

Religiosity, Fraud Rationalization, and Market Discipline on Non Halal Income and Fraud

by Harry Suharman

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Foreword Dean
Faculty of Accountancy
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Assalamu'alaikum warahmatullahi wabarakatuh

Alhamdulillah with all His blessings, we are gathered here for the International Conference on Accounting and Management 2019 (ICAM 2019) organised by the Faculty of Accountancy, UiTM Puncak Alam Campus, Selangor. This conference, with the theme “Valiant Transformations Toward Sustainable Development,” will showcase distinguished speakers from the academics and industry who will be sharing their experiences and knowledge on issues pertinent to the sustainability of accounting and management in the current economic landscape.

It is my great pleasure to welcome all local and international participants to ICAM 2019. It is an honour for the Faculty of Accountancy to host all of you at this conference. The ultimate aim of the conference is to offer a strategic platform for participants to share and discuss new and current work on accounting and management. I am genuinely confident that the outcome of the conference will contribute towards knowledge enhancement, provide potential collaboration both in academics and research, and, most importantly, offer an enjoyable experience to all participants.

I want to take this opportunity to congratulate the Organizing Committee for their efforts in organizing ICAM 2019. I would also like to express my gratitude to the Faculty of Economics and Business, Universitas Padjadjaran, Indonesia, as co-host of this conference.

Kind regards,

Prof. Dr. Faizah Darus

Dean
Faculty of Accountancy
Universiti Teknologi MARA
Puncak Alam Campus
Selangor

**Religiosity, Fraud Rationalization,
and Market Discipline on Non Halal Income and Fraud**

Tettet Fitrijanti

Dini Rosdini, Prima Yusi Sari, Harry Suharman

Said Aryonindito, Amelia R. Alamanda

(University of Padjadjaran, Indonesia)

3 ABSTRACT

Islamic bank customers are one of the main stakeholders of Islamic banks. It is predictable that customers deposit or withdraw funds in a particular Islamic bank with a certain consideration. Saving and withdrawing funds is a proxy of market discipline for Islamic banks. The consideration of Islamic bank customers is suspected to be influenced by attitudes that depend on a value they have. An Islamic bank is a bank that claims to engage sharia principles in its business. Therefore, conformity to sharia principles become one of its main foundations. To ensure this matter, Islamic banks in Indonesia must report non-halal income in their annual reports. In addition to reporting non-halal income, Islamic banks also report fraud. There is several information about the events of Islamic bank fraud announced by the mass media or social media.

The study aims to examine whether the customer conducts market discipline by intending to withdraw funds from an Islamic bank if it is known that the Islamic bank has a number of non-halal income and fraud, and to carry out further study on whether or not the attitude of the tendency to withdraw in response to non-halal income is affected by their religiosity. In connection with the occurrence of fraud at an Islamic bank, the study also examines whether or not the attitudes of customers withdrawing their funds are affected by their tendency to rationalize fraud; and whether the tendency of consumers to rationalize fraud is influenced by their religiosity. The research uses survey method. The samples of the study consists of 276 bank customers. Data processed by multiple regressions with age as a control variable.

The study shows that the more religious customers are, the more market disciplined occurs for non-halal income. The more religious customers are, the higher his/her tendency to withdraw funds from Islamic banks when the bank has non-halal income which is significantly increasing. Age does not affect the tendency of customers to withdraw or not withdraw funds from an Islamic bank if the bank experiences a significant increase in non-halal income.

The study also discovers that the more religious customers are, the less he/she rationalized fraud. However, the low rationalization of fraud by a customer, does not result in an increased tendency to conduct market discipline when an Islamic bank experiences fraud. And the more religious customers are, does not result in an increased tendency to conduct market discipline on fraud. It is suspected that the Islamic bank customers tend to believe that fraud at Islamic banks can be corrected. And customer discipline over non-halal income is more robust than customer discipline over fraud in an Islamic bank. However, the results of the sensitivity analysis and interviews indicate that market discipline will occur when customers believe that an Islamic bank can harm them by withdrawing their funds and transferring it to another Islamic bank.

Keywords: Islamic bank, Religiosity, Non halal Income, Fraud Rationalization, Market Discipline

INTRODUCTION

Sharia is the entire matters that are regulated in Islamic teachings as a command or prohibition for individuals who adheres to it (Rosly, 2010). His instructions include man's relationship with His Lord and with His fellow creatures. Acting in accordance with His references, the Alquran and Assunnah, is a form of obedience (Derigz & Marzban, 2008).

