

## ISLAMIC ACCOUNTING SUPPORT TO THE GROWING OF ISLAMIC FINANCIAL INSTITUTIONS IN INDONESIA

Nurul Fatimah

### ABSTRACT

The purpose of this research is to investigate whether the existing PSAKS, which set up by The Indonesian Institute of Accountants (IAI) - more specifically by The Indonesian Sharia Accounting Standards Board (DSAS), is already adequate to fulfill the reporting need of Islamic Financial Institutions (IFIs) in Indonesia. This research also aims to evaluate IFIs's compliance with the standard. Formerly, many scholars have examined the sharia reporting practice by Islamic banks in Indonesia, but few have put more attention to capital market and non-banking IFIs while these sectors also showed surprising growth recently. By adopting analytical approach based on a combination of archival, bibliographical and documentation of financial data, the research tried to describe a comparison of the reporting practice, standard adoption and compliance by all IFIs recognized by the end of 2017. The research found out that PSAKS exist today are quite enough to fulfill the IFIs' requirement, but still need improvement and further study to converge with AAOIFI. Most of the IFIs assessed had achieved unqualified opinion from auditor but few of which disclosed which standards they comply to.

**Keywords:** Banking sector, Islamic Accounting Standard, Islamic Financial Institutions, Non-Banking Sector

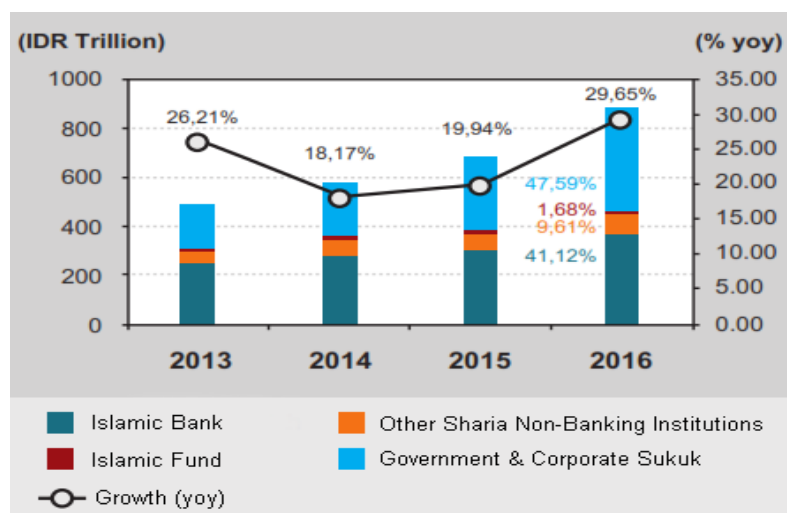
### INTRODUCTION

Islamic finance as an integral part of Islamic life system has experienced up-and-down milestones throughout decades (Suandi, 2013). Its existence faded away after the khalifa civilization collapsed in the early 19th century. Today, Islamic finance has re-emerged in the form of modern Islamic financial Institutions (IFIs) which have been growing remarkably in countries around the globe (Atmeh, 2017; Ben Abd El Afou, 2017; Erkol & Sherif, 2016).

Based on the Financial Stability Report in 2016, the global total assets of IFIs has increased significantly from USD 150 billion in 1990's to USD 2 trillion in 2015. It is expected that this number will jump up to USD 6.5 trillion in 2020 (Otoritas Jasa Keuangan, 2017). Despite of its world-wide spread, including in some Non-Muslim countries like United Kingdom, it is noted that IFIs development is highly concentrated in the Middle-East and Asian countries (Erkol & Sherif, 2016; Otoritas Jasa Keuangan, 2017).

Indonesia, as the world most populated Muslims country, is one of Asian countries where Islamic financial products are highly demanded by public (Suandi, 2013). IFIs in Indonesia, both banking and non-banking sectors, have grown dramatically since the establishment of Bank Muamalat Indonesia – the first Islamic bank – in 1992. Later it triggered the founding of other sector IFIs such as PT Asuransi Takaful Keluarga (the first Islamic insurance company) in 1994 and Danareksa Syariah Berimbang (the first sharia mutual fund) in 1997 (Otoritas Jasa Keuangan, 2017a). All these sectors keep growing as their total assets show a gradual increase in recent years (figure 1). Not surprisingly, Indonesia is considered as one of the most potential players in Islamic financial industry.

