Financial Reporting Quality: Sharia Compliance in Islamic bank (Indonesia)

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ABSTRACT

This study aims to know whether Sharia compliance improves the quality of financial reporting in Islamic banking in Indonesia. This study consists of 11 Islamic banks in Indonesia. The type of data used in this study is secondary data. The data was obtained from annual report of Islamic banking in Indonesia. The quality of financial reporting by discretionary accrual. This study finds that Sharia, ROA, SIZE,SHloss have positive relationship with the quality of financial reporting. LNAge, Big4 and SBBcross has negative relationship with the quality of financial reporting. Based on these findings, Sharia compliance affects the quality of financial reporting. The implications of sharia banking compliance on the quality of financial reports are higher transparency, increased customer trust, and encouraging sustainable economic growth. In addition, this compliance can also reduce legal and reputational risks, which in turn will attract more investment. Thus, sharia banking not only functions as a financial institution, but also as a driver of ethical and social values in society. The limitation of this study is that it only covers 2 periods. It is hoped that further research can add periods and use other methods in measurement.

Keywords : Financial Reporting Quality; Sharia Compliance; Modified Audit Opinion

I. INTRODUCTION

Financial institutions serve as a framework that facilitates convenience by offering a variety of services and facilities, including savings and financing of business operations. The role of financial institutions is very important in ensuring the economic stability of a country. Specifically, in the context of Islamic banking, the Islamic banking sector in Indonesia continues to face many challenges, one of which is related to compliance with questionable Islamic principles, as this is non-negotiable. Constraints on operational activities are basically rooted in the Quran and Sunnah, which include the Hadith of the Prophet Muhammad (PBUH). Secondary sources include Fatwa, Ijma, and Qiyas. Compliance with Islamic compliance does not depend on the legal framework of a country but rather depends on different criteria that are in line with Islamic teachings.

In the field of Islamic finance and compliance with Islamic principles, Islamic financial instruments generate ethical and sinless returns. In accordance with Islamic law, returns should not be based on interest, excessive speculation, or short-selling practices. The sharing of risk and reward (or loss) is essential between the creditor and the debtor. As a result, the creditor takes on the role of an ally of the debtor. Investments and companies are expected to generate proper returns, as they cannot be based on activities deemed impermissible by the Shariah. There are four Shariah indices that have been established by the Financial Times Stock Exchange, Standard and Poor's (S & P), Dow Jones, and Morgan Stanley Capital International (MSCI) (Ashraf, 2013). These entities do not engage in activities deemed impermissible under Shariah law. In order to comply with Shariah principles, companies are prohibited from engaging in business activities such as non-Islamic finance, alcoholic beverage production, tobacco-related companies, gambling, cloning, narcotics, pork, and adult entertainment. Islamic financial instruments cannot be based on such activities or corporations as they are deemed impermissible. This index classifies companies designated as “Shariah compliant” based on three specific criteria, which include business activities, financial ratios, and governance (Wan Zainal et al., 2016). This index serves to reflect stronger financial instruments and reduce associated risks.

Islamic financial instruments reduce risk for investors while ensuring legitimate returns through the prohibition of riba and the bundling of various contracts and products that minimize risk. Shariah-compliant financial instruments explicitly prohibit investors from gaining profits through short-selling activities. This prohibition is based on Islamic Shariah, serving as a distinguishing feature that distinguishes Islamic financial instruments from their conventional counterparts. Shariah-compliant banks engage in profit-and-loss sharing arrangements arising from collaborative funding of projects (Boulila Taktak et al., 2010). Shariah-compliant financial instruments, including Murabahah, Musharaka, Istisna, Mudharabah, Ijara, Wakala, Sukuk, and Zakat, generate assets, liabilities, income, and expenses for the individual or entity holding them (Organization of Islamic Cooperation's Standing Committee on Economic and Commercial Cooperation, 2017). Shariah-compliant financial instruments impose restrictions that prevent their holders from engaging in high-risk activities and gaining profits from trading based on short-selling. Given these constraints, Islamic financial instruments are anticipated to experience a decline in effective earnings management practices. These restrictions create a favorable difference (Pepis & de Jong, 2019).