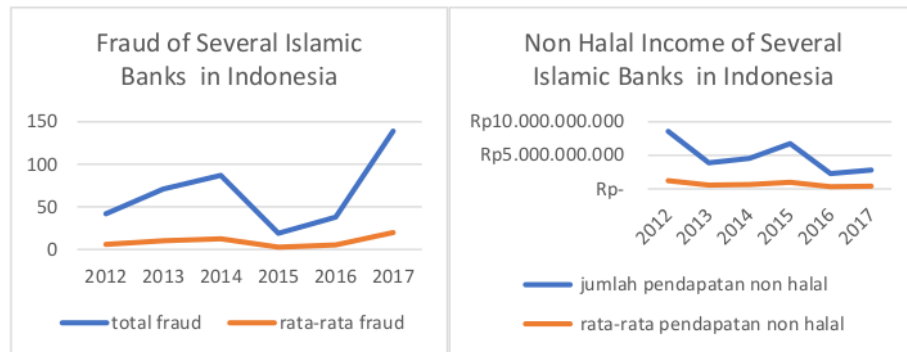
Islamic banks are characterized by principles, stating that business as a part of muamalah must evade matters that are prohibited in Islam, namely *maysir*, *gharar*, and *riba* (Gerrard & Cunningham, 1997; Rashid, Hassan & Yein, 2014). Profit acquisition for operating costs and the increase of stakeholders' welfare are obtained through the distribution of margin income, *ujroh*, service revenues and profit sharing which is referred to as profit-loss sharing (PLS) system (Siddiqui, 2008;). The existence of usury income in Islamic banks, also named as non-halal income based on the financial reporting standard for Indonesian Islamic entities, is one form of non-shariah compliance.

Sharia values not only underlie the commercial nature of the Sharia-based institution, including Islamic banks, but should also underlie the behavior of individual actors in carrying out their duties in Sharia-based institutions (Hamza, 2013). Attitudes and behaviors based on Islamic values are the dimensions of sharia principles that should be the standard value for business people in the internal and external parts of Islamic banks. Fraud in the Islamic Bank can therefore be considered to be actions with minimum occurrence. In Indonesia, fraud must be disclosed as a complete information to investors by Islamic banks.

Despite the presence of Shariah Standard Board (SSB) in Islamic banks, it appears that non-halal income can not be eliminated to a zero level. Likewise, Islamic banks holds highly stringent regulations, either from Financial Services Authority, Bank Indonesia Regulations and so forth, and yet, fraud still occurs (see Table 1). One example of fraud is occupational fraud or crime that occurred in 2012 through the involvement of certain people with a certain position in the Islamic Bank in Indonesia. These fraud cases in the form of fictitious customers has startled the public.

Table 1

Trends on The Number of Fraud and Non-Halal Income in Several Islamic Banks in Indonesia



Previous research has shown that customers withdraw their funds when there is an information or report of fraud has occurred in a bank (Rauyruen and Miller 2007, in Hoffman & Birnbrich 2012). The actions of customers withdrawing funds are referred to as market discipline. What about the information on non-halal income from Islamic banks? Do banks experience market discipline as well as fraud? No previous research has been found about the market discipline on non-halal income.

A person's attitude is shaped by the values they hold. A value adopted by a person determines his attitude towards the Islamic bank when sharia non-compliance occurs. Religiosity is the extent to which a person is committed to the teachings of his religion, in the form of individual attitudes and behaviors that reflect that commitment (Johnson et al., 2001: 25). Nizar Souiden Marzouki Rani (2015) states that consumer attitudes and purchase intentions towards Islamic banks are affected by their religiosity. Accordingly, it is suspected that religiosity affects the actions of customers in conducting market discipline at Islamic banks that experience non-halal income, and fraud as well.

Fraud can occur because of the opportunity, rationalization and pressure (Cressey, 1950). The Triangle of Fraud Theory is generally used to explain the background of the perpetrators in committing fraud. Previous research on customer attitudes that does and does not justify fraud called rationalizing a fraud has not been found. Likewise, no previous research has been found regarding the relationship of religiosity with the customers's attitude to rationalize or not to rationalize fraud in Islamic banks; and no previous research has been found regarding the

relationship between rationalizing or not rationalizing attitude towards fraud with market discipline on fraud.

