CORPORATE GOVERNANCE AND DISCLOSURE OF SHARIA COMPLIANCE BASED ON AAOIFI STANDARDS IN SHARIA BANKS IN INDONESIA

Lis Yulitasari [1*)], Tulus Suryanto [2], Syamsul Hilal [3]

Raden Intan State Islamic University Lampung, Indonesia

[*]Email author correspondent: lisyulitasari05@gmail.com

Abstract

Purpose – The main objective of this research is to analyze the corporate governance and disclosure of Sharia compliance in Indonesian Islamic banks based on AAOIFI standards.

Method – This qualitative study utilizes a literature review method. Sharia compliance in Islamic banks refers to adhering to the principles and Fatwa issued by the National Sharia Council, as these Fatwa represent the embodiment of Sharia principles and regulations that must be followed in Islamic banking.

Result – The study's findings indicate that, in general, Islamic commercial banks have implemented several AAOIFI standards regarding Governance and Sharia compliance. However, there is still one AAOIFI standard that remains unimplemented by Islamic commercial banks.

Implication – AAOIFI standard pertains to the Internal Sharia Review, which should be incorporated into the bank's policy.

Keywords : Corporate Governance, Sharia Compliance, Sharia Bank, Accounting and Auditing Organization for Islamic Financial Institutions

INTRODUCTION

Compliance refers to the adherence to values, behaviors, and actions that ensure adherence to Bank Indonesia regulations and relevant laws, including Sharia principles for Sharia commercial banks and Sharia units. If the phenomenon of Sharia compliance is related to the awareness of the Islamic community globally, then an understanding of the relationship between the concept of sharia compliance and Islamic law needs to be elaborated.[2] The idea of Islam is universal and rahmatan lil 'alamin so that adherence to the concept of Sharia for the Islamic banking industry is crucial. Along with increasing public awareness of the application of Islamic law, it must be balanced with increased adherence to Sharia principles.[3]

The development of Islamic banks in Southeast Asia shows their variations. The Islamic Financial Services Board (IFSB) 2018 released data regarding Islamic banks' market share in several ASEAN countries. Malaysia has a market share of 24.9% of Malaysian banking assets. Indonesia has a market share of 5.4% of total national banking assets. Brunei Darussalam experienced an increase in its market share for Islamic banks to 61.8% of Brunei Darussalam's total banking assets. Singapore and Thailand, as Muslim minority countries, have a market share of less than 1% of total banking assets in these countries.[4]

Sharia compliance plays a crucial role in implementing the risk management framework and fostering a culture of compliance within Islamic banking. It serves as a tangible expression of upholding all Sharia principles in institutions that possess the distinctive characteristics of Islamic banks, emphasizing integrity, and credibility.[5] To be able to regulate and supervise Islamic financial institutions, an appropriate methodology is needed in making regulations for each form and various types of Islamic financial institutions so that later these standards can also be accepted generally or globally.[6]

Efforts have been made to increase the transparency of financial conditions, as well as the preparation of financial reports that are relevant, comprehensive, reliable, and comparable, so there is a Sharia Accounting Standard (SAS) which is aimed at entities that carry out sharia transactions, both sharia institutional entities and non-sharia institutions in Indonesia. SAS development follows the general SAK model but is based on Sharia regarding the MUI fatwa.[7] PSAK Syariah is mainly taken from the standards issued by Accounting and Auditing for Islamic Financial Institutions (AAOIFI). The AAOIFI standard is an international Sharia accounting standard that is a uniform accounting treatment for global Sharia entities.[8] This uniformity is related to rules such as measurement methods, recognition, and reporting of products issued by Islamic banking abroad. Although Indonesia does not require the application of AAOIFI standards, this standard can be used as a reference in preparing accounting standards for Islamic financial institutions in Indonesia.[9]

