THE EFFECT OF ISLAMIC SOCIAL REPORTING INDEX ON ISLAMIC BANKING FINANCIAL PERFORMANCE IN INDONESIA

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Abstract

Purpose of this study: This study was conducted to analyze the factors that affect the disclosure of Islamic Social Reporting (ISR) in Islamic Banking on the stock exchange and analyze the data carried out on the annual report of six Islamic banks in 2013-2017. The results of this study are expected to facilitate the Islamic banks to apply the principle of full disclosure with Islam in a more comprehensive way.

Methodology: The sampling technique used is sampling considerations obtained with a total sample of six Islamic banks in Indonesia. The data analysis technique used is multiple linear regression.

Main Findings: The level of disclosure of social responsibility reporting in Islamic perspective, using ISR index explains that Islamic Banks having a high index of ISR obtained by Bank Muamalat Indonesia that managed to reach the value of 20 and above, more precisely 32 components of the total index of ISR 48 component in the year 2017. Based on the hypothesis testing, it is found that the F-test of profitability factor and leverage, simultaneously or together influence the factors in the disclosure of ISR in Islamic Banking in Indonesia. Based on the hypothesis testing for the t-test, it is found that profitability and leverage do not affect the disclosure of ISR in Islamic Bank in Indonesia.

Implication: This research will serve as a reference material for improving the ISR performance of Islamic banking in Indonesia so that there is an even distribution of income.

Keywords: Islamic Banking, Financial Performance, Islamic Social Reporting.

INTRODUCTION

The Islamic Social Reporting (ISR) index contains a compilation of standard items of corporate social responsibility (CSR) specified by Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) which are then developed by researchers on CSR items that should be disclosed by an Islamic entity. The ISR index is believed to be the first step in terms of CSR disclosure standards that fit the Islamic perspective. ISR index has an item or indicator of disclosure in reporting of the social performance of the sharia business institution. Five themes of ISR index disclosure, include funding and investment themes, products and service themes, employee themes, themes of society, and theme of the environment (Rizkiningsih, 2012). This was further developed by the addition of the theme of disclosure and the theme of corporate governance (Keling & Othman, 2009).

There is a great deal of involvement in CSR, thus raising the framework of the ISR concepts that are based on Shariah provisions. ISR not only necessarily decides for the Muslims, but also assist the company in carrying out its obligations to Allah SWT and society. ISR is a standard for reporting the social performance of sharia-based companies. This index was born and developed based on the reporting standards of AAOIFI (Virgowati, 2013).

The factors that may affect the reporting of social responsibility of Islamic Banking are the ratio of the Muslim population and firm size. In a study conducted by Farook & Lanis (2007), 47 samples of banks were taken from 14 nations, namely Egypt, Iran, Jordan, Bahrain, Bangladesh, Malaysia, Kuwait, Pakistan, Qatar, Saudi Arabia, Sudan, Turkey, Yemen, and the United Arab Emirates. The factors affecting ISR disclosure in the research of Othman and Thani (2010) were company size, probability, and leverage.

Islamic banking should ideally operate by following the principles governed by the Islamic law (sharia). One of the main sources for analyzing and evaluating the activities of Islamic banks is the annual report. The annual report is a way to describe the financial and non-financial performance of Islamic banks.

Islamic values brought by Prophet Muhammad S.A.W. can be used as the foundation of CSR just as in conventional companies. This concept in Islam emphasizes the form of human devotion to Allah SWT in company dimension. Othman and Thani (2010) concluded that Islamic values have relevant significance and contribute to the CSR concept that has
developed until date. Based on the background that the researchers tried to test, the size of the company, the probability, and leverage of the disclosure of ISR on Islamic banks in Indonesia are listed on the stock exchange.

Figure 1 shows the corporate governance theme of ISR with a high score which shows that the Islamic Bank (our study sample) is good enough in doing disclosure of corporate governance theme. While the environment theme of ISR with the lowest value shows that the Islamic Bankings, used as samples in this study is still not good in the disclosure of ISR, especially on environmental themes.

Islamic Bankings in the disclosure of ISR index looks good enough because it has increased every year. Although not all ISR index themes have increased, it can be said that Islamic Bankings whose operational activities are according to sharia principles during 2013 to 2017 have improved implementing, reporting, and disclosing social responsibility. This is expected to have a fresh and positive impact on the development of social responsibility and Sharia practices in Indonesia. Thus, the purpose of this study is to discuss the relationship of profitability and leverage in the disclosure of the ISR Islamic Bank in Indonesia.

LITERATURE REVIEW

Corporate Social Responsibility (CSR)

According to The World Business Council for Sustainable Development (WBCSD), it is stated that CSR is a business commitment to contribute to sustainable economic development, working with company employees, their families, local communities, and communities as a whole, to improve the quality of life. From this statement, seen are the efforts to get involved in sustainable economic development so that the independence of society becomes the benchmark of the success of a business.