Figure 1 Indonesia Sharia Finance Landscape 2013-2016



Source: Financial Services Authority (2017)

The rapid development of IFIs mentioned above is mostly driven by the faith that Islam, through *Qur'an* and *Hadith* as its primary source of law, is an integrated way of life which control human in any aspects of life, unexceptionally (Ben Abd El Afou, 2017; Mohammed, Ahmad, & Fahmi, 2016; Suandi, 2013). In economic aspect, Muslims are obliged to avoid *riba'* (usury) in conducting commercial transactions<sup>1</sup> which prevailing in conventional counterpart (Mohammed, Ahmad, & Fahmi, 2016; Mohammed Sarea & Mohd Hanefah, 2013b; Suandi, 2013). Lewis (in Ben Abd El Afou, 2017) stated that IFIs are established with the aim to conduct business operations which strictly comply to Islamic teaching (*Sharia*). This fundamental point of view suggests that the accounting framework underpinning IFIs should also sharia-compliant.

The predominant accounting standard – IFRS – is believed containing key assumptions that opposite the *sharia* such as the time value of money and substance over form concepts (Adnan, 1996; Aoss, 2015; KPMG and ACCA, 2010; Velayutham, 2014). Time value of money is strongly related to interest which used as a reference to determine discounted cash flows. On the other side, the substance over form concept is also perceived contradictive with *sharia*, because in Islam it is the legal form that will ultimately determine the accounting substance, not the contrary (Suandi, 2013). This consideration has motivated Islamic scholars and standard-setters to develop an independent accounting standard for IFIs (Ben Abd El Afou, 2017; Erkol & Sherif, 2016; Mohammed et al., 2016; Suandi, 2013).

Islamic financial accounting standard (FAS) was first established by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) in the early 1990's. To date, this institution has produced approximately 88 standards regarding *sharia*, accounting, auditing, and governance standards (Aoss, 2015).

However, the serious contribution of AAOIFI in development of accounting standards has not been universally accepted. Mohammed et al., (2016) stated that the choice of adopting AAOIFI FAS depends on national regulators. According to the survey conducted by Asian-Oceanian Standard Setters Group (AOSSG) in 2014, there are only 18% IFIs compliance with AAOIFI FAS. The 46% IFIs chose to comply with IFRS. 34% asserted compliance with local GAAP. While the rest 2% did not specify the standard adopted (Aoss, 2015). Based on the survey, Indonesia is one of those who selected local GAAP which included *sharia* accounting standards namely Statements of *Sharia* Accounting Standards (PSAKS). These standards set by *Sharia* Accounting Standards Board (DSAS) under Indonesian Institute of Accountants (IAI).

Currently, PSAKS comprises of 12 standards which will be described in more detail in the literature review section. Comparing to AAOIFI standards, this number is a lot fewer that the reporting of IFIs in Indonesia still mostly comply with the IFRS-converged PSAKS. Mohammed et al., (2016) indicate there are some reasons hampering the decisions to adopt AAOIFI FAS. First, all companies should also comply with IFRS for international reporting purpose, thus many practitioners think it is too costly to adopt two different standards at the same time. Second, some scholars perceived that AAOIFI FAS are actually similar with IFRS, except in minor cases. And the third consideration argues that IFIs products are copied from conventional one. It implies that the IFRS is actually adhere the *sharia* and thus compatible to IFIs.

This paper aims to investigate whether the existing PSAKS now are already adequate to fulfill the reporting need of IFIs to assure its compliance with *sharia*. The next question to be answered is that have all the IFIs (banking and non-banking) asserted their compliance with the PSAKS in financial statements. Many prior researches have investigated the *sharia* bank only, while the non-banking ones still rare. Therefore, this research tries to fill this vacancy and compares the both sectors.

## LITERATURE REVIEW

### Islamic Financial Institutions (IFIs) In Indonesia

IFIs are the manifestation of Muslims obedient to Allah, specifically what written in Surah Al-Baqara verse 275: “Those who eat *Riba* (usury) will not stand (on the Day of Resurrection) except like the standing of a person beaten by *Shaitan* (Satan) leading him to insanity. That is because they say: “Trading is only like *Riba'* (usury)”, whereas Allah has permitted trading and forbidden *Riba'*.....” (Mohammed Sarea & Mohd Hanefah, 2013b).