In practice, some Islamic banks still face challenges in achieving full Sharia compliance. These challenges arise due to variations in products, services, and Islamic financial instruments that are offered and marketed across different countries. Certain offerings might not be acceptable in certain countries because the scholars or religious authorities in those countries may deem the contract used as non-compliant with Sharia principles or inconsistent with the schools of thought followed by the government or the Muslim community in that particular country. These discrepancies in Sharia compliance can result in limited cross-border operations for Islamic banks and may require them to adapt their offerings to conform to the specific Sharia interpretations and regulations of each country they operate in. As a result, achieving uniform Sharia compliance across all jurisdictions can be complex and may necessitate careful consideration and engagement with local scholars or religious authorities to ensure full compliance with applicable Sharia principles.[10]

Indeed, the example of the Bai' Bitsaman Ajil (BBA) contract illustrates how certain Islamic financial instruments may not be universally accepted across different countries due to varying interpretations of Sharia principles. In Malaysia, BBA is utilized, but it is not used in the Middle East or Indonesia because it incorporates the Bai' al-Inah contract, which is considered non-compliant with Sharia principles by scholars in those regions. The presence of diverse regulations and interpretations of Sharia principles in each country contributes to the differences in rules and policies for Islamic banks operating internationally. This can lead to variations in the products and services offered, as well as the level of Sharia compliance achieved in different jurisdictions. One area that is significantly affected by these differences is Corporate Social Responsibility (CSR) disclosure in Islamic banks. The extent of CSR disclosure in an institution or company is influenced by numerous financial and non-financial factors. These factors may include the prevailing regulations and guidelines in the country of operation, the institutional culture, the stakeholders' expectations, and the level of awareness and commitment to CSR principles. As Islamic banks operate in multiple countries with diverse social, cultural, and legal environments, they need to navigate these complexities to align their CSR practices with the expectations of various stakeholders while adhering to Sharia principles. Adapting CSR disclosure to meet local standards and expectations can enhance the bank's reputation, foster trust with customers, and demonstrate their commitment to social responsibility in a manner consistent with local norms and regulations.[11]

Based on the mentioned challenges, this research focuses on Islamic commercial banks in Indonesia. It is important to note that Indonesia does not mandate the application of AAOIFI standards but rather utilizes them as a reference for formulating accounting standards for Islamic financial institutions within the country. The primary objective of this study is to analyze corporate governance and the extent of Sharia compliance disclosure in Islamic banks in Indonesia, using AAOIFI standards as a framework for assessment.

RESULTS AND DISCUSSION

The Islamic finance industry has increased rapidly, with the growth of 10-15% annually. Sharia banking assets amounted to IDR 538.3 trillion as of December 2019; even though it was in a crisis condition due to the COVID-19 pandemic, Sharia banking still had asset growth which increased significantly by IDR 608.9 trillion as of December 2020 (OJK, 2020). The increase in these assets was also influenced by the compliance of Sharia banking in carrying out all of its operational activities by Sharia principles. Islamic banks are responsible to all stakeholders to ensure that the products, services, and operational activities have met Sharia compliance by established standards. In this context, Sharia compliance is also a differentiator between banks that implement Sharia principles and those that do not (conventional).[13–15] If a Sharia Bank does not comply with Sharia compliance (shariah compliance), it will harm integrity and image as an institution that implements sharia principles, resulting in potential losses due to loss of customer trust.[16]

Sharia compliance is a manifestation of regulation and supervision of Islamic financial institutions as part of the risk management framework and the embodiment of a culture of compliance in risk management in Islamic banking. Sharia compliance has the characteristics, form, credibility, and integrity in fulfilling all Sharia principles in Sharia financial institutions and being one of the key players in implementing Good Corporate Governance.[5] To fulfill Sharia compliance, it is necessary to have standards that can be accepted generally or globally to produce financial reporting that is systematic and understood by all parties. Where every disclosure contained in the financial statements will represent all company activities by Sharia principles and values so that the trust of stakeholders and shareholders in Islamic financial institutions is appropriately maintained.[1] International Sharia Accounting Standards AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions) is a global accounting standard for Islamic financial institutions where every Islamic Bank is required to comply with established standards. The AAOIFI standard is used to standardize accounting provisions covering measurement, recognition, and reporting in products issued by Islamic financial and banking institutions around the world.[17]

