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Sharia Compliance and Islamic Social Reporting on Financial Performance of the Indonesian Sharia Banks

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***Abstract*— this research aims to determine and analyze the effect of Sharia Compliance (Islamic Income Ratio, Profit Sharing Ratio, Zakat performance ratio), Disclosure of Islamic Corporate Governance (Sharia Governance, General Governance) and Islamic Social Reporting to financial performance with firm size as a moderating variable. The population of this study is the sharia bank recorded in the Financial Services Authority of 2013-2017. The sample selection method uses census, and the number of samples used is 13 sample data. To analyze the data, thus study uses multiple linear regression and test of absolute difference of moderating variable with 5% significance level. The result of research shows that Sharia Compliance with Islamic Income Ratio indicator has no significant effect on financial performance, while Sharia Compliance with Profit Sharing Ratio indicator has significant positive effect and Zakat performance ratio has significant negative effect to financial performance. Disclosure of Islamic Corporate Governance with Sharia Governance indicator has significant negative effect and Islamic Corporate Governance with General Governance indicator has a significant positive effect to financial performance of Sharia Commercial Bank in Indonesia. Islamic Social Reporting has a significant negative effect on the financial performance of Sharia Commercial Banks in Indonesia. Firm size is found to moderate the effects of Sharia Compliance, Islamic Corporate Governance, Islamic Social Reporting on the financial performance of Sharia Commercial Bank in Indonesia.**

Keywords— Sharia Compliance; **Islamic Corporate Governance**; **Islamic Social Reporting; Financial Performance; Firm Size**

I. INTRODUCTION

Banking competition in Indonesia is more competitive, so that the banking institutions evaluate their company carefully. The one of evaluation that used is the bank performance of evaluation, especially sharia bank. This evaluation as the way that used to assess the success rate of Islamic banks in certain periods based on the work plans, reports on the realization of work plans, and bank periodic reports, compliance with provisions, and other aspects. Islamic bank performance evaluation in Indonesia is basically carried out by Indonesian Bank as the central bank. Performance evaluation can also be carried out by other parties for various purposes (Meilani & Rahmayati, 2015).

Sharia bank is the bank which the activities leave the usury. Therefore the usury avoidance is the dare of company. Thin condition can be affect the bank performance evaluation until level of compliance of Islamic banks, good corporate governance and the responsibility of Islamic banks to the social environment is more needed. This is due to the increasing awareness of the Muslim community regarding the rules of sharia and maqashid al-sharia theory. The implication of maqashid al-sharia theory is told about every muamalah activities should be based on Al-Quran and Hadiths Prophet Muhammad PBUH.

The bankruptcy event of Ihlas Finance House, the largest financial institution in Turkey in 2001, The Islamic Bank of South Africa, the Islamic Investment Companies of Egypt, financial difficulties at the Dubai Islamic Bank and Berhad Islamic Bank of Malaysia is allegedly a weakness of good corporate governance mechanisms and non-compliance with sharia principles (Pellegrini, Grais, & Matteo, 2006)

The rules regarding sharia compliance come from the Qur'an, Hadiths and Ijma of the ulama so that the nature of sharia compliance is still broadly outlined. IFSB as the authorized institution to provide a reference in measuring how compliant financial institutions that use sharia as the basis of their business provides the foundations for sharia compliance. Hameed, Wirman, Alrazi, Nor, & Pramono (2004) provide a better explanation in describing the indicators used to express sharia compliance in Islamic banking. Hameed, Wirman, Alrazi, Nor, & Pramono (2004) in his research entitled Alternative Disclosure and Measures Performance for Islamic Bank provides guidance on sharia compliance indicators called Islamicity Performance Index.

Falikhatun & Assegaf (2012) revealed that sharia compliance using the Islamicity Performance Index consisting of Islamic Investment Ratio, Profit sharing Financing ratio, and Islamic Income ratio had a significant positive effect on the health of Islamic banks in Indonesia. This is not in line with the research conducted by Utami (2017) revealing that Islamic compliance with the indicator of Islamic Investment Ratio, Profit Sharing Financing ratio has a significant positive effect on health while Islamic Income ratio has no influence on the health of Islamic banks in Indonesia.

