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Quality of financial reporting and the level of compliance with SAS: A case study of Islamic banking in Indonesia

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Abstract

The objective of this paper is to examine the effect of the level of compliance of financing accounting with SAS (Sharia Accounting Standards) on the quality of financial reporting, and the quality of the maqasid (objective) Sharia-based performance of Islamic banks in Indonesia. Understanding the basic principles of the accounting standards of Islamic banking has become increasingly important among most Sharia scholars and researchers in the implementation of accounting standards for Islamic Banking Industry (IBs). Currently, IBs are one of the fastest growing sectors locally and globally. The level of compliance of financing accounting with SAS, the quality of financial reporting, and maqasid Sharia-based performance were measured using questionnaires distributed to 34 directors and heads of Islamic banks. The study model was analyzed using partial least squares structural equation modelling (PLS-SEM). The study found that the level of financing accounting compliance with SAS had positive impacts in improving the quality of financial reporting and maqasid Sharia-based performance. Therefore, Islamic banks in Indonesia have fully adopted SAS. The limited number of indicators of financing accounting practices in the study mean that fewer comprehensive financing accounting practices are illustrated. Further studies could add other relevant financing accounting practices, as described by the IAI (Indonesian Accounting Association), in order to provide a more comprehensive overview. The study contributes to the accounting of Islamic banks by improving the conceptual framework of SAS, which could benefit future research. The paper supplements the limited number of empirical studies on financing accounting practices in the Islamic banking industry.

Keywords: Financing accounting, financial reporting, Islamic banks, Maqasid Sharia, Sharia Accounting Standards (SAS)

INTRODUCTION

Islamic accounting, an emerging model prominently represented by the Accounting and Auditing Organization for Islamic Financial Institutions AAOIFI (2015), established in 1990 and registered in Bahrain in 1991. Additionally, AAOIFI wanted to address the lack of standardization of Sharia accounting and auditing standards for IFIs in the GCC Countries. These standards are adopted in Bahrain, Dubai International Financial Centre (DIFC), Jordan, Lebanon, Qatar, Sudan and Syria. Some other jurisdictions, such as Indonesia and Pakistan, have issued their own Islamic accounting standards, with requirements similar to those of the AAOIFI (ISRA, 2012). Islamic accounting can be broadly defined as a system of information that communicates the economic position and operational results of an entity, and ensures that the information presented is correct, complies with *Sharia*, and is free from any misleading information (Harahap, 2003). The motivation for adopting international accounting standards is to improve the quality of financial reporting in order to increase the level of user confidence in financial statements when making decisions and to improve the comparability of statements between different organizations and countries (Ahmed et al, 2019; Sarea & Hanefah, 2013).

Islamic banks operate mainly in developing countries in the Middle East, Africa and South-East Asia and are facing difficulties in adopting unique accounting standards into their practice due to the absence of a legal framework and the inconsistency of financial reporting. The literature on compliance with AAOIFI standards by Islamic banks ignores the regulatory aspects affecting accounting practices. *De facto* compliance with AAOIFI standards by financial institutions partly depends on the national accounting and regulatory infrastructure (Ahmed et al, 2019). For instance, Vinnicombe (2012) have found compliance with AAOIFI standards by retail and wholesale banks in Bahrain to be above 60 per cent, while Ullah (2013) found that a sample of Islamic banks in Bangladesh complied with only 44.7 per cent of the disclosure requirements of the AAOIFI.

In Indonesia, the publication of Sharia Accounting Standards No. 59 Akuntansi Perbankan Syariah (2002) issued by the IAI (Indonesian Accounting Association) was a step forward for Sharia banking, which has existed since 1992. Basically, the application of recording transactions in Islamic Banking has met Sharia Accounting Standards and has been legally valid since 2002 i.e. Law Number 21 of 2008 (Dewan Perwakilan Rakyat Republik Indonesia (DPRD) and Presiden RI, 2008) in terms of Sharia banking. Sharia financial accounting standards are based on general accounting concepts that have been adjusted to Sharia principles and applied to parties conducting Sharia transactions, in accordance with the development of the DSN MUI fatwa. This is reflected in the Basic Framework for the Preparation and Presentation of Sharia Financial Statements as the basis for the development of Sharia accounting standards (Standar Akuntansi Keuangan Syariah, 2016).

Both AAOIFI (AAOIFI, 2015; Baydoun & Willett, 2000; Sarea & Hanefah, 2013) and Sharia Accounting Standards (SAS) (Standar Akuntansi Keuangan Syariah, 2016; Mukhlisin, 2015) in Indonesia find that financial reporting from an Islamic perspective is a process through which appropriate information is communicated to users, which enables them to assess whether the entity is operating within the bounds of Sharia and is fulfilling its responsibilities to society and the environment and enables users to make decisions that would persuade the entity to fulfil or to continue to fulfil such responsibilities (ISRA, 2012). For users to make such decisions, financial reporting needs to encompass more than just the preparation and presentation of financial statements. The process of financial reporting from an Islamic perspective may include financial and non-financial information, and may extend into areas beyond financial statements, such as other aspects of the annual report, and may contain elements of social and environmental reporting. Under the Sharia Accounting Standards (SAS) conceptual framework, the qualitative characteristics of financial reporting should be understandable, relevant, verifiable, appropriate and comparable (Standar Akuntansi Keuangan Syariah, 2016).

This study, however, goes beyond the conventional narrative by integrating two novel elements into the discourse of Islamic accounting. Firstly, it adopts the concept of Sharia Enterprise Theory (SET), as developed by Triyuwono (2001), which classifies the level of compliance of financing accounting. SET asserts a shift in orientation for Islamic banks, moving beyond profit- or stockholder-oriented approaches to becoming oriented towards zakat, the environment, and stakeholders (Triyuwono, 2001). This distinctive perspective emphasizes accountability to a broader range of stakeholders: God, humans, and nature.

Secondly, the study introduces the maqasid Sharia concept to assess the performance of Islamic banks, reflecting a comprehensive measurement aligned with the purpose of human interaction under Islamic law. The objectives of Sharia (maqashid Sharia) are expected to be fulfilled when implementing Islamic Sharia compliance. To ensure that stakeholders of Islamic banks are provided with full and fair disclosure of information, the AAOIFI expects Islamic banks to file with any information a statement of compliance with each of its standards (Ahmed et al, 2019). The mission of Islamic banks, especially to improve welfare in the world and the hereafter *(falah),* has implications for the indicators used to measure performance (Laela et al., 2018). Therefore, when assessing the performance of Islamic banks, this study uses the maqasid Sharia concept, which reflects comprehensive performance measurement in accordance with the purpose of human interaction under Islamic law.

