak internal control systems reduce the consistency of Sharia implementation. Consequently, some cooperatives continue to apply financing practices that resemble conventional financial institutions, even though they formally adopt Sharia contracts.

Sharia Compliance Issues

The results of this investigation show that, although Islamic cooperatives in Indonesia are normatively supported by a well-established Sharia compliance framework through both government regulations and fatwas issued by the National Sharia Council of the Indonesian Ulema Council (DSN-MUI) the practical implementation of Sharia principles continues to face substantive challenges. These findings highlight a significant gap between the normative framework of Sharia compliance and its operational realization within Islamic cooperatives. One of the primary issues identified relates to the implementation of financing contracts (*akad*). Consistent with the findings of Rohmah and Sakinah (2025), this study reveals that non-compliance frequently arises when contracts are not executed in accordance with Sharia requirements. For instance, the practice of *murabahah* financing without prior ownership of the underlying asset by the cooperative remains prevalent. Such practices introduce elements of *gharar* (uncertainty), rendering the contract invalid from the perspective of Islamic economic law. This finding underscores that inadequate understanding and weak supervision of contract implementation constitute major sources of Sharia compliance risk.

In addition, this study identifies significant issues related to transaction recording and transparency. The lack of clarity in determining and communicating profit-sharing ratios (*nisbah*) in *mudharabah* contracts may create perceptions of unfairness among members. Over time, such conditions can undermine member trust in Islamic cooperatives. This finding aligns with the fundamental principles of Islamic finance, which emphasize clarity, fairness, and transparency as essential conditions for the validity of contracts and institutional sustainability. Sharia compliance challenges are also influenced by the relatively low level of Sharia literacy among cooperative managers and employees. The findings suggest that a limited understanding of fundamental differences between contracts, such as between *qardh* and *ijarah*, may lead to administrative errors and practices that deviate from Sharia principles. This confirms that the quality of human resources plays a crucial role in ensuring the consistent application of Sharia principles in cooperative operations.

Furthermore, this study reinforces the findings of Atmajaya et al. (2024), which highlight structural constraints affecting Sharia compliance, including limited resources, regulatory complexity, and low levels of Islamic financial literacy among members. These challenges are further compounded by difficulties in integrating technological innovation with Sharia principles, as well as weak commitment from top management in prioritizing Sharia compliance as a core element of institutional governance. Another critical factor influencing Sharia compliance is the limited effectiveness of the Sharia Supervisory Board (Dewan Pengawas Syariah/DPS). The findings indicate that Sharia supervision is often conducted as a formal administrative exercise rather than a substantive evaluation of transactional practices. This condition is influenced by time constraints faced by DPS members who are often prominent scholars or community figures with multiple responsibilities as well as their limited expertise in the technical and operational aspects of Islamic cooperatives. As a result, supervision tends to focus on formal conformity of contracts rather than their practical implementation.

This issue is particularly concerning given that the existence of the DPS is a legal requirement. Regulation of the Minister of Cooperatives and SMEs No. 11 of 2017 mandates that every Islamic cooperative must establish a DPS as a key instrument to ensure Sharia compliance. In addition, Regulation of the Deputy for Supervision No. 02/Per/Dep. 6/IV/2017 explicitly identifies adherence to Sharia principles as a core indicator in assessing the health of Islamic cooperatives. However, the findings of this study suggest that the presence of such regulatory and institutional structures does not necessarily guarantee substantive compliance with Sharia in practice. One implication of weak Sharia supervision is the persistence of hybrid or mixed-contract practices within a single transaction. Such practices create ambiguity regarding the rights and obligations of the parties involved, potentially introducing elements of *gharar* and rendering the contract defective under Islamic economic law. This finding reinforces the argument that formal contractual compliance alone is insufficient without continuous and substantive supervision of its implementation.

The occurrence of hybrid contract practices reflects the gap between normative legal requirements and operational realities within Islamic cooperatives. In practice, cooperative managers may modify contractual arrangements to accommodate members' financing needs and maintain institutional sustainability. However, the analysis suggests that limited understanding of the legal characteristics of each Sharia contract, together with weak Sharia supervision, may unintentionally result in the combination of contractual elements that are inconsistent with Islamic economic law. Consequently, preventing hybrid contract practices requires not only stronger regulatory supervision but also greater Sharia literacy and governance capacity among cooperative managers.

Moreover, Sharia compliance issues are also shaped by the pragmatic orientation of cooperative management, which often prioritizes operational efficiency and business sustainability over strict adherence to Sharia principles. In certain cases, this orientation encourages the adoption of practices that resemble conventional financial models, thereby blurring the distinct identity of Islamic cooperatives as Sharia-based institutions. This reflects an inherent tension between operational pragmatism and normative Sharia ideals in cooperative management. In addition, this study reveals a conceptual challenge arising from the differences between classical Islamic jurisprudence and DSN-MUI fatwas. While Islamic cooperatives operate based on DSN-MUI fatwas as their normative reference, these fatwas represent collective *ijtihad* that adapts Sharia principles to contemporary contexts. For example, the use of collateral in *mudharabah* contracts traditionally not required in classical jurisprudence, is permitted under DSN-MUI fatwas as a risk mitigation mechanism. This illustrates that Sharia compliance in practice operates within a spectrum between normative idealism and practical necessity.