The AAOIFI has set seven governance standards for Islamic financial institutions, encompassing areas such as the appointment and composition of the Sharia Supervisory Board, Sharia review processes, internal Sharia compliance reviews, the establishment of an Audit & Governance Committee, ensuring the independence of the Sharia Supervisory Boards, adopting a comprehensive set of governance principles, and promoting Corporate Social Responsibility conduct and disclosure for Islamic financial institutions. These standards are crucial in ensuring effective governance and Sharia compliance within Islamic financial institutions.[8] AAOIFI advises LKS to implement internal or internal Sharia reviews practically. The aim is to ensure that LKS management performs its responsibilities to implement Sharia rules and principles established by DPS. Internal Sharia review can also be called the implementation of Sharia review. Applying internal sharia review is necessary because it is an integral part of LKS management. Internal Sharia review can be carried out by the Internal Audit Department or the Internal Control Department.[18]

Many factors affect disclosure, namely financial and non-financial factors. Quantitative sharia compliance using factors other than financial, such as shariah board diversity with its derivations, namely shariah board age and shariah board tenure, DPS characteristics (educational background of DPS), and firm age, are non-financial variables that several previous researchers have studied. Non-financial information in this study is expected to be a benchmark to increase confidence in the management control process, which is the primary variable for organizational success, including Islamic Banks.[19]

Islamic banks in Indonesia have low compliance with AAOIFI financial accounting standards related to murabaha, mudharabah, and musyarakah. Murabaha standards have the highest average compliance. In addition, the results of the study show that Islamic banks in Indonesia tend to have higher compliance with both murabahah, mudharabah, and musyarakah disclosure standards compared to Islamic banks in other countries such as Malaysia.[4] Supported by previous research by Sulaiti et al. (2018), who examined Islamic banks in Bahrain and Qatar showing that Islamic banks in these two countries are much more compliant in implementing AAOIFI financial accounting standards, where the level of disclosure of AAOIFI standards in Qatar as a whole reached more than 75%. While the level of exposure to AAOIFI standards in Qatar also runs more than 75%. These results are very different from the disclosure of AAOIFI standards in Indonesia, where the overall exposure to AAOIFI standards in Indonesia is only more than 30%. This level of compliance difference is thought to be caused by differences in regulation and culture in each country.[20]

AAOIFI standard disclosures conducted by Indonesian Sharia banks have little in common with Islamic banks in Bahrain and Qatar, namely the highest disclosure is in the murabahah principle, the Murabahah principle is a contract of buying and selling goods at the original price with an additional agreed profit. The seller must tell the cost of the product purchased and determine a profit level. This sale and purchase can be made for purchase orders. There is a difference between the disclosure of AAOIFI standards by Indonesian Islamic banks and the disclosure of AAOIFI standards by Islamic banks in Bahrain and Qatar, namely research by Sulaiti et al. (2018), who examined from 2012-2015 found that there was a significant increase from the years on murabaha disclosures, mudharabah, compliance with disclosure of financial standards for murabahah financing is the highest compared to the economic criteria for mudharabah and musyarakah financing. The economic bars for musyarakah financing show moderate to high disclosure compliance, while the financial means for mudharabah financing show a relatively low level. The relatively low level of disclosure compliance indicates that the contract is mudharabah complex and contains problems related to its terms. The application of Islamic governance is essential for Islamic banking. Islamic authority aims to protect the interests of stakeholders. Besides that, the implementation of Islamic rule is driven by international regulatory agencies such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB). There are rules from Bank Indonesia and international regulations; Indonesian Islamic banks must comply with Sharia principles to increase the trust of the banking stakeholders.[21]