The main contribution of this study lies in the context of Islamic banking, and it also complements scientific reviews using positive and empirical approaches concerning the financial accounting of Islamic banks, in the form of priority initiatives to provide financial reporting from an Islamic perspective. Some previous researchers (Ahmed et al, 2019; Sarea & Hanefah, 2013; Ullah, 2013; Vinnicombe, 2012) have also addressed the variables employed in this study, but their discussions of the financial accounting system in Islamic banking have been merely descriptive.

These additions distinguish this research from prior studies that have often been descriptive in nature. By integrating SET and the maqasid Sharia concept, this study contributes a novel conceptual framework to the discourse on Islamic accounting and banking.

This paper is structured as follows: Section 2 presents the literature review, and is followed by Section 3, which explains the hypothesis development. Section 4 describes the research method, and Section 5 presents the empirical results and an interpretation of the results. Section 6 contains the conclusions and contributions.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

1. Financing accounting practices and quality of financial statements

The practice between financing accounting and the quality of financial statements in Shariah Enterprise Theory (SET) is zakat-, environment- and stakeholder-oriented (Triyuwono, 2001). In principle, the financial reporting process in Islamic banking includes financial statements on commercial and/or social activities to meet the needs of a large number of users, related to whom added value has been distributed, while contributions made by stakeholders (especially direct stakeholders) will be seen on the balance sheet. The report provides information on the value-added successfully created by the company and its distribution to those who are entitled to receive it (Baydoun & Willett, 2000; Triyuwono, 2016). According to (Haniffa & Hudaib, 2010; Chapra, 2008; Mohammed & Razak, 2008), those who are entitled to receive the distribution of added value are classified into two groups, namely:

1. Parties directly related to the company's business (direct stakeholders), consisting of shareholders, management, employees, creditors, suppliers, government, amongst others, and
2. Parties not directly related to the company's business (indirect stakeholders), consisting of the *mustahiq* community (recipients of zakat, infaq and shadaqah) and the natural environment (for example, for the preservation of nature).

Financial reporting standards lay down the principles relating to recognition (what items need to be recorded and when they should be recorded); measurement (the amount at which an item is recorded); disclosure (information about the item recorded); and presentation (where in the financial statements an item is recorded) (Fitriati and Mulyani, 2015; Standar Akuntansi Keuangan Syariah, 2016; ISRA, 2012). The process of financial reporting from an Islamic perspective may require additional information in the financial statement and its notes, and may extend to areas outside the financial statement; for example, (a) reports by directors, statements by the chairman, discussion, and analysis by management and similar items that may be included in a financial or annual report; (b) social or environmental reports; and (c) other items of non-financial reporting. According to the SAS and AAOIFI conceptual framework, the fundamental qualitative characteristics of financial reporting information should provide relevance, reliability, understandability, and comparability to users (ISRA, 2012).

2. Financing accounting in Islamic banking

According to SAS 105 Standar Akuntansi Keuangan Syariah (2016), *mudarabah* is a contract in which one party provides capital (*shahibul maal,* i.e. the capital provider), and the other party provides work (*mudarib,* i.e. the entrepreneur). Under *mudarabah,* profits are shared between the parties according to a pre-determined profit-sharing ratio, whereas losses are borne by the capital providers, unless in the case of violation of the stipulated contract by the entrepreneurs, who will then bear any losses.

Accounting for *mudarabah*

Mudarabah capital is measured at the initial carrying value, except for the repayment of capital, which should be deducted from *mudarabah* financing. However, if a partial loss of capital occurs (e.g., through theft or fire) before work on the *mudarabah* contract begins (and not due to negligence of the *mudarib*), this should also be deducted from the *mudarabah* financing account and debited to the profit and loss account. If the complete *mudarabah* capital is lost, the *shahibul maal* must bear the loss and terminate the contract. Any unpaid amounts remaining become a bank receivable from the *ex-mudarib* (Dusuki & Bouheraoua, 2011; Hasan, 2011; Laldin & Furqani, 2013; Mohammed & Razak, 2008; Muneeza & Hassan, 2014; Vejzagic & Smolo, 2011; Z. Shafii & A. Rahim, 2016).

In accordance with Islamic Sharia Pembiayaan Mudharabah (Qiradh) (2000), the board of Islamic Sharia issued a fatwa or regulation no. 07/DSN-MUI/IV/ 2000, contained in Allah's words in QS An-Nisa (4): 29; QS al-Ma'idah (5): 283, the Prophet's Hadith narrated by Thabrani; narration of Ibn Majah from Shuhaib; Tirmizi from Amr bin 'Auf, Ijma; and Qiyas, and the rules of fiqh.

Accounting for *musharakah*

According to SAS 106 Standar Akuntansi Keuangan Syariah (2016), *musharakah* is a partnership between an Islamic bank and its clients, wherein both parties (a) contribute equal or varying amounts of capital to establish a new project or to share in an existing one; (b) possess capital, which can be on a permanent or declining (capital) basis, and the partners will receive their due share of the profits; and (c) share proportionate losses according to the capital contribution and not otherwise.

Musharakah is divided into constant *musharakah,* in which the partners' shares in the capital remain constant throughout the period, as specified in the contract and *musharakah mutanaqisah* (diminishing *musharakah*), in which the Islamic bank agrees to gradually transfer to the other partner its (the Islamic bank's) share of the *musharakah* financing, so that the bank's share decreases and the other partner's share increases, until the latter becomes the sole proprietor of the venture (Dusuki & Bouheraoua, 2011; Hasan, 2011; Laldin & Furqani, 2013; Mohammed & Razak, 2008; Muneeza & Hassan, 2014; Vejzagic & Smolo, 2011; Z. Shafii & A. Rahim, 2016).

This is performed in accordance with Islamic Sharia, Musyarakah Mutanaqisah (2008) DSN No. 08/DSN-MUI/IV/2000, contained in Allah's words in QS Shad (38): 24; in QS al-Ma'idah (5): 1; hadith narrated by Abu Daud from Abu Hurairah, narrated by Tirmidhi from 'Amr bin'Awf, Ijma; and the principles of fiqh.

Accounting for *murabahah*

According to SAS 102 Standar Akuntansi Keuangan Syariah (2016), there are two types of *murabahah: murabahah* and *murabahah* to the purchase orderer. *Murabahah* is frequently referred to as "cost-plus financing" and commonly appears as a form of trade finance based upon letters of credit. In its simplest form, this agreement entails the sale of an item on a deferred basis. A commodity *murabahah* transaction is the sale of an asset to a purchaser for payment on a deferred basis, who then sells the asset to a third party for cash (Dusuki & Bouheraoua, 2011; Hasan, 2011; Laldin & Furqani, 2013; Mohammed & Razak, 2008; Muneeza & Hassan, 2014; Vejzagic & Smolo, 2011; Z. Shafii & A. Rahim, 2016).