Overall, the findings of this study demonstrate that Sharia compliance issues in Islamic cooperatives are multidimensional, encompassing regulatory limitations, supervisory effectiveness, human resource capacity, managerial orientation, and the dynamic interplay between normative Sharia principles and practical realities. Therefore, strengthening Sharia compliance requires a more comprehensive approach that goes beyond formal regulation, including enhancing human capital, strengthening institutional commitment, and improving the substantive effectiveness of Sharia supervision. Overall, the findings demonstrate that Sharia compliance should not be understood merely as compliance with written regulations. Instead, substantive Sharia compliance depends on the interaction between legal provisions, governance mechanisms, managerial commitment, and institutional capacity. Therefore, strengthening Sharia governance, particularly through enhancing the effectiveness of the DPS and improving managerial competence, is essential to bridge the gap between normative legal requirements and operational practice. This finding supports the argument that governance is the key determinant of substantive Sharia compliance in Indonesian Islamic cooperatives.

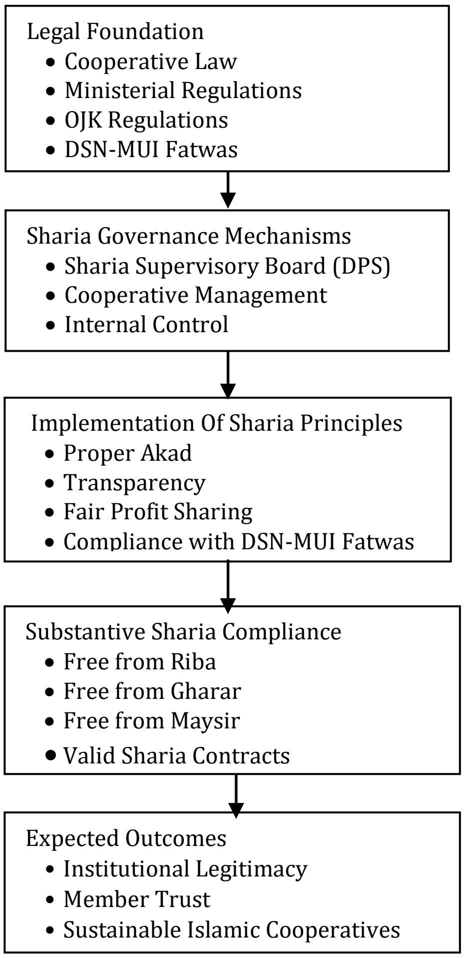

Figure 1.
Governance-Based Framework for Strengthening Sharia Compliance

Figure 1 illustrates the conceptual framework developed from the findings of this study. The framework shows that statutory regulations and DSN-MUI fatwas provide the legal foundation for Sharia compliance in Islamic cooperatives. However, substantive compliance cannot be achieved solely through regulatory requirements. Effective Sharia governance, particularly through the role of the Sharia Supervisory Board (DPS), cooperative management, internal control, and Sharia audit, functions as the key mechanism linking legal norms with the implementation of Sharia principles. The findings further indicate that governance challenges, including weak DPS effectiveness, limited managerial Sharia literacy, hybrid contract practices, and the gap between regulation and implementation, hinder the realization of substantive Sharia compliance. Consequently, strengthening governance mechanisms is essential for enhancing institutional legitimacy, member trust, and the long-term sustainability of Islamic cooperatives.

CONCLUSION

This study examined Sharia compliance in Indonesian Islamic cooperatives from the perspective of Islamic economic law using a governance-based approach. The findings demonstrate that although Indonesia has established a comprehensive legal framework through statutory regulations and DSN-MUI fatwas, substantive Sharia compliance has not yet been fully achieved. The main challenges lie not in the absence of regulations but in their implementation, including ineffective Sharia supervision, limited managerial understanding of Islamic economic law, inconsistent application of Sharia contracts (*akad*), and the persistence of hybrid contract practices. These findings indicate that Sharia compliance should be viewed not merely as a legal or administrative obligation but as a governance issue that requires effective institutional mechanisms to ensure the practical implementation of Sharia principles.

From a theoretical perspective, this study contributes to the literature by extending the understanding of Sharia compliance beyond formal regulatory conformity toward substantive Sharia compliance grounded in the principles of Sharia governance and Islamic economic law. The proposed governance-based framework demonstrates that effective Sharia compliance depends on the interaction between legal regulations, governance mechanisms, and organizational capacity. By emphasizing governance as the mechanism linking legal norms with their practical implementation, this study complements previous research that has primarily focused on operational, managerial, or financial aspects of Islamic cooperatives.

Practically, the findings guide cooperative managers and Sharia Supervisory Boards (DPS) to strengthen governance through continuous Sharia supervision, regular training in Islamic economic law, and improved internal control systems. From a policy perspective, regulators, particularly the Ministry of Cooperatives and SMEs and the National Sharia Council of the Indonesian Ulema Council (DSN-MUI), should enhance supervisory standards, strengthen the competency of DPS members, and establish more systematic Sharia audit mechanisms to ensure that Sharia compliance is implemented substantively rather than merely administratively.

This study is limited by its normative legal approach, which relies exclusively on documentary and literature-based analysis without empirical investigation of governance practices within individual Islamic cooperatives. Future research is therefore encouraged to adopt qualitative case studies, mixed-method approaches, or comparative studies involving cooperative managers, DPS members, regulators, and other Islamic financial institutions to provide a more comprehensive understanding of how governance mechanisms influence Sharia compliance in practice. Ultimately, this study argues that strengthening Sharia governance is essential for transforming formal legal compliance into substantive Sharia compliance, thereby enhancing institutional legitimacy, strengthening member trust, and ensuring the long-term sustainability of Indonesian Islamic cooperatives.

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