THEORETICAL FRAMEWORK

Non-Halal Income

Non-halal income is an account within a financial report, designed by the sharia accounting standard drafting board and the stakeholders involved, to accommodate all revenue of sharia entities that do not fulfill the halal criteria. This non-halal income is not an income that will be accumulated as a source of profit sharing. Non-halal income, together with the income from infaq, alms, outcomes from waqf management, and fines can only be used for public purposes, donations and productive virtue funds.

Islamic banks are required to disclose non-halal income in their reports regarding the sources and uses of virtue funds as regulated in PSAK 101. This report is an inseparable part of the financial statements and annual reports of Islamic entities in Indonesia, including Islamic banks. This reporting is a form of effort to encourage the realization of sharia entity compliance. No previous specific research on non-halal income of islamic bank has been found.

Fraud & Fraud Rationalization

Fraud is an act of enriching oneself or another party by abusing power or authority to fulfill personal interests (ACFE, 2010). Based on the Fraud Triangle Theory by Donald Cressey (1950) one of three matters that may cause a person to commit fraud is rationalization. With respect to rationalization, fraud is carried out when a person cannot realize that their actions are unethical. Cressey (1953, in Rabi'u Abdullahi Noorhayati Mansor Muhammad Shahir Nuhu 2015) states that rationalization of fraud refers to the justification that unethical behavior is something other than criminal activity. Examples of rationalization are "I committed a fraud because I was paid too low" or "I had to steal to provide for my family" (Cressey 1953, in Rabi'u Abdullahi Noorhayati Mansor Muhammad Shahir Nuhu, 2015)

The attitude of rationalizing fraud is allegedly adopted by individuals outside an institution. This attitude is expected to affect an individual when responding to fraud information.

He might say, for example, "I can tolerate the occurrence of fraud because the penalty for the fraud here is not too strict".

Religiosity

Religiosity is inherent in individuals and has a personal dimension that represents a person's real relationship with God (Slater et al., 2001). Religiosity from Islamic perspective is defined as a consciousness of God and a desire to strike a balance between obedience to God's commands and worldly needs (Fariza and Salahuddin 2015, in Jamaliah 20...).

Dimensions of religiosity are ¹¹ the active illegal (such as "Drinking a can of soda in the store without paying for it.), the passive illegal ¹¹ (such as, "Getting too much change and not saying anything), the active legal (such as, "Returning merchandise to a store by claiming that it was a gift when it was not) and no harm (such as, "Installing software on your computer without buying it) (Vitell, S. J., Paolillo, J. G. P., & Singh, J. J., 2005). Dimensions of Islamic religiosity are iman, islam and ihsan.

Market Discipline

Market discipline discusses the issue of conflict of interest in market imperfections that cause agency problems (Ingo Walter, 2004). According to Bliss and Flannery (2001), market discipline is divided into two components, namely market monitoring and market effects. Market monitoring refers to the hypothesis that investors accurately evaluate changes in company conditions and they incorporate this valuation appropriately into the value of a company's securities. Market effect is a process when external parties influence the actions of a company (Mark J Flannery, 2001).

Market discipline refers to market-based incentive schemes where investors in bank obligations penalize banks for taking greater risks by demanding higher returns on those obligations. The reason market discipline is needed is that banks tend to engage in moral hazard behavior (Erlend Nier & Ursel Baumann, 2006).

HYPOTHESIS DEVELOPMENT

Research by Monique Arnold and Peter-Jan Engelen (2007) shows that market discipline is in the form of a negative reaction from shareholders to the announcement of illegal activities. According to Rashidah Abdul Rahmana and Irda Syahira Khair Anwar (2014), fraud imposes various costs for organizations experiencing fraud, such as a loss of reputation, finance, human resources, and are exposed to the risk of bankruptcy. Fraud can damage the bank-customer relationship because of broken trust (Krummeck, 2000, in Hoffman & Birnbrich 2012). Fraud can negatively affect customer loyalty and stimulate switching behavior (Rauyruen and Miller, 2007; Gruber, 2011, in Hoffman & Birnbrich 2012).

Such market discipline needs to be aware of Islamic banks. When a customer finds an Islamic bank where he can deposit funds according to his expectations regarding Islamic bank criteria, he/she may keep the funds in that Islamic bank. Conversely, when a customer is disappointed with a bank, he/she may transfer his/her funds to another bank.