Murabahah and *murabahah* to the purchase orderer are standards that cover the treatment of *murabahah* financing. SAS 102 Standar Akuntansi Keuangan Syariah (2016) prescribes two accounting treatments to measure the asset value after its acquisition by the Islamic bank. In the sale of *murabahah* to the purchase orderer, the bank follows the Sharia ruling that obliges the client to fulfil his promise after the bank acquires the asset, and it is required to use the historical cost to measure the asset ordered by the client at the end of the financial period. Alternatively, if in accordance with the bank's Sharia ruling, the client is at liberty to fulfil his promise or not, and the cash equivalent value of the asset at the end of the financial period is less than than its historical cost, then the bank is required to use the cash equivalent value to record the value of the asset.

This is performed in accordance with Islamic Sharia, Murabahah (2000) DSN No. 04/DSN-MUI/IV/ 2000, contained in Allah's words in QS. an-Nisa (4): 29; QS. al-Baqarah (2): 275, 280; QS. al-Ma'idah (5): 1; Al-Baihaqi and Ibn Majah's hadith; Tirmidhi's history from 'Amr bin Auf'; Ijma and the majority of scholars on the ability to buy and sell by way of Murabaha, and the rules of fiqh.

3. Performance of Islamic banks: perspective of maqasid sharia

Maqasid Sharia is defined as a manifestation of the realization of the benefits involving the public interest, and as a way of achieving goals through the establishment of Sharia law (Dusuki & Bouheraoua, 2011). According to Akram Laldin & Furqani (2013), maqasid Sharia is a comprehensive concept to realise the ideals/goals of Sharia-related human life. The maqasid framework in Islamic financial and banking activities leads to the actualisation of Sharia objectives by realising maslahah (benefits) and preventing or repelling mafsadah (danger). The maqasid (objectives) will include smooth circulation; wealth, fairness and transparency in financial practices; and fairness and equality at the micro and macro levels. A comprehensive performance measurement model was developed by Mohammed & Razak (2008), who coined the maqasid Sharia index. Their study used the concept of the maqasid Sharia developed by Al-Ghazali, which is a refinement of teacher Al-Juwayni's theory. Al-Ghazali Ebrahim E. I. Moosa (1995), who is in *al-Mustafa's* (1937) book, in perspective and evaluate its significance in the genre of *usul al-fiqh* literature, breaks up the maqasid Sharia into five important or essential elements, namely: 1) maintaining faith (*hifz ad-dien*); 2) protecting oneself or human life (*hifz an-nafs*); 3) maintaining intellect (*hifz al-Aql*); 4) protecting posterity or offspring (*hifz an-Nasl*); and 5) safeguarding wealth or property (*hifz al-Maal*). All these elements are considered as a necessity (*dharuriyyat*) to achieve the goal of Sharia. This aligns with the context of the Indonesian Islamic banking industry, which applies the principle of benefit (*maslahah*). According to Wiroso (2016), the essence is all forms of goodness and benefits which are of worldly and *ukrawi* dimensions, material and spiritual, as well as individuals and collectives. The benefit that is recognized must fulfil two elements, namely Sharia compliance (*halal*), and benefit and goodness (*thayib*) in all aspects as a whole, thus not causing any harm. As a result, problematic Sharia transactions must fulfil all the elements that are the objectives of Sharia provisions (maqasid Sharia) in the form of the maintenance of rules, faith and piety (*dien*), intellect (*'aql*), descent (*nasl*), soul and salvation (*nafs*), and property (*mal*) (Bedoui, 2012; Soualhi, 2015).

4. Hypothesis development

The implementation of financing accounting in relation to the quality of financial reporting

The relationship between accounting practices and the quality of financial reporting can be seen from the scope of the financial reporting process, which includes financial statements on commercial and or social activities to meet the needs of a large number of users. Users of financial statements include current and potential investors; *qard* fund owners; owners of temporary *syirkah* investment funds; owners of deposit funds; payers and recipients of *zakat, infaq, sadaqah* and *waqf*; Sharia supervisors; employees; suppliers and other business partners; customers; the government and its institutions; and the community (Wiroso, 2016).

Based on Sharia Enterprise Theory, it can be concluded that there is a relationship between Sharia accounting practices and the quality of financial statements. Previous studies have reinforced the conclusion that there is a positive relationship between the level of compliance and financial statement disclosures, which are influenced by several factors. These studies include research conducted by (Saleh & Samia, 2015), who found that at the level of compliance with the AAOIFI guidelines on general presentation and disclosure in the financial statements of the Gumhouria Sharia Fashlown Bank branch, the quality of financial statements was low, which was due to several factors: a lack of training programs on AAOIFI standards; a lack of financial and administrative independence at the Fashlown branch; and a lack of CBL and Sharia management at the bank with regard to instructions for applying AAOIFI standards. Research by (Sellami & Tahari, 2017) found that there was a positive relationship between the level of compliance and AAOIFI standards, which affected disclosures in financial statements. Other results of their research indicated that the aspect of accounting compliance with Sharia principles significantly influenced the quality of financial reporting of Sharia entities. Based on the above, the following hypothesis is proposed.

H1. The transactions of financing accounting, including *mudarabah, musharakah* and *murabahah*, positively affect the quality of financial reporting.

The implementation of financing accounting in relation to maqasid sharia performance

Sharia financing transactions, in this case, transactions in *mudharabah*, *musyarakah* and *murabahah* contracts that are considered to have merit, must fulfil all the elements that are the objectives of Sharia (maqasid *Sharia*), in the form of maintenance of (a) creed, faith and piety (*dien*); (b) intellect (*'aql*); (c) heredity (*nasl*);

(d) soul and salvation (*nafs*); and (e) property (*mal*) (Ahmed, 2012; Akram Laldin & Furqani, 2013; Al Zyoud; Almsafir & Al-Smadi, 2013; Haniffa & Hudaib, 2010; Kamali, 2015; Chapra, 2008).

According to Azhar (2010), financing accounting practices that use the Islamic maqasid approach demonstrate that the financing transaction contract does not include the value of usury. If usury occurs through loans and loans with interest, this will cause financial turmoil, leading to economic crisis.

With regard to the application of the concept of Islamic maqasid in Islamic financial institutions, Ahmed (2012) developed a framework for assessing its implementation in financial products. Two requirements needed to be met for the implementation of maqashid sharia at the product level: legal and social.

Ahmed; Sabirzyanov & Rosman (2016) conducted research on the legal structure in Islamic bank financing contracts. Their results showed that transactions practices in *mudharabah*, *musyarakah* and *murabahah* financing contracts must follow the objectives of Sharia/maqasid Sharia. Related to this, the measurement refers to the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI, 2015).