Islamic banking compliance with Islamic rules and principles can be achieved with a proper Islamic governance framework.[22] Bank Indonesia has full authority to oversee, regulate and supervise compliance with Islamic banking, so Bank Indonesia must ensure that Islamic banking has implemented good Islamic governance. Bank Indonesia can be placed to identify what are the potential problems in implementing Islamic government and what issues are being faced by the Sharia Supervisory Board in these Islamic banks. In addition, to develop a comprehensive governance system, it is crucial to ensure the active involvement of Islamic scholars, industry practitioners, and regulators. A sustainable and proper Islamic governance framework aims to give credibility to Islamic banking and provide transparency, trust, ethical behavior, and credibility.

The pattern of coordination between DPS and the Board of Commissioners is part of the oversight function, while DPS and IC have an inspection function. Coordination of the inspection function is contained in the aspects of Sharia review and internal Sharia review. The Sharia Supervisory Board is responsible for establishing and providing their opinion on the conformity of the LKS to Sharia principles. Then to ensure that the LKS management carries out their responsibilities concerning the implementation of Sharia regulations and codes set by the DPS, an internal Sharia review is needed, which can also be referred to as an implementation of Sharia review. Assessment of Sharia governance in Islamic banks for Sharia compliance guarantees is already running quite well. It's just that the evaluation is based on the results of auditor supervision (DPS, commissioners, and IC), the completeness of organizational structure functions, and the level of employee understanding of Sharia regulations. Assessments disclosed by the board of directors have yet to be announced in total (full disclosure) because all audit results are controlled or confidential.

CONCLUSION

The study's conclusion highlights the development of the Islamic banking industry, evidenced by the increasing diversity of Islamic banking products and the expansion of its service network. As Islamic banking grows, the significance of implementing Islamic governance becomes apparent. Islamic governance is a vital aspect within Islamic banking, as it is equivalent in importance to corporate governance for any institution. This framework ensures the alignment of business activities, transactions, products, and instruments with Sharia principles. The importance of Islamic governance lies in its role in instilling and maintaining trust in the Islamic banking and finance industry from the perspectives of its stakeholders.

The research demonstrates that Bank Indonesia Regulations oversee the application of Islamic governance in Indonesia. Indonesian Sharia banking must adhere to various terms and conditions pertaining to government guidelines and Sharia principles. However, despite these regulations, Islamic banking in Indonesia still encounters challenges in fully implementing Islamic governance in its daily operational activities. For Islamic banking to be more effective, efficient, and accountable in the future, a robust application of Islamic governance is necessary. Additionally, the full implementation of Corporate Governance standards issued by AAOIFI in Islamic banking in Indonesia is yet to be realized.

REFERENCES

Bank Indonesia. Peraturan Bank Indonesia Nomor 13/2/PBI/2011 tentang Pelaksanaan Fungsi Kepatuhan Bank Umum. *http://www.bi.go.idNRrdonlyres56D77B3A-FAEC-4E65-AF00- A38D7670D7F822060PBI_130212.pdf* 1 (2011).

Setyowati, R., Heradhyaksa, B. & Wekke, I. S. Sharia compliance in the islamic banking percepetion in Indonesia. *Int. J. Innov. Creat. Chang.* **5**, 1608–1620 (2019).

Daulay, W. E., Azhari, F. I., Triningsih, C. & Nasution, J. Penerapan Good Corporate Governance Terhadap Kecurangan (FRAUD) Perbankan Syariah. *Ekon. Bisnis Manaj. dan Akunt.* **3**, 929–940 (2022).

Azlan, F. Y. & Serly, V. Analisis Pengungkapan Standar Akuntansi Syariah Aaoifi Pada Bank Syariah Di Indonesia Dan Malaysia Periode Tahun 2017-2018. *J. Eksplor. Akunt.* **1**, 1604–1616 (2019).

Sukardi, B. Kepatuhan syariah (shariah compliance) dan inovasi produk bank syariah di Indonesia. *J. IAIN Surakarta* **12**, 107–133 (2012).