It can be said from the above opinion that the improvement of the quality of life means the ability of human beings, as individual members of society, to be able to respond to existing social conditions, enjoy, and utilize the environment including changes that are maintained at the same time. CSR is the way companies organize business processes to produce positive impacts on society (Taufik, 2015).

CSR has put the company and stakeholders, not in two different positions; instead, it keeps the company and stakeholders in one arena with limited natural resources and drives to the destination of the company's continuity in harmony with the interests of stakeholders. Corporate communications undergo a development process similar to CSR and have a broader new position, function, and strategy. CSR can work well if corporate communications are effective, whereas company communications find a new place in corporate management through CSR.
Islamic Social Reporting (ISR)

Islam comes from the Arabic word "Aslam-yuslimu-islaman" which means “to save”. Islam is a religion that completely regulates all aspects of human life on earth. The basic foundation of the Islamic religion is aqidah, worship or sharia, and morality. In addition to that described earlier, other principles cannot be separated from the aspect of Islamic teachings of Tawheed. This is because the principle of monotheism is at the heart of the Islamic religion. Istiah tawhid contains the sense of sweeping Allah SWT in worship and not associate Allah SWT.

Social reporting is an extension of the financial reporting system that reflects the new and broader estimates of society for the role of the business community in the economy. Social reporting is a process to communicate the social and environmental effects of economic actions and actions done by the company to the community. ISR is the disclosure of social and financial statements of companies that look to Islam or Islamic perspective. There are several important things in social reporting according to the Islamic view of understanding of accountability, social justice, and social ownership. These three things are very important with social relationships among humans.

ISR is the concept of ownership. Islam recognizes the existence of individual ownership, keeping in mind that the ownership is not absolute because everything in this world belongs to the creator of Alla AlmT’s universe. It can be said that Islam wants to erect between economic activities and also spiritual in business. Islamic sharia has three interconnected dimensions of seeking Allah's blessings as a primary goal in building socioeconomic justice, providing benefits to the society and bringing prosperity. Therefore, creating the reporting of social responsibility as per the Islamic sharia principles should be based on three dimensions.

Therefore, the hypothesis of this study includes:

\[ H_0: \text{Leverage and profitability have a positive effect on the level of ISR disclosure}. \]

\[ H_1: \text{Leverage and profitability have a negative effect on the level of ISR disclosure}. \]

METHODOLOGY

Sample

The sample model used in this study is the consideration model (Widiawati, 2012). The sample of six Islamic Banks include BNI Islamic Bank, Bank Mega Syariah, Bank BRI Syariah, Bank Muamalat Indonesia, Bank BCA Syariah, and Bank Syariah Mandiri from 2013 to 2017. The samples were selected by considering the following criteria:

- Islamic banks have issued annual financial statements as of December 31.
- A complete Islamic Bank and have data directly related to the variables that have been determined by the researcher.

Islamic Banking that are not elected are due to incomplete data of annual financial statements (Annual Report) of the company and the unavailability of published financial statements of the company.

The research variable is that everything that will be the object of observation of the study is then drawn to conclusions, there are two variables used in this study, namely independent variables which are expressed by the symbol X and the dependent variable which is stated by the symbol Y. Table 1 describes the identification of the variables in this study along with their measurements as follows:

| No | Name of Variable | Definition of Variable | Indikator |
|----|------------------|------------------------|-----------|
| 1. | Islamic social Reporting (ISR) | A social performance reporting standard for sharia-based companies. | By doing content analysis, namely: |
|    |                  |                        | • Equate between the annual report of the company and the six themes of the ISR. |
|    |                  |                        | • Create a table of ISR index scores. |
|    |                  |                        | • Then provide values for each ISR theme component in a dichotomy, namely 1 if the component is disclosed in the Annual report and 0 if it is not disclosed in the Annual report. |
|    |                  |                        | • The value obtained by each company is then added to get the total ISR index value |
| No | Name of Variable | Definition of Variable | Indikator |
|----|-----------------|------------------------|-----------|
| 2. | Leverage (LEV)  | Tool to measure how much the company depends on creditors in financing company assets. | (Total Liability) / (Total Equity) |
| 3. | Profitability (PROF) | The ability of a company to achieve profit. | (Net Profit) / (Average Total Assets) |

Source: Various sources (2017)

Data Collection

The data used in this study is secondary data obtained from financial publications issued by Bank Indonesia, Indonesia Stock Exchange, and the Central Bureau of Statistics with the period of data taken from 2013 to 2017. The data must be obtained first is the list of an Islamic Banking in Indonesia listed in the List of Indonesia Stock Exchange or Bank Indonesia for five periods during the period 2013-2017.