Based on the results of the above studies, it can be interpreted that achievement of good financial accounting practices requires the performance between various factors in financing transactions that simultaneously and dynamically harmonies with each other. It can consequently be concluded that there is an influence of the implementation of financial accounting in terms of measurement and disclosure on the maqasid Sharia-based performance in Islamic banking entities (AAOIFI, 2015; Ahmed, 2012; Ahmed; Sabirzyanov & Rosman, 2016; Akram Laldin & Furqani, 2013; Al Zyoud; Almsafir & Al-smadi, 2013; Haniffa & Hudaib, 2010; Kamali, 2015; Azhar, 2010). The following hypothesis is consequently tested:
H2. The transactions of financing accounting including *mudarabah, musharakah* and *murabahah* positively affect maqasid Sharia-based performance.

The quality of financial statements in relation to maqasid sharia performance

The need for transparent and useful financial reporting practices to meet the needs and accountability of stakeholders requires Islamic financial institutions to develop the presentation and disclosure of Sharia transactions based on Sharia principles (Khan & Bhatti, 2008; Naser & Pendlebury, 1997).

Sharia-based transactions in Indonesia refer to Sharia financial accounting standards that are prepared in accordance with the development of the MUI DSN fatwa and take into account the dynamics of Sharia-based economic activities, especially Sharia financial business activities. Sharia financial accounting standards are based on general accounting concepts that have been adapted to Sharia principles and applied to the parties conducting the transaction (Sukmadilaga & Nugroho, 2017; Wiroso, 2016).

Financial reporting of a Sharia entity also shows what management has done (stewardship), or management's responsibility for the resources entrusted to it, so the information submitted must be useful for stakeholders. There are four qualitative characteristics of financial statements; they should be (1) understandable; (2) relevant; (3) reliable; and (4) comparable (Fitriati & Mulyani, 2015; Standar Akuntansi Keuangan Syariah, 2016). Good financial reporting meets the reporting objectives. The qualitative characteristics of good financial reporting include the fact that it is relevant (relevance) and trusted (faithful representation). Disclosure in financial reporting is the most efficient and effective mechanism for encouraging managers in their management of companies (Standar Akuntansi Keuangan Syariah, 2016).

Therefore, in assessing the performance of Islamic banking, the maqasid concept of Sharia, which reflects comprehensive performance in accordance with *muamalah* objectives according to Sharia principles, is applied. According to Al-Ghazali, cited in (Chapra, 2008), the main objective of Sharia (maqasid Sharia) is to advance the welfare of society, in the form of safeguarding the following aspects: faith (*dien*), soul (*nafs*), intellect (*'aql*), descendants (*nasl*), and property (*mal*). According to Al-Ghazali, benefits (*maslahah*) should be in harmony with the maqasid of Sharia (Dusuki & Bouheraoua, 2011).

In general, on the basis of previous studies, it can be concluded, according to Ascarya; Rahmawati & Sukmana (2017), that there have indeed been many efforts to build the Islamic Banking Maqasid Index (IMBS), even though this is basically determined by the ability of Islamic banks to present and disclose the quality of their financial statements, so that they can realize the benefits related to the public interest, and as a way of achieving goals through a stipulation of Sharia law.

Based on the above, the following hypothesis is proposed.

H3. The quality of financial statements positively affects maqasid Sharia-based performance.

RESEARCH METHODS

Instrument development and survey method

The study used three variables measured by multiple indicators through questionnaires. The respondents were asked to express their point of view on a five-point Likert-type scale regarding the statements made, ranging from "less important" (1) to "more important" (5). A total of questions was grouped into four sections. The first section was designed to collect general information on market segment, performance indicators and the importance of research variables for their Islamic banks. The remainder of the questionnaires was related to the following three variables: financing accounting, quality of financial statements, and maqasid Sharia-based performance.

The initial questionnaires were adopted from previous relevant studies, namely, SAS 105, SAS 106, SAS 102 Standar Akuntansi Keuangan Syariah (2016), a fatwa or regulation Pembiayaan Mudharabah (Qiradh) (2000), Pembiayaan Musyarakah (2000), Murabahah (2000), Dusuki & Bouheraoua (2011), Hasan (2011), Hassan & Muneeza (2014), Laldin & Furqani (2013), Mohammed & Razak (2008), Vejzagic & Smolo (2011), Shafii and Rahim (2016) for Financing accounting, Baydoun & Willett (2000) Fitriati & Mulyani, (2015), Haniffa & Hudaib (2010), Standar Akuntansi Keuangan Syariah (2016), ISRA (2012) Chapra (2008), Mohammed & Razak (2008), Triyuwono (2016) for quality of financial statements and Bedoui & Mansour (2015), Dusuki & Bouheraoua (2011), Laldin & Furqani (2013), Mohammed & Razak (2008) for maqasid Sharia-based performance.

The Islamic banks which were respondents in the study were located in 34 provinces throughout Indonesia. For most respondents outside Java, the questionnaires were sent using an express postal service, with a delivery time of two to three working days. As for all the fully-fledged Islamic banks and Islamic business units with headquarters in Jakarta, the questionnaires were delivered. In-depth interviews were also conducted with several respondents in person to discuss the contents of the questionnaires. Phone calls and correspondence were carried out using WhatsApp Messenger and email to initiate and monitor the data collection process. Table I shows the distribution and collection of the questionnaires.

Table 1. Group of Respondents, Response Rate, Data Collection Method

Types of Islamic bank	Questionnaires distributed	Completed and returned questionnaires	Response rate (%)	Data Collection method
Fully-fledged Islamic banks (BUS)	11	11	100	Direct visit, WhatsApp messenger, email, posted mail
Sharia Business Units (UUS)	23	23	100	Direct visit, WhatsApp messenger, email, posted mail
Total	34	34	100	

Source: Data compiled from study survey

Operational variable

Variable operationalization is the process of operationalizing the concept of a variable so that the variable can be measured, which is formulated based on the dimensions of the concept and then categorized into measurable elements (Sekaran & Bougie, 2017). There are 2 (two) variables in this research, namely:

1. The independent (exogenous) variable consists of the financing accounting implementation variable (X1)
2. The dependent (endogenous) variable consists of the financial report quality variable (Y1) and the Maqasid Syariah performance variable (Z).

Study sample

The survey through questionnaires was conducted with the help of 34 Islamic banks, consisting of 11 full-fledged Islamic banks (BUS), 23 Islamic business units (UUS) listed in the 2019 directory of Bank Indonesia. Of the total population, 34 Islamic banks contributed to the study, consisting of 11 BUS, and 23 UUS as shown in Table I. The results of this study are representative of Islamic banking in Indonesia because of the inclusion of all BUS and UUS, which control 97.9 per cent of Islamic banking assets. The involvement of all BUS and UUS, has resulted in this study being free of sample bias.

The respondents were the division heads of accounting and finance and of compliance. 64 percent of the respondents had undergraduate degrees, and 36 percent master's degrees. 53 percent of the respondents had more than ten years' working experience in Sharia accounting, while 47 percent had less than ten years' experience. 47 percent had more than 10 years' working experience in financial accounting at Islamic banks, and 53 percent had less than ten years' experience. The profiles confirmed that the respondents were competent to answer the research questions related to financing accounting and reporting, and to the maqasid Sharia performance of their business units. Table II presents the profiles of the respondents in more detail.

