

Influence of Sharia Supervisory Board Characteristics on the Shariah Compliance

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Abstract. The purposes of this study are to identify the influence of SSB Characteristics on Shariah Compliance of AAOIFI Disclosure and to examine the influence of Shariah Supervisory Board (SSB) Characteristics on Shariah Compliance of AAOIFI Disclosure related to shariah supervisory board (SSB). The population of this study comprises financial firms operating in compliance with the Shariah principles in the Indonesian Islamic banking. This research concentrates on the annual report of Islamic banking, although firms may use other media of communication, such as public relations and internet sites to demonstrate shariah compliance disclosure. SSB characteristics are presented in the experience of SSB, meetings of SSB and cross membership of SSB. The findings of the regression analysis show a positive influence between Cross Membership on the Shariah Compliance Disclosure at one per cent significance level. While, the regression analysis shows a not positive influence between the Shariah Compliance Disclosure between meeting of SSB and experience of SSB. The significance of the cross membership of SSB suggests that the cross membership off is influential factor in determining Shariah Compliance Disclosure.

Keywords: Sharia Compliance, Sharia Supervisory Board, Disclosure

INTRODUCTION

Indonesia, as a country with a population of about 255.2 million people, with Muslim population 87% [1]. Although Indonesia is one of the countries that has a large population, especially Muslims, but the development of Islamic financial institutions in Indonesia has not been comparable with the population. Islamic Financial Institutional in Indonesia has only the asset of 2.5 per cent total IFIs global assets and 3.7 per cent total national asset in 2014 [2].

The establishment of Islamic financial institutions (IFIs) initially is an act of response towards Shariah prohibition of paying and receiving *riba* (interest) [3]. The governance structure of Islamic banks (IFIs) is distinct from their conventional counterparts as a result of the existence of Shariah compliant activities and the Shariah supervisory boards (SSBs). The issue of Shariah compliance in IFIs is given the attention when IFIs grew. Furthermore, it is given the rate of growth of the IFIs, the continuous sustainability of the development by IFIs in

both Islamic and non-Islamic countries needs Islamic accounting.

To understand IFIs comprehensively, it is very important to have some basic understanding of Shariah standards and compliance [4]. The earlier standardization efforts by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) becomes less dominantly applied by IFIs [5]. The literature on compliance with AAOIFI explores the compliance level [6], [7], [8], [9] and the determinants of the compliance, considering Sharia Supervisory Board (SSB) characteristics [9], [10].

The AAOIFI Governance Standard No. 1 [11] defined Sharia board as an independent bodies which has the duty to direct, review and supervise the Islamic Financial Institutions (IFIs) operations to comply the Sharia rules. Ahmed [12] stated that the main role of SSB is as the gate-keeper to ensure the Sharia implementation and compliance in their institutions. Each member of SSB has to review and assist the product and IB operations that comply to the Sharia rules and principles

METHOD

This research is to identify the influence SSB Characteristics on Shariah Compliance of AAOIFI Disclosure and to examine the influence of SSB Characteristics on Shariah Compliance of AAOIFI Disclosure related to shariah supervisory board (SSB). Therefore, this research uses quantitative type.

The population of this study comprises financial firms operating in compliance with the Shariah principles in the Indonesian Islamic banking. The sample was drawn from the list of Islamic financial institutions on the website of Indonesian Stock exchange (www.idx.co.id), Indonesian Central Banks (www.bi.co.id) and the firms part of sample website. There are more than 13 Islamic financial institutions in the Indonesia. The final sample includes 39 annual report of Islamic banks in year 2013-2015. The fiscal year of 2013-2015 was chosen for this research as most of the banks had already uploaded their annual reports in their websites and, it is sufficiently recent to ensure reasonable access to the company's corporate reports, and gives a rational picture of shariah compliance disclosure practice. This research concentrates on the annual report of Islamic banking, although firms may use other media of communication, such as public relations and internet sites to demonstrate shariah compliance disclosure.

We use Ordinary Least Square (OLS) where the independent variable is compliance/ disclosure score with AAOIFI Governance standards No 1 and No 5 related to Shariah Supervisory Board (SSB). The independent variable is the characteristics of SSB (the meeting of SSB, the experience of SSB and the cross membership of SSB).

The list of Compliance Level with AAOIFI Governance standards No 1 and No 5 related to Shariah Supervisory Board (SSB) was used by [10].