Individual differences in religiosity are related to differences in established perceptions that might guide individuals in the process of selecting solutions for specific needs (La Barbera, 1987). Religiosity plays an influential and dominant role in the formation of attitudes and is related to the reasons why people consume something (Razzaque and Chaudhry, 2013). There is a relationship between Muslim religiosity and purchase intentions of various categories of Islamic financial products (Farhana Tahmida Newaz, 2016). As what has been conveyed by Ahmet F. Aysan, Mustafa Disli & Meryem Duygun & Huseyin Ozturk (2016) that religious reasons may play a strong role in the decision to deposit funds to Islamic banks.

This research used customer reaction as a form of market discipline for sharia non-compliance with Islamic banks. Customers deposit their funds in Islamic banks because they assumed that the banks comply with the sharia principles. The awareness, and even the reaction of customer upon sharia non-compliance is allegedly dependent on their religiosity. It is assumed that customers are aware of the sharia compliance in Islamic banks. Although there is a study by Ahmet F. Aysan, Mustafa Disli & Meryem Duygun & Huseyin Ozturk (2016) which concludes that although a profit-and-loss sharing framework might contribute to market discipline, the influence of religious commitment on depositors' sensitivity to bank financial conditions is not unequivocal.

The existence of non-halal income is assumed as a non sharia-compliance reported by sharia entities. A significant number or growth of non-halal income may assumed by the customers indicates that the entity does not optimally maintain its compliance with the main principles of the Sharia entities. Customers may assume that the Islamic bank is similar with conventional bank that relies on interest income. In view of the fact that customers keep their funds in Islamic banks because they avoid interest, it can be suspected that the existence of interest income in Islamic banks can disappoint customers.

Rationalization is the justification of fraudulent behavior due to a lack of personal integrity, or other moral reasons (Rae and Subramanian, 2008, in Rabbi Abdullah, Abdullah, Noorhayati, Mansor Muhammad Shahir Nuhu 2015). Individuals who commit fraud have a certain mindset that allows them to forgive, excuse or justify their fraudulent actions (Hooper and Pornelli, 2010). The tendency to commit fraud depends on one's ethical values (Rabbi Abdullah Abdullah Noorhayati Mansor, Muhammad Shahir Nuhu 2015). Religiosity is statistically significant and negatively correlated with misuse of assets (Jamaliah Said, Md. Mahmudul Nature, Zulyanti Abdul Karim, Razana Juhaida Johari, 2018). Then the attitude of rationalizing fraud might be influenced by religiosity as well. But unfortunately, as customers increasingly tend to rationalize fraud, it is not automatically reduce the market discipline of fraud. Religiosity is statistically significant and negatively correlated with misuse of assets

Alternative hypothesis:

- The more religious customers are, the more market discipline on a significant increase of non-halal income in Islamic bank occurs
- The more religious customers are, the more market discipline on fraud in Islamic bank occurs.
- The more religious customers are, the less rationalization on fraud of Islamic bank
- The more fraud rationalization by customers are, the more market discipline on fraud occurs in Islamic bank.

THE RESEARCH METHODS

Specifically, this research aimed to verify the causal association between variables through hypothesis testing. The data of this research are primary data. The research uses survey

method. Data processed by multiple regressions with age as a control variable. This research is primarily quantitative research, but we also conduct interviews to gain insight into discussions that are closer to the facts of the respondents' views.

The variables of the research Religiosity, Market discipline on Non Halal Income, Market Discipline on Fraud and Fraud Rationalization. Religious dimensions include active and passive illegal, active legal and no harm considering that religiosity referred to this research will be examined for its effect on the rationalization of fraud and market discipline on fraud and non-halal income. Derived questions from these dimensions can be mapped into relationships with God and relationships with God's creatures