Table 2. Profile of Respondents

Type of Islamic bank	Education level		Working experience in Sharia accounting at the IB (years)		Working experience in financing accounting at the IB (years)					
	S1 level	S2 level	<10	>10	*Mudharabah*		*Musyarakah*		*Murabahah*	
					<10	>10	<10	>10	<10	>10
Fully-fledged Islamic Banks (BUS),	7	5	3	9	6	6	6	6	5	7
Sharia Business Units (UUS)	15	7	15	7	19	3	19	3	16	6
Total	22	12	18	16	25	9	25	9	21	13
Total (%)	64	36	53	47	74	26	74	26	62	38

Source: Data compiled from study survey

Measurement model testing

Verification analysis aimed to examine the effect of the latent variables in the study. Use of the Partial Least Squares Structural Equation Modeling (PLS-SEM) method included evaluation of the measurement model (outer) and structural model (inner). The measurement model aimed to describe how well these indicators could be used as instruments for measuring latent variables by testing the validity and reliability of each indicator and the dimension of the research variables. The following section describes the evaluation of the measurement and structural models.

As the number of respondents is only 34, simplified models with latent variable score are used as suggested by (Hair et al., 2014). As shown in Figure 4.1, 4.2, and 4.3, this study combines three measurement models using confirmatory factor analysis (CFA) and one structural model using concept of regression. Three measurement models represent relationship between variables of financing accounting (Fa) with three indicator X1.1 (Mudharabah), X1.2 (Musyarakah), X1.3 (Murabahah), Financial statements (Fs) with three indicator Y2.1 (the quality of time), Y2.2 (the quality of content) and Y.2.3 (format of the financial statements) and maqasid Sharia-based performance (Msp) with five indicator Z1 (the guarding of religion/*hifz ad-dien*); Z2 (of the soul/*hifz an-nafs*); Z3 (of the intellect/*hifz al-'aql*); Z4 (and the guarding of descent/*hifz an-nasl*) and their indicators using first order CFA. Then, the structural model is the relationship between financing accounting, financial statements and maqasid shariah performance.

Variable Implementation of Financing Accounting (IAM) has the dimensions: Recognition of Mudharabah Accounting Measurements (PPAM 1), Presentation of Musyarakah Accounting (PAM 1) and Murabahah Accounting Disclosure (PAM 2). Image of the SEM measurement model and its equations are as follows:

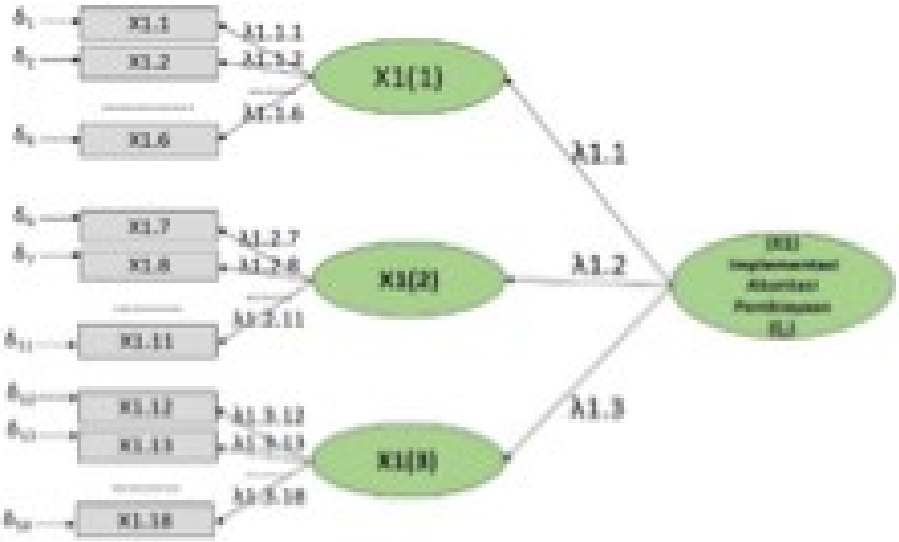

Figure 1. SEM Model Financing Accounting Implementation Variables (X1)

Source: The author

The Financial Report Quality variable has the dimensions of the quality of the financial report time, the quality of the content of the financial report, and the quality of the financial report format. Image of the SEM measurement model and its equations are as follows:

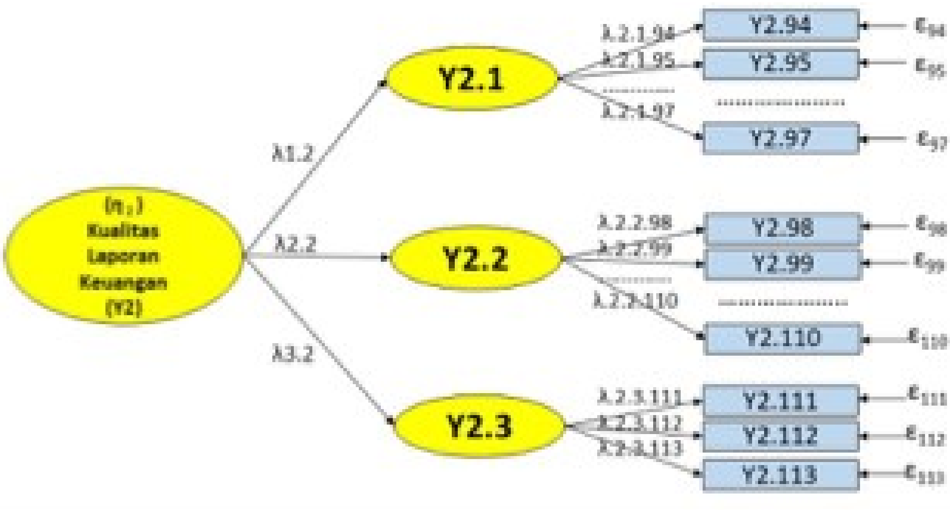

Figure 2. SEM Model of Financial Report Quality Variables

Source: The author

The Maqasid Syariah Performance Variable has the dimensions of religion (diin), life (nafs), reason ('aql), lineage (nasl), and wealth (maal). Image of the SEM measurement model and its equations are as follows:

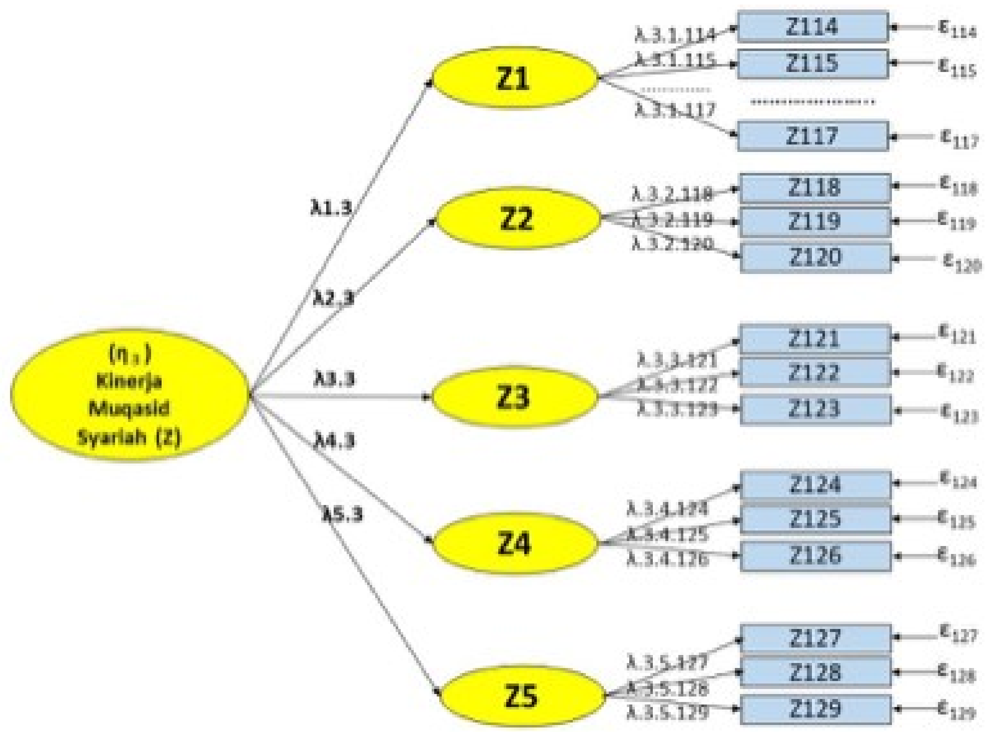

Figure 3. SEM Model of Financial Report Quality Variables

Source: The author

The measurement model was tested with the confirmatory factor analysis (CFA) approach, which was conducted to determine the validity of the indicators on each variable. The results of the CFA testing are explained below.

Table 3. Summary of Cross Loading for Variable Measurement in Implementing Financing Accounting, Quality of Financial Statements and Maqasid Sharia Performance

Indicator	X1	Y2	Z
X1.1	**0.648848**	0.188898	0.420395
X1.2	**0.821784**	0.351782	0.370061
X1.3	**0.687622**	0.343361	0.2252
Y2.2	0.430916	**0.971918**	0.354018
Y2.3	0.194589	**0.725971**	0.058425
Z1	0.202245	0.110186	**0.790614**
Z2	0.472351	0.246019	**0.953339**
Z3	0.364509	0.147368	**0.902497**
Z4	0.173561	-0.002063	**0.767241**
Z5	0.554952	0.490003	**0.907499**

Source: Research results

Table 3 highlights that the cross-loading weighting values indicate that the loadings of the indicators on each latent variable was greater than the other variables, indicating that the indicator was able to explain each of its latent variables.

Table 4. Summary of Outer Cross Loading for Variable Measurement in Implementing Financing Accounting, Quality of Financial Statements and Maqasid Sharia Performance

Indicator	Outer Loading	t-count	Description
X1.1	0.6488	6.4365	Valid
X1.2	0.8218	13.5535	Valid
X1.3	0.6876	6.3926	Valid
Y2.2	0.9719	24.8114	Valid
Y2.3	0.7260	3.6337	Valid
Z1	0.7906	9.1214	Valid
Z2	0.9533	61.0602	Valid
Z3	0.9025	17.5591	Valid
Z4	0.7672	8.8320	Valid
Z5	0.9075	39.2299	Valid

Source: Research results

Table 4 shows that the value of the outer loading factor weight of each indicator was greater than 0.50 and that the t count was higher than 1.96, which means that the indicators in the Implementing Financing Accounting, Quality of Financial Statements and Maqasid Sharia Performance variables were valid as measurement tools.

Structural model testing

Before testing the structural model, a model suitability test was conducted with the goodness of fit index approach. This approach aimed to ascertain whether the model which was built on theory had good suitability with the empirical data collected through the questionnaires.

Table 5. Overview Results of Model Goodness Testing

Latent Variable		AVE	Composite Reliability	R Square	Cronbach's Alpha	Communality
X	Financing Accounting	0.523052	0.765008		0.537674	0.523052
Y	Quality of Financial Statements	0.73583	0.845115	0.166201	0.704454	0.73583
Z	Maqasid Sharia Performance	0.752128	0.937758	0.240221	0.924623	0.752128

Source: Research results

The results of the model goodness test shown in Table 4.3 demonstrate that all the indicators with values of AV E> 0.50, Composite Reliability (CR) > 0.7, and Cronbach's Alpha (CA) > 0.6 have a very good level of fit. From the combination of various sizes of model suitability, it can be concluded that the study model as a whole had a very good level of compatibility. The research hypothesis is conducted. The results of testing the research hypothesis are shown in Figure 4.

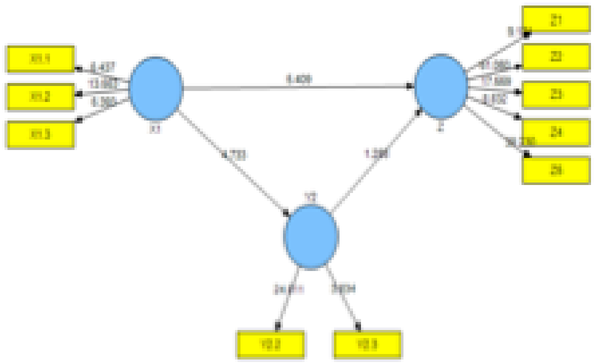

Figure 4. Structural Model Diagram of T-Value Research

Source: The author

The level of the effects produced between the latent variables can be identified by observing the path coefficient value formed, which is shown in Figure 5.

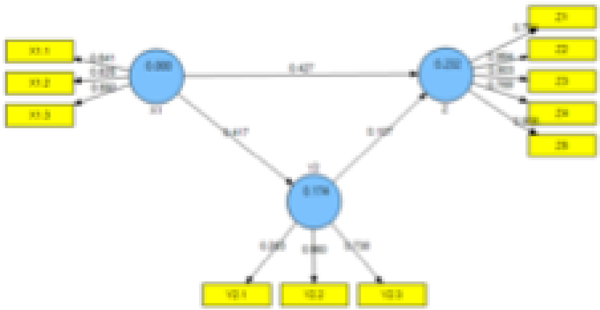

Figure 5. Structural Model Diagram of Standard Solution Factor Stage 1

Source: The author

One indicator of Y2.1 had a loading value of less than 0.5, so had to be dropped.