All financial institutions in Indonesia, both conventional-based and *sharia*-based, are under control of Financial Services Authority (OJK). In regards of IFIs, OJK made three classifications of entities: banking, capital market and non-banking IFIs.

The banking sector IFIs including Islamic commercial bank (BUS/full fledged), Islamic Business Units (UUS), and Islamic rural banks (BPRS) (Otoritas Jasa Keuangan, 2017a). The first Indonesian Islamic Bank is Bank Muamalat Indonesia which established in 1992 by Banking Act No. 7 (Suandi, 2013). Since then, Indonesia formally has been conducting dual-banking system, conventional and Islamic banking.

Islamic capital market comprises of Islamic stock, *sukuk* and Islamic mutual fund. Formerly, this sector was under control of Capital Market Supervisory Agency and Financial Institutions (Bapepam-LK), but now – since 2011 - taken over by OJK. In its historical milestone, Indonesian capital market IFIs was founded in 1997 (Otoritas Jasa Keuangan, 2017a). Three years later,

<sup>1</sup> Qur'an 2: 275

exactly in 2000, Jakarta Islamic Index (JII) was launched. A public company whose business operation complies with sharia principle; does not have interest-based debt more than 45% and non-halal income less than 10% is grouped into this index.

The last group –non-banking IFIs-, refers to specific Islamic financial industries other than bank and capital market. This group includes various sectors such as Islamic insurance (*takaful*), Islamic pension fund, Islamic investment companies and Islamic microfinance companies (Otoritas Jasa Keuangan, 2017a).

### Islamic Accounting

The foundation of Islamic accounting is accountability concept as implicitly spoken through The Holy *Qur'an* and *Hadith* (Ben Abd El Afou, 2017). This is relevant with stakeholder theory which saying that islamic financial statement is a means of communication or accountability to a wider range of stakeholder, other than shareholders and creditors (Ben Abd El Afou, 2017; Mohammed Sarea & Mohd Hanefah, 2013a).

Islamic accounting is built above Islamic principles such as *Tawheed* (Unity of God), *'Adl* (justice), *Waad* (fulfilling one's promises), *Ummah* (Community), *Taqwa* (piety) and *Sabr* (patience) (Husein, 2018).

### PSAKS: Indonesian Local GAAP with differential requirements for Islamic transactions

PSAKS originally developed in accordance with AAOIFI FAS. But after more than a decade of its existence Indonesia, represented by IAI, claimed to apply national Islamic accounting standard through the establishment of DSAS instead. The standards set by this body were claimed to be more comprehensive, and thus have different treatment towards particular transactions with AAOIFI's.

Per August 2017, PSAKS comprises of twelve standards as follows:

**Table 1 Sharia Accounting Standard (PSAKS)**

	Framework for Preparation and Presentation of Islamic Financial Statements.
PSAK 59	Accounting for Islamic Banking
PSAK 101	Islamic Financial Statement Presentation (Similar with FAS 1)
PSAK 102	Accounting for <i>Murabaha</i> (Similar with FAS 2)
PSAK 103	Accounting for <i>Salam</i> (Similar with FAS 7)
PSAK 104	Accounting for <i>Istishna'</i> (Similar with FAS 10)
PSAK 105	Accounting for <i>Mudaraba</i> (Similar with FAS 3)
PSAK 106	Accounting for <i>Musharaka</i> (Similar with FAS 4)
PSAK 107	Accounting for <i>Ijarah</i> (Similar with FAS 8)
PSAK 108	Accounting for Islamic Insurance Transactions (Similar with FAS 12)
PSAK 109	Accounting for <i>Zakat</i> , <i>Infaq</i> , and <i>Sadaqah</i> (Similar with FAS 9)
PSAK 110	Accounting for <i>Sukuk</i> (Similar with FAS 25)
PSAK 111	Accounting for Wa'd

Source : (Ikatan Akuntan Indonesia, 2016)

The first Islamic accounting standard in Indonesia was PSAK 59: Accounting for Islamic Banking which established in 2003. But this standard was limited to Banking sector. Thus, in 2010 IAI transformed DSAK to Sharia Accounting Standards Board (DSAS) and set 10 specific standards (PSAK 101-110) (Suandi, 2013). Those standards are applicable for all types of IFIs in accordance to transactions conducted such as PSAK 102 for trade with marked-up price (*murabaha*); PSAK 103 for advance purchase (*salam*); PSAK 104 for purchase order (*istishna*); PSAK 105 for profit sharing (*mudaraba*); PSAK 106 for profit and loss sharing (*musharaka*); PSAK 107 for lease financing (*ijara*); PSAK 108 for insurance (*takaful*); PSAK 109 for Zakat, Infaq and Shadaqa; and PSAK 110 for *Sukuk* (Ikatan Akuntan Indonesia, 2016). The adoption of each standard depends on what financial service offered by an IFI. For example, if a sharia bank offers both *murabaha* and *musharaka* at once, thus the bank should adopt both PSAK 105 and 106. PSAK 111 is a brand-new standard that was set up in 2017. Up until now, PSAKS keeps improving.