Library research process is used to get a strong foundation and concept to solve the problem. Therefore, the writer conducts library research to obtain the necessary data in this research by reading books, literature, notes on the internet and other reading materials relating to the problem under study.

The theoretical basis and development of hypotheses is derived from search results and data collected from books, scientific journals, and other writings related to research. Searching and collection of scientific journals are done by using online journal facilities through several websites, such as Scholars, Proquest, and others.

Data Analysis

Relationship between independent variables and the dependent variable by reference to data in the form of numbers are categorized as quantitative research using statistical analysis.

The testing technique used in this research is Multiple Linear Regression. The regression equation model can be formulated systematically as follows:

\[
	ext{ISR}_i = a + \beta_1 \text{PROF} + \epsilon_i \quad \text{......(1)}
\]

\[
	ext{ISR}_i = a + \beta_2 \text{LEV} + \epsilon_i \quad \text{......(2)}
\]

where

ISR = Islamic Social Reporting;

i = Company sample;

t = year period;

a = Constants;

b = Constants;

\(\beta_1, \beta_2 \) = Regression coefficients;

PROF = Probabilities;

LEV = Leverage;

E = Error

RESULT AND DISCUSSION

The Analysis of ISR Index

When viewed from the entire sample of Islamic Bankings in 2013 and 2014 that have the highest score in the ISR index is Bank Muamalat Indonesia by obtaining 30 points from 48 index points ISR, but in the year 2015 the highest ISR index was obtained by Bank Syariah Mandiri with 30 points from 48 index points ISR. Although Bank Muamalat Indonesia did not get the highest score in 2015, but in 2016 and 2017, the highest value was obtained by Bank Muamalat Indonesia by getting 31 points from 48 points in 2016 and 32 points from 48 index points ISR in 2017.

Figure 2 shows the results of the ISR index experiencing a significant increase, on an average from 2013 to 2017. From the above data, it can be seen that the highest average value in the disclosure of the ISR index is obtained by Bank Muamalat Indonesia with the average value of 30.4 and the lowest average value 24.8 is obtained by BRI sharia.
The high value of ISR index obtained by Islamic banks that get many points from the ISR theme provided can be caused by a fairly binding regulation regarding disclosure of social report in Indonesia, especially in corporate governance theme. Implementation of a good corporate governance by sharia commercial banks and sharia business units in Indonesia is governed by Indonesian bank regulations. Besides, Indonesia is also regulated on the reporting of social responsibility in the law of a limited liability company (Rizkiningsih, 2012).

The results of the above analyses show that Islamic banks that have the highest ISR index value are occupied by the same Islamic Banking every year, although in 2015 it was not the same but the year next to the former one again occupied the same bank. This shows a fairly consistent action in disclosing social reporting every year. Islamic Bankings that score low tend to disclose only the corporate governance.

**Profitability of the company has a good effect on the disclosure of ISR**

The multiple linear regression equation between ISR and profit is represented in Table 2 and Table 3.

### Table 2: The Profitability Coefficients

| Model | Unstandardized Coefficients | Standardized Coefficients | T | Sig. | Collinearity Statistics |
|-------|-----------------------------|---------------------------|---|------|-------------------------|
|       | B                           | Std. Error                | Beta | T    | Sig. | Tolerance | VIF |
| 1 (Constant) | 18.508 | 2.048 | 9.037 | .000 |       |          |     |
| PROF | -53.201 | 90.990 | -.099 | -.585 | .564 | .800 | 1.250 |

*a Dependent Variable: ISR

### Table 3: Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|-------|---|----------|-------------------|---------------------------|
| 1     | .633a | .401     | .332              | 2.183                      |

*a Predictors: (Constant), LEV, PROF

The output model summary adjusted R² is 0.332, which means that 33.2% variation of ISR can be explained by the variation of independent variables, profitability and leverage. While the rest (100%-33.2% = 66.8 percent) is explained by other causes apart from the model which is the contribution of other independent variables apart from the three independent variables.

The F-count for the study is 4.696 with significance (sig.) value 0.004 < 0.05, indicating a significant influence between profitability variables and leverage to ISR variables simultaneously, or it can be interpreted that the model in this study is worthy to be studied.
The hypothesis proposed states that the profitability of the company affects the ISR index. The coefficient of profitability variable found in the study is -0.585 with p-value, 0.564 > 0.05, indicating that the profitability of the company does not influence disclosure of ISR. Thus, it is concluded that the first hypothesis that profitability affect ISR disclosure is rejected.