Stage 2 (after dropping Y2.1)

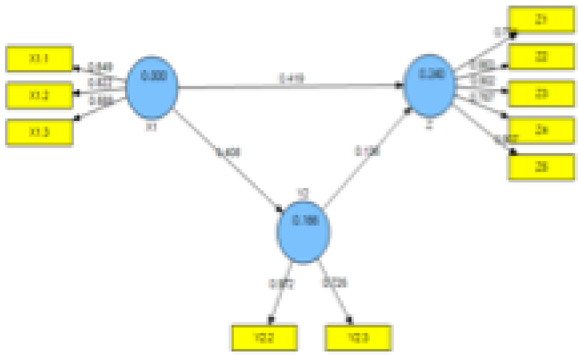

Figure 6. Structural Model Diagram of Standard Solution Factor Stage II

Source: The author

Figures 4 and 6 show the results of the research hypothesis testing, while the level of causal relationship between the research variables is presented in Table 6.

Table 6. Hypothesis Testing Results of the Direct and Indirect Influences

Hypothesis		Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	Standard Error (STERR)	T Statistics (|O/STERR|)	Hypothesis Result
H1	X1 -> Y2	0.4077	0.4570	0.0861	0.0861	4.7325	Accepted
H2	X1 -> Z	0.4189	0.4398	0.0774	0.0774	5.4088	Accepted
H3	Y2 -> Z	0.1357	0.1277	0.1054	0.1054	1.2880	Rejected
H4	X1 toward Z through Y2	0.0553	0.0584	0.0958	0.0958	0.5778	Rejected

Source: Research results

Note: if the value of |t count| is > t table (1.96) alpha 5% it is acceptable

RESULTS

This section discusses the results of the empirical tests for each problem statement. The discussion is based on the underlying theory, the results of previous studies, descriptive analysis, and hypothesis testing.

The implementation of financing accounting in relation to the quality of financial reporting

The results of the hypothesis testing show that the implementation of financial accounting had a positive influence of 0.4077 on the quality of financial statements. These results provide empirical evidence that the better the implementation of financial accounting, the better the quality of financial statements in Indonesian Islamic banking.

Islamic banking of which financial statements complied with SAS makes explicit and without exception statements about compliance with SAS in its financial statement records, so that the quality of financial statements produces relevant and reliable information for the needs of stakeholder decision making (Fitriati & Mulyani, 2015; Standar Akuntansi Keuangan Syariah, 2016).

The influence of the implementation of financial accounting practices on the quality of financial statements is in line with the study of Sarea & Hanefah (2013), who conducted research on 129 accountants in Bahrain Islamic banking and revealed that 85% of the respondents stated that the financial accounting practices undertaken based on AAOIFI had a positive influence on the quality of financial statements. Vinnicombe (2012) also found that there was a positive influence of the implementation of financial accounting practice based on AAOIFI on the quality of financial statements.

Based on the responses and the results of the interviews conducted for this study, it can be concluded that Islamic banking has implemented records, measurement and accounting reports of its financing based on the relevant Sharia accounting standards at 61.77%, as shown in Table 7.

Table 7. Average Islamic Banking Records, Measurement and Accounting Reports in Hybrid Financing Contracts

No	Description	Result
1	Implementation of SAS related to hybrid contracts	61.77%
2	Combination of SAS with IFRS	5.88%
3	Self-modification	2.94%

Source: Research results

This research reinforces the Sharia Enterprise Theory Triyuwono (2001) by emphasizing that the application of financial accounting in Sharia banking using *mudharabah, musyarakah* and *murabahah* agreements is in accordance with Sharia accounting standards, and leads to efforts to provide information to stakeholders in making decisions as a form of accountability to Allah SWT. The findings in this research are important and very closely related to the financial reporting process which includes financial statements on commercial and/ or social activities to meet the information needs of a large number of users. Islamic banking must continue to be fair in presenting and disclosing its financial position and the results of operations of Sharia entities in an honest manner and in accordance with Islamic Sharia.

The implementation of financing accounting in relation to maqasid sharia performance

The hypothesis testing results indicate that the implementation of financial accounting had a positive influence of 0.4189 on the performance of Sharia maqasid. This performance was measured by the indicators of the guarding of religion/*hifz ad-dien*; of the soul/*hifz an-nafs*; of the intellect/*hifz al-'aql*; and the guarding of descent/*hifz an-nasl*. The results provide empirical evidence that the better the implementation of financial accounting, the better the performance of Islamic maqasid in Indonesian Islamic banking.

The influence of the implementation of financial accounting on the performance of Islamic maqasid is in line with research conducted by Azhar (2010) and Haniffa & Hudaib (2010), who state that the practice of financial accounting using the Islamic maqasid approach treats each transaction in accordance with its position in the rules of *muamalah*, which prohibit the elements of usury, tyranny, *maysir, gharar,* and *haram*. Vinnicombe (2012) conducted research on 27 Islamic banks in Bahrain using AAOIFI standards and found that the implementation of financial accounting, in this case transactions in *mudharabah*, *musharaka*, and *murabahah* contracts of Islamic banking, had an influence on compliance with Islamic maqasid principles. Al Zyoud; Almsafir & Al-smadi (2013) revealed that transactions in *murabaha* contracts affected the performance of maqasid Sharia through adherence to Sharia principles.

Based on the responses and the results of the interviews, it can be concluded that Islamic banking has implemented records, measurement and accounting reports of its financing based on the elements that constitute Sharia provisions (maqasid Sharia) at 47.06%, as presented in Table 8.

Table 8. Questionnaire General Information

Description	Result
The extent of the importance of an Account Officer/AO who has a background in accounting or non-accounting education in financial accounting practices (such as recognition, measurement, and presentation of *mudharabah, musyarakah,* and *murabahah* transactions) in assisting Islamic banking to implement applicable Sharia accounting standards.	Highly Important 47.06% Important 44.12% Not Important 8.82%

Source: Research results

In relation to this notion, the results of the Sharia banking performance indicators based on financial and non-financial aspects can be seen in Table 9. These show that Islamic banking has implemented products and operations complying with Sharia at a level of 14.71%.

Table 9. Islamic Banking Performance Indicators based on Financial and Non-financial Aspects

No	Performance Indicator	%
1	High business profit	58.82%
2	High business/asset growth rate	14.71%
3	High business/branch office expansion rate	14.71%
4	High employee benefit rate	5.88%
5	High level of pious environment creation	5.88%
6	High level of work safety and health	17.65%
7	Reasonable level of profit sharing from savings and deposits, and affordable financing costs for customers	14.71%
8	Products and operations complying with sharia	14.71%
9	High ZISWAF collection and distribution rates	11.76%
10	Level of concern for financing MSME sector	20.59%
11	Level of environmental friendliness in financing	20.59%
12	Distribution of funding to the real sector	8.82%
13	High contribution of Islamic banks in economic growth	17.65%
14	Number of depositors	23.53%
15	Others	32.35%

Source: Research results

This study reinforces the Sharia Enterprise Theory Triyuwono (2001) by emphasizing that financial accounting in Sharia banking was analyzed according to its implementation with applicable Sharia accounting standards and has led to increased efforts to provide information to stakeholders in making decisions, as a form of accountability to Allah SWT.