### METHOD

This research employs a simple quantitative approach by exploring the literature study based on relevant prior researches as well as using descriptive statistic to evaluate IFIs financial report compliance. The evaluation is conducted by assessing the explanation of financial statement regarding which reporting standard or PSAKS is adopted by each company and the auditor opinion of the financial statement.

The population of this research is all IFIs exist or are under control of OJK and already published yearly financial statement of 2017. The data collected from various documents such as literature and reports which then organized and measured by statistical descriptive technique.

### RESULTS AND DISCUSSION

The population of all IFIs is sorted as on table 2. From totally 464 companies listed in OJK, only a half published complete financial statements and thus qualified to be in research sample.

**Table 2 Population Detail**

	<b>Sector</b>	<b>Sub-Sector</b>	<b>Total</b>
A	Banking	Islamic Commercial Bank	13
		Sharia Business Units	21
		Sharia Rural Bank	167
B	Capital Market		136
C	Non-Bank Financial Institutions	Insurance	58
		Investment Company	49
		Specific Financial Service Company	7
		Microfinance Company	13
<b>Total</b>			<b>464</b>

Source : (Otoritas Jasa Keuangan, 2017b)

### 1. Banking Sector

Among the three types of Islamic Banks, commercial bank provides the most number of services to the market. Like the conventional ones, Islamic commercial banks offer various kinds of services such as *mudaraba*, *musyaraka*, *istishna*, *salam*, *ijara*, pension fund, even pawning service. Therefore, they adopt many standards in PSAK. The biggest companies in this group adopt seven PSAKS' (PSAK 101, 102, 104, 105, 106, 107, and 110), they are PT Bank Muamalat Indonesia Tbk. And PT Bank Syariah Mandiri, Tbk. Most of companies (six companies) adopt six PSAKS' concerning financial presentation, *mudaraba*, *musyaraka*, *ijara*, and *sukuk*. This implies that most of the Islamic commercial banks today exist in Indonesia are still focused on those services. Only few of them also offer *salam*, *istishna*, pension fund, *takaful* or even *wa'ad*.

In Sharia Business Units and Rural Banks, the number of PSAKS adopted is fewer than the prior one. They only adopt two to five PSAKS' relating to their subject of services. Most of the services provided by these groups are PSAK 102, 103, 104, 107 and 108. It implies that they conduct some services which are not offered by the majority of commercial banks such as *salam* and *istishna*.

Meanwhile the adoption of PSAK 109 about *Zakat*, *Infaq* and *Shadaqa* is not found in the entire companies assessed. This is because the obligation to pay zakat in Indonesia is still debatable (Suandi, 2013). Zakat obligation only assigned for institutions which collect and distribute zakat, eventhough actually IFIs are also allowed to do so.

Regarding the compliance towards the standards, nearly all companies in this sector are judged "unqualified" by the external auditors. Unqualified means that there are no material errors found in the financial statement and the standards are adopted consistently (Arens, Elder, & Beasley, 2012).

### 2. Capital Market Sector

The majority of capital market entities assessed in this research is Islamic mutual fund companies which categorized into four types i.e money market, fixed-income, mixed and stock sharia mutual fund. Among the entire companies observed, it is difficult to find a full disclosure of what PSAKS is adopted other than PSAKS 101, due to limited information disclosed in the financial statements published.

### 3. Non-Bank IFIs

The first non-bank IFIs is Islamic insurance totaling 58 companies. Most of which only expressed that they comply with the existing financial standards without mentioning exactly which standards are they. They also stated that the adopting of the standards is adjusted to fulfill the requirement of Bapepam Act No PER.06/BL/2011. Nevertheless, few of them explicitly mentioned that they adopted PSAKS 101 about financial statement presentation, PSAKS 108 about Islamic insurance, and 110 about *sukuk*.