The results of this study are consistent with the research conducted by Astuti (2014) which states that the profitability of the company has a negative and insignificant effect on the ISR but contrary to the research conducted by Keling and Othman (2009) and Rizkiningsih (2012) which provides evidence that profitability has a good and significant effect on ISR disclosure.

The results of this study successfully support the theory of legitimacy that states profitability negatively affects the disclosure of CSR. This study also found strong allegations that the funds used in the implementation of social responsibility implemented by Islamic banks are not derived from the profit obtained from Islamic banks, but comes from zakat funds, infaq, alms, and non-halal income.

This is consistent with the studies by Astuti (2014). Thus, it can be concluded in this study that profitability does not affect the level of implementation and ISR disclosure on Islamic banks. This is in accordance with the words of Faith Ghazali which states that the motive of economic actors is profit, so also Islamic banks in conducting profit-oriented operations, but the Islamic banks also have other goals, namely the prosperity of the community which one way by carrying out social activities with the disclosure report social responsibility in a good and true way.

One of the funding sources of responsibility activities is usually derived from the profit earned by Islamic Bankings. But in this study, the statement is not supported. The possibility of social activity funds used by Islamic banks in implementing and disclosing social activities is derived from alms, infaq, and zakat as well as non-kosher income collected by Islamic banks. Both the funds are managed directly by the Islamic Bankings and formed institutions that directly cooperate with the Islamic Bankings.

Thus, the second hypothesis conclude that by carrying out social activities, Islamic banks carry out the principle of wealth distribution by following Islamic sharia principles, so that wealth is not spent by overreaching, there is no greed, and does not benefit itself.

**Leverage company good influence on the disclosure of Islamic Social Reporting (ISR)**

The multiple linear regression equation between ISR and leverage is represented in Table 4 and Table 5.

| Model | Unstandardized Coefficients | Standardized Coefficients | t | Sig. |
|-------|-----------------------------|---------------------------|---|-----|
|       | B | Std. Error | Beta | | |
| 1     | (Constant) | 18.508 | 2.048 | | |
|       | LEV | .885 | .445 | .335 | 1.986 | .058 |
|       | a | Dependent Variable: ISR |

| Model | Sum of Squares | df | Mean Square | F | Sig. |
|-------|----------------|----|-------------|---|-----|
| 1     | Regression | 82.912 | 3 | 27.637 | 5.800 | .004* |
|       | Residual | 123.888 | 26 | 4.765 | | |
|       | Total | 206.800 | 29 | | | |
|       | a | Predictors: (Constant), LEV, PROF |
|       | b | Dependent Variable: ISR |

The study obtained coefficient of leverage variable to be 1.986 with p-value 0.058 > 0.05, thus indicating that leverage does not influence the disclosure of ISR. Thus, it can be concluded that leverage has a good effect on the disclosure of the rejected ISR. The results of this study are consistent with the research conducted by Marsuki et al. (2009) in Rizkiningsih (2012) which states that leverage has no significant effect on ISRdisclosures conducted on Islamic Banks in Malaysia, but contrary to researches conducted by Purnaswidi (2011) and Astuti (2012) which provides research results stating that leverage has a significant influence on ISR disclosure.
This study proves that leverage size assessing the risk of corporate funding structure did not affect the extent of disclosure of social responsibility in sharia. Leverage has a positive regression coefficient, which means that banks that have high leverage must perform a broader disclosure compared to banks that have lower ratios.

In other words, higher the leverage level of Islamic Banking, lower is the ISR disclosure rate. This happens because a company with a high level of debt shows poor corporate performance and tend not to reveal the situation. Disclosing social information will cause expenditure for the disclosure, thus reducing the company’s earnings during the period (Rizkiningsih, 2012, p. 61).

Companies such as banking with high debt funding levels will be more careful than companies that rely on capital funding. As a result, companies with high leverage tend to disclose more information.

CONCLUSION

Conclusions

The following conclusions can be derived based on the above findings and discussions:

- Social responsibility reporting in Islamic perspective, using ISR index explains that Islamic Bank has the highest index of ISR obtained by Bank Muamalat Indonesia that managed to reach the value of 20 and above more precisely 32 components of the total index of ISR 48 component in the year 2017.

- Hypothesis testing found that the F-test of profitability factor and leverage together influence the factors in the disclosure of ISR in Islamic Banking in Indonesia.

- Hypothesis testing on t-test found that profitability and leverage do not affect the disclosure of ISR in Islamic Bank in Indonesia.

Suggestions

- For further research, it is expected to increase the number of Islamic Banks and its researching year by at least six years to be able to see better disclosure of ISR expression.

- For further research, it is desirable to add other independent variables that may affect the ISR disclosure.

Based on the results of the study, it is expected for Islamic banks to implement ISR in pentagram social responsibility tagging and more to reveal the index ISR.

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