FINANCIAL STATEMENT FRAUD OF INDONESIAN ISLAMIC BANKS

a Elis Mediawati

ABSTRACT

Objective: Financial statement fraud (FSF) in Islamic institutions is considered unethical due to its production of inaccurate information for stakeholders. In this study, we examine some institutional characteristics, particularly those pertaining to corporate governance, that have the potential to regulate the occurrence of financial statement fraud (FSF).

Methodology: Data was gathered quantitatively. The study utilized a sample including 11 commercial Islamic banks operating in Indonesia. The observation period spanned from 2019 to 2022.

Result: Through an examination of Islamic banks in Indonesia, it was observed that some characteristics of the Sharia Supervisory Board (SSB) of these banks, including their level of knowledge, the size of the board, and the frequency of their meetings, had the potential to mitigate Financial Statement Fraud (FSF). In addition, the composition of the audit committee and the perceived credibility of the external auditors can also contribute to the effective management of financial statement fraud. This study does not identify any significant impact of the board of commissioners' structure on the financial stability of the firm (FSF). One additional discovery pertains to the three SSB traits examined in this study, with the most significant impact on regulating FSF being the specialised knowledge and proficiency in accounting, finance, or economics possessed by each SSB.

Conclusion: It is recommended that each Sharia Supervisory Board (SSB) be equipped with professionals in relevant disciplines, in addition to their experience in Islamic jurisprudence.

Keywords: sharia supervisory board, audit committee, external auditor, financial statement, reporting.

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a PhD in Accounting, Universitas Pendidikan Indonesia, E-mail: elis.mediawati@upi.edu, Orcid: https://orcid.org/0000-0002-2773-9652
RESUMO

Objetivo: A fraude do demonstrativo financeiro (FSF) em instituições islâmicas é considerada antiética devido à sua produção de informações imprecisas para as partes interessadas. Neste estudo, examinamos algumas características institucionais, particularmente aquelas referentes à governança corporativa, que têm potencial para regular a ocorrência de fraude de demonstrativos financeiros (FSF).

Metodologia: Os dados foram coletados quantitativamente. O estudo utilizou uma amostra que incluiu 11 bancos islâmicos comerciais operando na Indonésia. Thel observation pelriod se estendeu de 2019 a 2022.

Resultado: Através de uma análise dos bancos islâmicos na Indonésia, observou-se que algumas características do Conselho de Supervisão da Sharia (SSB) destes bancos, incluindo o seu nível de conhecimento, a dimensão do conselho e a frequência das suas reuniões, tinham potencial para mitigar a Fraude de Demonstrativos Financeiros (FSF). Além disso, a composição do comitê de auditoria e a percepção da credibilidade dos auditores externos podem também contribuir para uma gestão eficaz da fraude nas demonstrações financeiras. Este estudo não identifica qualquer impacto significativo da estrutura do conselho de comissários na estabilidade financeira da empresa (FSF). Uma descoberta adicional refere-se aos três traços SSB examinados neste estudo, com o impacto mais significativo na regulação da FSF sendo o conhecimento especializado e proficiência em contabilidade, finanças ou economia possuídos por cada SSB.

Conclusão: Recomenda-se que cada Conselho de Supervisão da Sharia (SSB) seja equipado com profissionais em disciplinas relevantes, além de sua experiência na jurisprudência islâmica.

Palavras-chave: conselho de supervisão sharia, comitê de auditoria, auditor externo, demonstrativo financeiro, relatórios.

1 INTRODUCTION

Islamic banks have existed in Indonesia since 1992, when Bank Muamalat became the country's first Islamic commercial bank (Hendrawaty, et al., 2023). In recent times, numerous articles have reached the consensus that there exists no discernible distinction between Islamic and conventional banks. This consensus extends to the assertion that fraudulent activities can transpire within both conventional and Islamic banking systems. This discovery is incongruent with the tenets of Sharia due to the adherence of Islamic banks to Islamic jurisprudence, which upholds principles of integrity, equity, and transparency. Several studies have examined fraud cases in Islamic banks, including those conducted by Yusuf et al. (2016) and Mukminin (2018). Additionally, Rahman and Anwar (2014a) have specifically investigated fraud cases in the Islamic Bank of Malaysia Berhad (BIMB). Other studies have explored fraud cases in various Islamic banks such as Taqwa Bank, Faisal Islamic Bank, Kuwait Finance House, and the International
Islamic Bank of Denmark (Awang & Ismail, 2018). Instances of fraud in Islamic banks have been reported in Indonesia, as evidenced by the cases of Bank Syariah Mandiri, Bank Jateng Syariah (Mukhibad, 2017), and Bank Syariah Jabar Banten (Astuti et al., 2019).