In conventional banking, the discussion of Good Corporate Governance (GCG) has been very good and deep ranging from the Anglo Saxon model which tends to the interests of Shareholders and the European Model that emphasizes Stakeholders (Gustani, 2017). On the contrary there are still not many studies that discuss good corporate governance according to Islamic views or Islamic Corporate Governance (ICG), especially in the context of Islamic finance (Gustani, 2017). The concept of Islamic Corporate Governance (ICG) contained in the Al-Quran and Hadith makes it different from the concept of Good Corporate Governance (GCG) in the western world view. In the view of Islam, good corporate governance must be integrated with the rules of sharia and tauhid as the core.

The issue of Corporate Social Responsibility (CSR) today cannot be separated from the business activities of a company. Many studies reveal that CSR practices and disclosures in Indonesia are growing rapidly along with the many multinational companies that set up branches in Indonesia (Utama, 2007). So the need for disclosure of corporate social responsibility to stakeholders and shareholders.

The development of global Islamic financial instruments makes CSR disclosures that do not involve religious aspects considered insufficient to explain the required disclosures in sharia principles. Among them are the distribution and collection of zakat, infaq, alms and endowments. Related to this, Ross Hanifa in 2002 developed Islamic Social Reporting (ISR). The ISR index is believed to be the first step in terms of CSR disclosure standards that are in line with Islamic perspectives. (Fitria & Hartati, 2010)

The results of research conducted by Arshad, Othman, & Othman (2012) revealed that CSR disclosure in Islamic banks reported in the annual report has a significant influence on financial reputation and performance with ROA and ROE proxies in Islamic banks. The results of the study are also the same as the research conducted by Platonova, Asutay, Dixon, & Mohammad (2016) showing that CSR disclosure has a positive effect on the financial performance of Islamic banks in several countries. Unlike the research conducted by Andni (2016) which revealed that CSR disclosure in Islamic banks did not have a significant effect on financial performance with ROI proxies.

II. METHOD

A. Sample

The sample on this study consist of all Islamic banks in Indonesia from the year 2013-2017, for five years sampled with 65 cases.

B. Measurement

TABLE.I. DEFINITION AND MEASUREMENT OF VARIABLES

Variable Acronym	***Definition***	***Measurement***
ROA	Return on Assets	Earnings before interests and tax divided by total assets
IsIR	Islamic Income Ratio	Islamic Income divided by Islamic Income and Non Islamic Income
PSR	Profit Sharing Ratio	Mudaraba and Musyarakah divided by total Financing
ZPI	Zakat Performance Ratio	Zakat divided by total assets
SG	The extent of Islamic Corporate Governance	Self-constructed disclosure index
GG	The extent of Islamic Corporate Governance	Self-constructed disclosure index
ISR	The extent of Islamic Social Reporting	Self-constructed disclosure index
Size	Firm size	Log natural of total assets

Source: Processed By Researchers From Various Sources

Sharia compliance measurements used the indicators of Islamic income ratio (IsIR), profit sharing ratio (PSR) and zakat performance ratio (ZPI) (Hameed, Wirman, Alrazi, Nor, & Pramono, 2004). The analysis content was used to measure the disclosure of Islamic corporate governance and Islamic social reporting. The disclosure of Islamic corporate governance involved two main categories, namely Sharia Governance and General Governance. Sharia Governance consists of 3 dimensions, namely the Sharia Supervisory Board, the Sharia Compliance Internal Unit, and the Sharia Internal Unit Review / audit that described the Islamic governance system. While General Governance consists of 7 dimensions that described the general governance system of

Islamic banks, namely the board of commissioners, board of directors, board of committees, internal control and external audit, risk management, Investment Account Holders (IAH) and Corporate Governance reporting (Gustani, 2017). The measurement of Islamic social reporting in this study referred to the research index developed by Arshad, Othman, & Othman (2012). The disclosure index analyzes several things, namely: development and social goals / philanthropy, employees, environment, customers, general / public stakeholders / community, workplace, marketplace and sharia supervisory board. In addition to the moderating variables used, the size of the company used the total assets as the measurement. The definition and variables used in this study are listed in Table I.