Subardi, H. M. P. Kebutuhan AAOIFI Sebagai Standar Akuntansi Keuangan Syariah Dalam Harmonisasi Penyajian Laporan Keuangan. *Owner* **3**, 16 (2019).

Nur Azifaha, K. F. Determinan pengungkapan sharia compliance perbankan syariah berdasarkan standar akuntansi syariah internasional aaoifi. *Jurnal* **1**, 1–13 (2022).

AAOIFI. *Shari'ah Standards for Islamic Financial Institutions*. (2017).

Andraeny, D. Corporate Governance and Disclosure of Sharia Compliance: An Insight Based On Aaoifi Standards. *JIFA (Journal Islam. Financ. Accounting)* **4**, 1–13 (2021).

Ascarya. Comparing Islamic Banking Development in MALAYSIA and INDONESIA: Lessons for Instrument Development. *Pap. Present. Period. Discuss. Dir. Monet. Manag. Bank Indones. Jakarta* 61 (2016).

Kurniasari, D., Lubis, A. T. & Kamal, M. Determinasi Pengungkapan Sharia Compliance Berdasarkan Standar AAOFI Pada Bank Syariah Di Asia Tenggara. *J. Akunt. Dan Keuang. Islam* **7**, 103–120 (2019).

Akhmad, D. DETERMINASI PENGUNGKAPAN SYARIAH TERHADAP STANDAR

AAOIFI : STUDI TERHADAP DAFTAR EFEK SYARIAH DI INDONESIA Ahmad Dzakiyuddin (DES) yangtelah mulai diterbitkan pada tahun 2007 (Khoiruddin dan Akuntansi Syariah oleh Ikatan Akuntan Indonesia . Standar Aku. *J. Huk. Ekon. syariah* **2**, (2019).

Abduh, M., Dahari, Z. & Omar, M. A. Bank customer classification in Indonesia: Logistic regression Vis-à-vis artificial neural networks. *World Appl. Sci. J.* **18**, 933–938 (2012).

Ahmed, H. Islamic Banking and Shari'ah Compliance : A Product Development Perspective. *J. Islam. Financ.* **3**, 15–29 (2014).

Mardian, S. Tingkat Kepatuhan Syariah di Lembaga Keuangan Syariah. *J. Akunt. Dan Keuang. Islam* **3**, 57–68 (2019).

Ilhami, H. Pertanggungjawaban Dewan Pengurus Syariah sebagai Otoritas Pengawas Kepatuhan Syariah bagi Bank Syariah. *Mimb. Huk.* **21**, 476–493 (2009).

Siregar, L. H. Perbandingan Standar – Standar Operasional Perbankan Syari'ah dan Penerapannya di Negara Indonesia. *J. War. Ed. 50* **21**, 1–9 (2016).

'Aabid, F. & Suprayogi, N. Penerapan tata kelola syariah lembaga keuangan islam. *J. Ekon. Syariah Teor. dan Terap.* **3**, 346–358 (2016).

El-Halaby, S. & Hussainey, K. Determinants of compliance with AAOIFI standards by Islamic banks. *Int. J. Islam. Middle East. Financ. Manag.* **9**, 143–168 (2016).

Al-Sulaiti, J., Ousama, A. A. & Hamammi, H. The compliance of disclosure with AAOIFI financial accounting standards: A comparison between Bahrain and Qatar Islamic banks. *J. Islam. Account. Bus. Res.* **9**, 549–566 (2018).

Srimaya, L. S. *et al.* Penerapan Tata Kelola Islam dalam Perbankan Syariah di Indonesia : Sebuah Studi Kepustakaan. **9**, 199–206 (2023).

Mihajat, M. I. S. Oman's Islamic Banking Performance amidst Covid-19 Outbreak: Prospects and Challenges. *Shirkah J. Econ. Bus.* **6**, 38–51 (2021).