Indonesia is home to a variety of sharia compliant financial institutions, including Muamalat, BNi Syariah, BRi Syariah, BCA Syariah, BSM, and others. The sharia banking sector in Indonesia is still relatively underdeveloped when compared to its conventional banking counterparts. The Islamic finance index lags significantly behind, recording only 9.1 percent compared to the national financial index, which stands at 76.19 percent. Despite these differences, the sharia banking industry has shown a consistent growth trajectory. Evidence of this development is reflected in the accumulation of assets in 2014, where the total assets of sharia banking entities, both conventional and sharia business units, reached IDR 260.36 trillion. This figure is only 4.78% of the total assets in the conventional banking sector, which reached IDR 5,445.65 trillion, and then increased to IDR 296.26 trillion in December 2015, marking a substantial increase of 20.33%, reaching a peak of IDR 356.50 trillion at the end of December 2016. After that, assets jumped to IDR 435 trillion in 2017, and then to IDR 589 trillion in 2018. This data shows strong performance in the banking sector, as evidenced by consistent annual asset growth. This upward trend raises questions about whether the rate of expansion of Islamic banking institutions is in line with the increasing level of compliance and how profit management strategies adapt in relation to the company's business growth.

This research was developed from the journal of (Can, 2021) but what differentiates it is the measurement of sharia compliance and the quality of financial reports. This study aims to reveal whether Sharia compliance improves the quality of financial reporting in Islamic banking in Indonesia. By providing a different perspective on the quality of financial reporting of Islamic companies, namely by measuring the quality of financial reporting with discretionary accruals and modified audit pinion.

II. RESEARCH METHOD

This research is a type of research with a quantitative method. This study consists of 11 Islamic banks in Indonesia are Muamalat, BNI Syariah, BRI Syariah, Mandiri Syariah, Mega Syariah, Maybank Syariah, Panin Dubai Syariah, BJB Syariah, Victoria, Bukopin Syariah and Bank BCA Syariah.

The type of data used in this review is secondary data. The data was obtained from the 2019-2021 annual report of Islamic banking in Indonesia. Samples have a variety of qualities that require clarification. This study uses data collection techniques with purposive sampling and uses regression analysis.

To test the hypothesis, this research model examines the effect of Sharia compliance on the quality of financial reporting with the following models:

MAO = a + þ1 SADit + þ2SIZEit + þ3ROAit+þ4AGEit+þ5BIG4it+þ6SBBCROSSit+þ7SBBSIZEit+þ8CHOLDit+þ9GROWTHit +þ10Lossit + ϵit

III. RESULTS AND DISCUSSION

The SAD variable has a positive effect on the quality of financial reports in accordance with the hypothesis prediction where the task of the sharia audit department in maintaining sharia compliance of Islamic banking is to conduct a thorough examination and assessment of all transactions and products offered, ensuring that every step taken is not in accordance with Islamic law.

ROA has a positive effect on the quality of financial reports, this result is in accordance with the researcher's initial prediction that companies with high ROA tend to have lower suspicions of a modification of audit opinion.

The Size variable has a positive effect on financial reports, which means that large companies tend to be the focus of attention from various parties, because of the possibility of obtaining greater profits compared to small companies, so that companies with larger sizes are less likely to make audit adjustments, because large companies tend to act carefully in managing profits efficiently, so that the Financial Report is good (Ashraf, 2013; Boulila Taktak et al., 2010; Can, 2021; Islam et al., 2023; Jawadi et al., 2013; Pepis & de Jong, 2019; Wan Zainal et al., 2016)

The Big4 variable has a negative effect on the quality of financial reports, this result is not in accordance with the initial prediction, perhaps because not all companies audited by Big4 are guaranteed the quality of their financial reports. SSBcross and loss have a negative effect on the quality of financial reports.

Table 1. Result

No.	Variable	Prob
1.	SAD	0.0445**
2.	ISFIN	0.165
3.	SSBSIZE	0.4535
4.	SSBCROSS	0.0955*
5.	ROA	0.001***
6.	SIZE	0.068*
7.	BIG4	0.017**
8.	LNAGE	0.0165**
9.	SHLOSS	0.042**
10.	GROWTH	0.007***
11.	CHOLD	0.008***

IV. CONCLUSION

Based on the results of the test and discussion in the previous chapter, it can be concluded that there is a positive relationship, which means that the higher the level of sharia compliance, the higher the quality of financial reports, because banks are able to maintain and safeguard sharia principles. These results are in accordance with the hypothesis that sharia compliance has a positive effect on the quality of financial reports. This study only uses 2 periods, namely 2019 - 2020 with 10 sharia banks in Indonesia. This research method uses regression analysis, to be able to see the comparison between before and after covid19 can use DID. The quality of financial reports can be measured in other ways, for example the Dechow model, from the sanctions given to KAP, auditor competence, working paper quality, discretionary accrual measurement method with the Kasznik method on the dependent variable of financial report quality and others. Another limitation is the measurement of sharia compliance where there are still many other variables to measure sharia compliance. So, it is hoped that further research can develop this research by adding other variables that are suspected of having an effect on the quality of financial reports.

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