Table 2
“Religiosity Variable”
Operational Definition & Measurement

Dimensions	Statements in questioner	Dimensions	Score
Active illegal	1. Abandoning compulsory prayers several times in life is a normal thing that does not need to be regretted	Relationship with Allah	Strongly agree = 1
Active illegal	2. It is not normal to return debt to family and close friends without an apology	Relationship with Human	Strongly agree = 1
Passive illegal	3. In a transaction, you receive an excess of money without being realized by the seller/cashier. Considering the practical reasons, these excessive money are not required to be returned and can be used for personal purposes	Relationship with Human	Strongly agree = 1
Passive illegal	4. A children offers him/herself to work full time. Considering this is his/her request, then it is not a mistake of the minor for you to accept him/her working full time	Relationship with Human	Strongly agree = 1
Active legal	5. Maintaining and carrying out the mandate is important as a virtuous human being that is not related to self-service as a servant of God	Relationship with Allah	Strongly agree = 1
Active legal	6. Providing assistance to the poor is good for getting good repayments from fellow human beings and is not related to self-service as a servant of God	Relationship with Allah	Strongly agree = 1
No harm	7. The persecution of a minority group by the majority that occurred in an area far	Relationship with Human	Strongly agree = 1

No harm	8. The most important thing in doing something is to make it useful to yourself, even when it can be harmful to others.	Relationship with Human	Strongly agree = 1
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Market discipline is measured by the attitude of switching or attracting customer funds (negative effects) (Rauyruen and Miller, 2007; Gruber, 2011, in Hoffman & Birnbrich 2012) as a response to fraud and non-halal income on Islamic banks.

Table 3
“Market Discipline on Non Halal Income & Fraud Variables”
Operational Definitions & Measurements

Cases	
The media reported a fraud action occurs at an islamic bank and the perpetrator was one of the bank's management. If you are a customer of the islamic bank, then your attitude towards the islamic bank:	An islamic bank discloses a number of non-halal income in its annual report which, although not significant, the number tends to increase. If you are a customer of the islamic bank, then your attitude towards the islamic bank:
1. It is unlikely that you will immediately transfer your funds to another Islamic bank (SA=1) 2. It is unlikely that you will immediately transfer your funds to a conventional bank (SA=1) 3. You will not necessarily invite your friends and relatives to immediately move your funds to other Islamic banks (SA=1) 4. You will not necessarily invite your friends and relatives to immediately move your funds to conventional banks (SA=1) 5. You tend to remain willing to be a customer of the Islamic bank (SA=1) 6. You will not easily decide to immediately withdraw your funds from the Islamic bank, regardless of where you are going to move it (SA=1) 7. For you, the Islamic bank is still safer than other Islamic banks (SA=1) 8. For you, Islamic banks are still safer than conventional banks (SA=1)	

(SA, Strongly Agree)

Table 4

**“Fraud Rationalization Variable”
Operational Definitions & Measurements**

Fraud Rationalization is the justification of fraudulent behavior by forgiveness, excuse or justify the fraudulent actions (Hooper and Pornelli 2010; Rae and Subramanian 2008 in Rabbi Abdullah, Abdullah, Noorhayati, Mansor Muhammad Shahir Nuhu 2015)

1. Someone committing an act of fraud (fraud) / contrary to the law can be due to personal needs. Therefore you think cheating people can be tolerated (SA = 5)
2. Someone committing an act of fraud (fraud) / contrary to the law can be caused by many of the actions done by others. Therefore you think cheating people is normal (SA = 5)
3. Someone commits acts of fraud (contrary to law) in the hope that they will have the opportunity to ask God for forgiveness before death comes. Therefore you think cheating people is easy to forgive (SA = 5)
4. Someone cheating / contrary to the law can be because the environment does not consider fraud as a crime. Therefore you think the person's actions are natural (SA = 5)
5. Someone cheating / contrary to the law can be due to penalties for cheating is not effective. Therefore you think that person's actions can be understood (SA = 5)
6. Someone committing fraud (contrary to the law) can be caused by the leader concerned doing the same thing before. Therefore you think that person's actions can be understood (SA=5)
7. Someone committing fraud (contrary to the law) can be caused by doing so the person concerned is more accepted by his environment. Therefore you think that person's actions cannot necessarily be considered wrong (SA = 5)
8. Someone cheating / contrary to the law can be due to his assessment that the fraud is immaterial. Therefore you think that the person's actions are insignificant to be considered cheating (SA=5)

*SA = Strongly Agree

The models are:

$$\text{MD on NHI} = \alpha + \beta_1 R + \beta_2 \text{Age} \quad (1)$$

$$\text{MD on F} = \alpha + \beta_3 R + \beta_4 \text{Age} \quad (2)$$

$$\text{FR} = \alpha + \beta_5 R + \beta_6 \text{Age} \quad (3)$$

$$\text{MD on F} = \alpha + \beta_7 \text{FR} + \beta_8 \text{Age} \quad (4)$$

Where:

MD on NHI = Market discipline on Non Halal Income

MD on F = Market discipline on Fraud

R = Religiosity

FR = Fraud Rationalization

The respondents of the study are 276 bank customers, consists of 172 of an islamic bank customers & conventional as well (double type of banks), 101 respondents of a conventional bank customers only, and 3 respondents with no bank information.