Item disclosure related to SSB:

1. Names of Shariah Supervisory board members
2. Brief about each members in the Sharia board (Background and qualification)
3. The role and responsibilities of the board
4. The authorities of the board
5. The Sharia auditing department in the bank
6. Is the website or annual report disclosure the Fatwa for the SSB related to Islamic service
7. SSB report assigned from the board members
8. Information about the bank's responsibility of zakat
9. Information about the bank's responsibility of activities not comply with Sharia and how bank deal with it
10. Information about how profit distribution process in the bank comply with Islamic Shariah
11. Information about the independency of the SSB with charter
12. Information about opinion for the SSB about compliance with shariah
13. The board discloses its opinion after reviewing all documents and all financial statement for the bank
14. Is the report shows that the bank comply with the AAOIFI's standards
15. Information about the date of report and name of bank

RESULT

Level of compliance by IFIs

Table 1 shows the compliance levels with AAOIFI Governance Standards No.1 and 5 related to Shariah Supervisory Board (SSB). It shows that the average compliance level for our selected banks are 9.7 item for shariah compliance disclosures related SSB from 15 Items or 65%. Table 1 shows the number of meeting of SSB on average for one year as such as 13 times. While SSB has an average experience for 7.7 years and cross membership of SSB has an average cross membership in six Islamic Financial Institutions for total number SSB in firm or three firm for one persons.

Table 1. Descriptive Statistics

Variables	Mean	Std. Deviation	N
Compliance Disc	9.7692	1.54684	39
Meeting	13.0513	3.01705	39
Experience	7.6923	6.91358	39
Cross membership	5.7949	2.80206	39

Regression result is shown in the table 2. It shows the cross-sectional OLS regression for the aggregated score of shariah compliance disclosure and the SSB Characteristics (the meeting of SSB, the experience SSB and cross membership of SSB).

The model in this research is significant at one per cent level. The adjusted R² was 0.165. The findings of the regression analysis show a positive influence between Cross Membership on the shariah compliance disclosure at one per cent significance level. The significance of the cross membership of SSB suggests that the cross membership off is influential factor in determining Shariah Compliance Disclosure. This result is in line with the study of [10] who found that the cross membership was an important determinant in influencing the disclosure level of CSR. This result is supported to the study of [9]. Cross-membership is an important feature of SSBs in IFI. The members of SSB with cross membership will be able to adopt their knowledge into their application of Shariah rulings in Islamic banking [9].

SSB is connected to the external environment as cross-SSB membership may enable SSBs to monitor external IFIs and disseminate information from this IFI. Interlocking SSB members can be considered as a source of information on the activities and policies of the other IFI.

While, the regression analysis shows a not positive influence meeting of SSB on the shariah compliance disclosure. In Indonesia based on Bank Indonesia regulation number. 11/33/PBI/2009, Sharia supervisory board obliges to hold meeting once in a month. Members of the Sharia Supervisory Board hold monthly meetings with the Chairman of the Sharia Supervisory Board regarding the evaluation of the work of the Sharia Supervisory Board. The results show that Sharia supervisory board often meetings do not necessarily make the shariah compliance in Islamic financial institutions to be better.

The regression analysis shows a not positive influence experience of SSB on the shariah compliance disclosure. There is a perception that SSB generally do not experience any tests for their credibility and integrity as that of other financial professionals such as lawyers, accountants and bankers who are regulated by their professional bodies and compelled by certain professional ethics [13].

With respect to the SSB members in IFI, scholars who have financial knowledge and experience are more effective in their performance as compared to those scholars without these capabilities [9]. Indeed, the vast majority of SSB members in IFI are Islamic scholars, and only some of them have accounting, banking, economic and finance expertise [14]. Most SSB scholars have a lack of experience in banking which affect their ability to issue well-informed decisions on financial products and activities [15].

Hence, many IFIs have replaced their whole SSB because the scholars have limited knowledge and exposure to both the Shariah principles and product

knowledge, and therefore, they could not function well [16]. The SSB scholars with knowledge in accounting and finance can have a positive and significant impact on the IFI performance as knowledge in Shariah law besides knowledge in business, accounting and finance assist the SSB in enhancing the performance of IFI [17]

Table 2. Coefficients

Model	Unstandardized Coefficients		Adjusted R Square
	B	Std. Error Sig.	
(Constant)	9.403	1.112	.000
Meeting	-.079	.085	.359
Experience	-.055	.038	.163
Cross Membership	.313	.098	.003

This implies that the crossmemberships of SSB is effective for monitoring and controlling the Islamic banks' activities related to shariah compliance issues according to Shariah rules and principles.

CONCLUSION

Based on the result analysis of this study can be concluded that the cross membership has a positive influence on the shariah compliance disclosure. While the meeting of SSB and experience of SSB have not positive influence on the shariah compliance disclosure.

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