C. Analysis

All statistical analyses in this study were conducted by using the Statistical Product and Service Solution (SPSS) software. The processing data used in this study was descriptive statistics, Pearson Correlation test, F-test and t-test.

III. FINDING AND DISCUSSION

A. Description Statistics

The description statistics for variables use in this study, it shows in the Table II.

TABLE II. DESCRIPTIVE STATISTICS

	N	***Minimum***	***Maximum***	***Mean***	***Std. Deviation***
Islamic Income Ratio (X_1)	65	.78	1.00	.98	.029
Profit Sharing Ratio (X_2)	65	.00	.91	.33	.244
Zakat Performance Ratio (X_3)	65	.00	.07	.004	.012
Sharia Governance (X_4)	65	.35	.94	.64	.149
General Governance (X_5)	65	.45	.98	.70	.134
Islamic Social Reporting (X_6)	65	.36	.77	.55	.134
Return On Asset (Y)	65	-20.13	11.19	.43	4.141
Firm Size (Z)	65	10.93	18.29	15.58	1.659
Valid N (list wise)	65				

Source: Author's Processing Data Results, Using SPSS

B. Pearson Correlation Test Result

TABLE III. PEARSON CORRELATION TEST RESULTS

	ROA	***Islamic Income Ratio***	***Profit Sharing Ratio***	***Zakat Performance Ratio***	***Sharia Governance***	***General Governance***	***Islamic Social Reporting***
ROA	1.000	.056	.247	-.204	-.215	-.002	-.266
Islamic Income Ratio	.056	1.000	-.167	-.032	-.144	-.087	.037
Profit Sharing Ratio	.247	-.167	1.000	-.200	-.055	.125	.189
Zakat Performance Ratio	-.204	-.032	-.200	1.000	-.169	-.250	-.302
Sharia Governance	-.215	-.144	-.055	-.169	1.000	.345	.107
General Governance	-.002	-.087	.125	-.250	.345	1.000	.560
Islamic Social Reporting	-.266	.037	.189	-.302	.107	.560	1.000

Source: Author's Processing Data Results, Using SPSS

Correlation analysis tests performed in order to get an overview of the relationship between variables and multicollinearity by using Pearson Correlation Test, and found to be well within the satisfactory range.

C. Simultaneous Test (F-test)

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TABLE IV. ANOVA

Model		***Sum of Squares***	***df***	***Mean Square***	***F***	***Sig.***
1	Regression	29.973	6	4.996	4.820	.000[b]
	Residual	60.112	58	1.036		
	Total	90.085	64			

Source: Author's Processing Data Results, Using SPSS
Note: Dependent Variable: ROA; Predictors: (Constant), Constant Islamic Social Reporting (X_6), Islamic Income Ratio (X_1), Profit Sharing Ratio (X_2), Sharia Governance (X_4), Zakat Performance Ratio (X_3), General Governance (X_5)

The simultaneous test is used to test the coefficient (slope) regression whether the independent variables as a whole have influence on the dependent variable

D. Partial Test (t-test)

TABLE V. T-TEST RESULTS

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-1.937	4.598		-.421	.675
	Islamic Income Ratio (X_1)	3.832	4.448	.096	.862	.392
	Profit Sharing Ratio (X_2)	1.243	.552	.256	2.253	.028
	Zakat Performance Ratio (X_3)	-27.692	11.220	-.286	-2.468	.017
	Sharia Governance (X_4)	-2.253	.937	-.283	-2.405	.019
	General Governance (X_5)	2.716	1.228	.307	2.211	.031
	Islamic Social Reporting (X_6)	-4.807	1.185	-.546	-4.056	.000

Source: Author‘s processing data results, using SPSS

Judging from the significant value of each variable, the conclusion that only Islamic income ratio was no partial effect on ROA.

E. Simultaneous Test (F-test) for Moderating Variable

The simultaneous test used to test the coefficient (slope) regression whether the independent variables as a whole had the influence on the dependent variable with moderating variable.