RESEARCH RESULT

We conduct reliability & validity test and the results indicate the questioners are reliable & valid. The demography of the respondents:

Table 5
Demografi of Respondents

	Demografi	Number	%
Gender	Man	123	44.6%
	Woman	153	55.4%
		276	100%
Age	<22	22	8.0%
	22-39	126	45.7%
	40-60	122	44.2%
	>60	6	2.2%
		276	100%
Bank account	Islamic & conventional banks	153	55%
	sharia banks only	19	7%
	conventional banks only	101	37%
	no information	3	1%
			100%

276

From table 5 we can see 62% of respondents already have islamic bank account. And 90% of respondents ages are at around 22 – 60 years old.

Table 6
Hypothesis Testing Results

Hypotheses	Exepected sign	All Samples		Without Conventional Bank Customer	
		Coefficient	Sig. value	Coefficient	Sig. value
The more religious customers are, the more market discipline occurs for non-halal income	(+)	0.222*	(0.012)	0.276*	(0.035)
The more religious customers are, the less he/she rationalized fraud	(-)	- 0.534*	(0.000)	-0.400*	(0.000)
The more customer rationalized fraud, the less market discipline occurs	(-)	-0.078	(0.348)	-0.793	0.262
The more religious customers are, the more market discipline occurs on fraud	(+)	0.107	(0.206)	0.041	0.732
	(+)	0.132*	(0.042)	0.264*	(0.013)
The more religious customers are, the more market disciplined occurs on fraud					

The test results in table 6 presents that the more religious customers are, the more market disciplined occurs for non-halal income. Both of the coefficients are positive, 0.0222 and 0.276, and statistically significant, for all samples (276 respondents) and for customers whose islamic banks account (172 respondents). The more religious customers are, the less he/she rationalized fraud, with negative coefficients (-0.534 and -0.400) and both are statistically significant.

However, the low rationalization of fraud by customer does not result in an increased tendency to conduct market discipline when an Islamic bank experiences fraud. It is suspected that Islamic bank customers tend to believe that fraud in Islamic banks can be corrected.

And the more religious a customers are, does not result in an increased tendency to conduct market discipline on fraud. Customer discipline over non-halal income is more robust than customer discipline over fraud in an Islamic bank.

We conduct a sensitivity analysis by removing statements of moving funds to conventional banks from the questionnaire, so that the choice of attitude available was to move funds to other Islamic banks when fraud occurred at an Islamic bank. The result of the sensitivity analysis indicate that the more religious customers are, the more market disciplined occurs on fraud. The customers whose Islamic banks accounts off course are more sensitive to give negative respond on fraud in an Islamic bank by moving their funds into the other Islamic banks.

DISCUSSIONS

As mentioned by Razzaque and Chaudhry (201300), religiosity has an influential and dominant role in the formation of attitudes. Religiosity results an individual desire to strike a balance between maintaining obedience to God's commands and meeting worldly needs. The results of the research show that the religiosity of individu increases the market discipline on fraud, especially of customers whose islamic banks account. So, the islamic banks experience fraud may bear losses in the form of loss of funds, customers, which automatically also may threaten its reputation.

Several the novelties of the research are the finding that the religiosity could increase the market discipline on non halal income. This finding of research insubstance inline with the previous research that religious reasons may have a strong role in the islamic banks customer decision to deposit or withdraw funds into or from Islamic banks (Ahmet F. Aysan, Mustafa Disli & Meryem Duygun & Huseyin Ozturk, 2016). We can see that banks customers are more sensitive into non halal income information, include conventional bank customers. The other novelty of this research is the finding that religiosity reduce fraud rationalization by customer of bank. The third novelty is the finding that commitment to obey into God's teaching forms a clear attitude to reject fraud. Unfortunately, the less fraud rationalization does not increase the market discipline on fraud, consistent in the 2 types of samples. Customers of islamic banks may be

emotional customer. For Islamic banks's customers, staying hold their fund in the Islamic bank is better than going to conventional banks because of the syariah compliance.

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