The quality of financial reporting in relation to maqasid sharia performance

The results of the hypothesis testing show that the quality of financial statements did not have a positive influence on improving the performance of Islamic maqasid. This quality was measured by the indicators of the quality of time, content and format of the financial statements.

The Accounting and Auditing Organization for Islamic Financial Institution AAOIFI (2015) states that the measurement of information regarding financial position and performance must meet the basic qualitative characteristics of relevance, reliability, understandability and comparability. However, based on the results of this study, there was no direct impact of the implementation of financial statement quality on the performance of maqasid Sariah in Islamic banking.

The findings of this study support the research conducted by Haniffa & Hudaib (2010) on the annual reports of Islamic banking in five Islamic financial institutions in the GULF region/The Arab states of the Persian Gulf. The results show that only two Islamic financial institutions in Bahrain had followed AAOIFI standards in their financial reporting. Al-baluchi (2006) conducted research on 14 banks in Bahrain, 26 in Sudan, two in Qatar, and two in Jordan. The results show that the financial statement disclosure in Sudan was lower than in the other three countries. The findings of the study were supported by Abdullah (2007), who conducted research on 499 academics, external auditors and employees of Islamic banks in Saudi Arabia. The results show low awareness of conducting financial reporting measurements based on AAOIFI standards. In addition, Aida & Nadzri (2009) conducted research on 25 Islamic financial institutions in Bahrain, Sudan, Palestine, Bangladesh, Qatar, UAE, Saudi Arabia, Malaysia, the UK, Jordan and Kuwait, and found low exposure of AAOIFI accounting standards in financial statement disclosure in Islamic financial institutions. Only a few countries have implemented these standards: Bahrain, Sudan, Palestine, Bangladesh and Qatar. Referring to the findings of this study, they could become input for regulators, which would be very important for improving compliance with AAOIFI standards in the presentation and disclosure of Sharia banking financial statements, in order to improve the quality of the financial statement information received and understood by stakeholders.

The influence of implementing financial accounting onmaqasid sharia performance through financial statement quality

Based on the test results, the study concludes that the implementation of financial accounting indirectly did not have a positive influence on the performance of maqasid Sharia through the quality of financial statements. The reason is that the financial statements prepared to meet the objectives of Sharia (maqasid Sharia) have not provided useful information to most users. In other words, the financial statements have not provided all the information that a large number of users may require regarding non-commercial Sharia transactions carried out, including the granting of loans or bailouts (*qard*), and the collection and distribution of social funds such as *zakat*, donations, alms, *waqf* and grants.

The findings of this study are in line with research conducted by Ahmed & Khatun (2013) on 17 Islamic banks in countries that have used AAOIFI standards. Their results show that the compliance level of Islamic banking in implementing AAOIFI standards was still low. This is similar to the results of research conducted by Ullah (2013) on seven Islamic banks in Bangladesh, which show that the average level of compliance with AAOIFI standard was 44.68%. Hence, the disclosure of financial statements did not provide information in the form of the collection and distribution of social funds such as *zakat*, donations, alms, *waqf* or grants.

The implications of this study are the need to improve the quality of financial statement information to meet the needs of the large number of users in economic decision making and to improve the comparability of financial statements between periods to identify trends in financial and non-financial positions and performance among Sharia entities from various countries (Sarea & Hanefah, 2013). In addition, another objective is to improve the quality of information to help evaluate the fulfilment of the responsibilities of Islamic entities of the mandate of securing funds, investing them at an appropriate profit level and increasing information on the level of investment returns obtained by investors and stakeholders of temporary *syirkah* funds, as well as information on fulfilling the obligations of the social functions of Sharia entities, including the management and distribution of *zakat*, donations, alms and *waqf*, so that the main objectives of Sharia are fulfilled (Sharia maqasid). Therefore, the measurement and presentation of financial influences of similar transactions and other events must be made consistently for Sharia entities, between the same Sharia entity periods, for different Sharia entities, and with other entities (Standar Akuntansi Keuangan Syariah, 2016).

CONCLUSION

The research findings paint a nuanced picture of the relationship between various aspects of financial accounting, the quality of financial reporting, and the performance of maqasid Sharia in Indonesian Islamic banking.

Implementation of Financing Accounting and Quality of Financial Reporting: The investigation reveals a positive correlation (0.4077) between the implementation of financial accounting practices and the quality of financial statements in Indonesian Islamic banking. Notably, adherence to Sharia Accounting Standards (SAS) contributes to the clarity and comprehensiveness of financial records, providing relevant and reliable information for stakeholders. This echoes previous research findings that suggest a favorable impact of financial accounting practices on the quality of financial statements within the Islamic banking sector.

Implementation of Financing Accounting and Maqasid Sharia Performance: Further exploration uncovers a positive influence (0.4189) of financial accounting implementation on the performance of Sharia maqasid in Indonesian Islamic banking. This positive correlation aligns with the broader understanding that financial accounting practices, when in line with Islamic principles, uphold the prohibition of usury, tyranny, maysir, gharar, and other elements deemed haram. The study highlights that Indonesian Islamic banking has achieved a 47.06% level of compliance with Sharia provisions (maqasid Sharia) in the implementation of financing accounting.

Quality of Financial Reporting and Maqasid Sharia Performance: Surprisingly, the quality of financial statements, as measured by indicators such as time, content, and format, does not exhibit a direct positive influence on improving the performance of Islamic maqasid in Indonesian Islamic banking. This contrasts with expectations and mirrors findings from previous research indicating a general low compliance with AAOIFI standards in financial reporting across Islamic financial institutions in various countries.

Influence of Implementing Financial Accounting on Maqasid Sharia Performance through Financial Statement Quality: The study concludes that the implementation of financial accounting does not have a direct positive impact on the performance of maqasid Sharia through the quality of financial statements. The reasoning behind this conclusion lies in the observation that financial statements prepared to meet Sharia objectives may fall short in providing essential information, particularly regarding non-commercial Sharia transactions, social fund collection and distribution, and the fulfillment of social functions by Sharia entities.

In summary, the research underscores the vital importance of aligning financial accounting practices with Sharia principles to enhance the quality of financial reporting and contribute positively to the performance of maqasid Sharia in Indonesian Islamic banking. The findings also shed light on areas that warrant improvement, specifically in the disclosure of social funds and the fulfillment of social functions in financial statements. These insights carry implications for regulatory standards and the ongoing development of Sharia-compliant financial reporting practices.

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