The other institution assessed in this sector is Investment companies. They are similar to leasing companies in conventional system. In Islamic sector, there are five companies which conduct investing service full-fledgedly. Most of which stated that they complied to PSAKS 101 and 107 (*ijara*), and some also adopt PSAK 102, 103, 104, 107, 108 and 110; similar to banking and insurance financial institutions. Both insurance and investment companies in this research fulfill the "unqualified" opinion from external auditors.

Regarding PSAKS 111, accounting for *wa'ad*, it is known that almost all the IFIs did not assert their compliance to this standard due to its new launching at the same year observed.

## CONCLUSION

Based on the literature study and financial report assessment, I conclude that in some cases, the current PSAKS are considered adequate for the existing IFIs. But it does not completely ensure that the IFIs purely shariah, due to mixed reporting standard with the IFRS-converged standards. Besides, as the IFIs business transactions getting more complex in the future, DSAS should prepare and held a continuous study regarding the need to design a completely independent sharia accounting standards like AAOIFI, otherwise fully adopt it.

In regards of IFIs compliance, most of the IFIs in Indonesia achieved “unqualified” opinion from auditor, but few of them explicitly asserted to which standards they comply to. Particularly, capital market IFIs, most of which do not publish the complete financial statement nor asserted their compliants. This limitation led to expectation that in the future research, the researcher should also employ questionnaire survey directly to the IFIs for confirmation of the results.

## REFERENCES

- Adnan, M. A. (1996). An investigation of accounting concepts and practices in Islamic banks: The cases of Bank Islam Malaysia Berhad and Bank Muamalat Indonesia. *ProQuest Dissertations and Theses*, 1. Retrieved from <http://search.proquest.com/docview/304340611?accountid=13771>
- Aossg. (2015). *Financial Reporting by Islamic Financial Institutions* (pp. 1–89).
- Arens, A. A., Elder, R. J., & Beasley, M. S. (2012). *Auditing and Assurance Services* (14th ed.). New Jersey: Pearson Prentice Hall.
- Ben Abd El Afou, R. (2017). Knowledge of Islamic accounting among professionals: evidence from the Tunisian context. *Journal of Islamic Accounting and Business Research*, 8, 304–325. <http://doi.org/10.1108/JIABR-03-2015-0008>
- Erkol, C. T., & Sherif, M. (2016). Sukuk and Conventional Bonds: Shareholder Wealth Perspective. *Journal of Islamic Accounting and Business Research*.
- Ikatan Akuntan Indonesia. (2016). *Standar Akuntansi Keuangan Syariah Efektif Per 1 Januari 2017*. Ikatan Akuntan Indonesia.
- KPMG and ACCA. (2010). *Harmonising financial reporting of Islamic finance. The Association of Chartered Certified Accountants* (pp. 1–23).
- Mohammed, N. F., Ahmad, A. E., & Fahmi, F. M. (2016). Accounting Standards and Islamic Financial Institutions: the Malaysian Experience. *Journal of Islamic Banking and Finance*, 4(1), 33–38. <http://doi.org/10.15640/jibf.v4n1a4>
- Mohammed Sarea, A., & Mohd Hanefah, M. (2013a). Adoption of AAOIFI accounting standards by Islamic banks of Bahrain. *Journal of Financial Reporting and Accounting*, 11(2), 131–142. <http://doi.org/10.1108/JFRA-07-2012-0031>
- Mohammed Sarea, A., & Mohd Hanefah, M. (2013b). The need of accounting standards for Islamic financial institutions: evidence from AAOIFI. *Journal of Islamic Accounting and Business Research*, 4, 64–76. <http://doi.org/10.1108/17590811311314294>
- Otoritas Jasa Keuangan. (2017a). *Roadmap Pengembangan Keuangan Syariah Indonesia 2017-2019*.
- Otoritas Jasa Keuangan. (2017b). *Statistik Perbankan Syariah 2017*.
- Suandi, A. B. (2013). Islamic Accounting in Indonesia: A Review from Current Global Situation, 241–264.
- Velayutham, S. (2014). “Conventional” accounting vs “Islamic” accounting: the debate revisited. *Journal of Islamic Accounting and Business Research*, 5 No. 2. <http://doi.org/10.1108/JIABR-05-2012-0026>

Nurul Fatimah  
School of Business Ekuitas, Bandung, Indonesia  
Email: nurulfatimah.upi@gmail.com