TABLE VI. ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	38.635	13	2.972	2.946	.003[b]
	Residual	51.450	51	1.009		
	Total	90.085	64			

Source: Author‘s processing data results, using SPSS.
Note: Dependent Variable: ROA; Predictors: (Constant), Moderating_6, Zscore: Profit Sharing Ratio, Zscore: General Governance, Zscore: Islamic Income Ratio, Moderating_3, Zscore: Company Size, Zscore: Sharia Governance, Moderating_2, Moderating_4, Moderating_5, Zscore: Zakat Performance Ratio, Zscore: Islamic Social Reporting, Moderating_1

Absolute difference in moderating variables test showed that simultaneously the size of the company was able to moderate the relationship between the variables of Islamic income ratio, profit sharing ratio, zakat performance ratio, sharia governance, general governance and Islamic social reporting on ROA significant value of 0.003.

According to the results of the F test simultaneously showed that the variables of Islamic income ratio, profit sharing ratio, zakat performance ratio, sharia governance, general governance, and Islamic social reporting affect ROA with a significant value of 0.000 < 0.05. The regression coefficient value of the Islamic Income Ratio of 3.832 was positive. This value can be interpreted that Islamic Income has a positive effect on ROA but the significant value of Islamic income was 0.392 > 0.05 and t count value was 0.862 <t table 2.00, it can be concluded that the variable Islamic income ratio had a positive and not significant effect on ROA. Pro fit sharing ratio regression coefficient value of 1.243 was positive. Significant value of profit sharing ratio was 0.028 <0.05 and t count 2.253> t tables 2.00, it can be concluded that the variable profit sharing ratio has a significant positive effect on ROA. Zakat performance ratio regression coefficient value of -27.692 was negative. This means that there was a negative relationship between zakat performance ratio and ROA. Sig value of zakat performance 0.017 < 0.05 and t count | -2,468 | > t table 2.00 it can be concluded that zakat performance Ratio (X_3) has a significant negative effect on ROA.

The Sharia Governance regression coefficient value was -2.253 negative. This means that there was a negative relationship between sharia governance and ROA. The significant value of sharia governance 0.019 < 0.05 and t count | -2.405 | > t table 2.00, the conclusion is that Sharia Governance had a significant negative effect on ROA. The general governance regression coefficient value of 2.716 was positive. The significant value of general governance 0.031 <0.05 and t count 2.211> t table 2.00 it is concluded that general governance had a significant positive effect on ROA. Islamic Social Reporting regression coefficient value of -4.807 was negative. Significant value of Islamic social reporting 0.000 <0.05 and t count | -4,056 | > t table 2.00, it can be concluded that Islamic Social Reporting had a significant negative effect on ROA.

The F test results indicated that the significance level was 0.003 far below 0.05. This showed that the firm size variable can simultaneously moderate the relationship between the variables of Islamic income ratio, profit sharing ratio, zakat performance ratio, sharia governance, general governance, Islamic social reporting with ROA.

IV. CONCLUSION

Sharia compliance (Islamic income ratio, profit sharing ratio, and zakat performance ratio), Islamic corporate governance (sharia governance, general governance) and Islamic social reporting disclosure simultaneously affected the ROA of Islamic Commercial Banks in Indonesia. Partially Sharia Compliance with the Islamic Income Ratio indicator had a positive and not significant effect on financial performance while Sharia Compliance with the Profit Sharing Ratio indicator had a significant positive effect and Sharia Compliance with the Zakat performance ratio indicator had a significant negative effect on the ROA of Islamic Commercial Banks in Indonesia. Disclosure of Islamic Corporate Governance with Sharia Governance indicators had a significant negative effect and Islamic Corporate Governance with General Governance indicators had a significant positive effect on the ROA of Islamic Commercial Banks in Indonesia. Islamic Social Reporting disclosure had a significant negative effect on the financial performance of Islamic Commercial Banks in Indonesia.

Firm size was able to moderate the relationship between the variables of Islamic Income Ratio, Profit Sharing Ratio, Zakat Performance Ratio, Sharia Governance, General Governance, and Islamic Social Reporting with ROA.

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