Occupational fraud encompasses various forms, including dishonest financial reporting, asset misappropriation, and corruption (Australia, 2011; Awang & Ismail, 2018; Carroll, 2015; Muthiah & Mediawati, 2023; Nawawi & Salin, 2018; Wells, 2017). Occupational fraud poses a significant challenge, as evidenced by the findings of the Global Fraud Survey, which indicate that the banking and financial services sector constituted 16.7 percent of the total 1,388 recorded incidents of occupational fraud. According to Awang and Ismail (2018), the occurrence of occupational fraud resulted in a median loss of $232,000. This finding indicates that the banking and financial services sector saw the fifth biggest median loss as a consequence of fraudulent activities.

The presence of fraudulent activities within Islamic banks is a notable irony (Anisykurlillah et al., 2020; Mukhibad et al., 2023; Musa, 2015). Islamic banks are financial institutions that adhere to the principles of Islamic law in conducting their banking operations. Fraud is vehemently condemned under the framework of Islamic law. Islamic banks are expected to possess a higher level of security against fraudulent activities compared to regular banks due to the implementation of Islamic regulations as the foundation for their operations. Furthermore, it is imperative to promptly address the issue of occupational fraud in Islamic banks, as the foundation of a bank's operations relies heavily on establishing and maintaining trust. Furthermore, Islamic financial institutions foster principles of integrity and transparency by employing a profit-sharing mechanism.

According to a study conducted by N’Guilla Sow, Basiruddin, Mohammad, and Abdul Rasid (2018), a loss in trust towards banks will have a negative impact on stakeholders' trust and result in a decline in the number of clients engaging in investments with Islamic banks. In the event of such an occurrence, it is anticipated that there will be a subsequent drop in their performance. Fraud is an intentional action perpetrated by someone with the aim of securing personal advantages (Bales & Fox, 2011; Dorminey et al., 2012; Muthiah & Mediawati, 2023; Wells, 2017). Dishonest activities encompass various forms, including the misuse of assets, dishonest financial reporting, and corruption (Australia, 2011; Kiymaz, 2020; Wells, 2017). According to Rahman and
Anwar (2014a), among the three categories of fraud discussed, financial statement fraud (FSF) was identified as the most prevalent form of fraud observed in Islamic institutions. Financial statement fraud (FSF) is a deceptive practice that involves the manipulation of financial statements with the intention of misleading the recipients of these reports (Awang & Ismail, 2018).

The existing body of research on the topic of fraud in Islamic banks is found to be insufficient in its scope and coverage. In their study, Rahman and Anwar (2014b) conducted research on a sample of 146 workers working in Islamic banks in Malaysia. Their findings revealed that instances of fraud were attributed to factors such as greed, inadequate control mechanisms, and extensive chances. The implementation of password changes has been identified as a potential measure to mitigate the risk of fraudulent activities (2014a). In a study conducted by Fathi, Ghani, Said, and Puspitasari (2017), it was discovered that factors such as gender, age, position, and religiosity contribute to the occurrence of asset misappropriation.

According to Hamdani and Albar (2016), leaders who possess confidence and hold positions associated with the allocation of funds in Islamic banks exhibit limited control, hence increasing the likelihood of engaging in fraudulent activities. Previous academics have employed an institutional approach, specifically focusing on the structure of corporate governance, to examine its relationship with fraudulent activities. In a study conducted by Suryanto and Ridwansyah (2016), it was observed that adherence to auditors' standards and skills has a significant role in deterring fraudulent activities. However, the presence of Sharia Supervisory Boards (SSBs) in banks did not demonstrate any discernible impact on fraud prevention. In a study conducted by Ngumar, Fidiana, and Retnani (2019), it was elucidated that fraud can be influenced by directors, internal controls, and the banks' SSBs. However, the board of commissioners was found to have no significant impact in this regard.

Based on prior research, two distinct perspectives may be identified in the examination of the determinants of fraud. These perspectives include the actor-centric viewpoint, which encompasses aspects such as attitude, religiosity, ethics, and financial pressure, among others. Additionally, the institutional perspective considers factors such as corporate governance, internal control, and the specific characteristics of each specific business entity. This study employs the institutional viewpoint as a theoretical framework to elucidate the phenomenon of fraud, as it is deemed the most viable aspect for
comprehending fraudulent financial statement reporting. According to Rahman and Anwar (2014a), the occurrence of FSF, a sort of fraud, is prevalent in Islamic banks.

In addition, this study will utilize the comprehensive qualities of the banks' SSBs, which surpass the limited attributes employed in earlier research. Prior studies relied solely on proxy composite value assessments made by the Islamic banks themselves (Suryanto & Ridwansyah, 2016)). The proxies employed in this study encompass education level, cross membership, and the knowledge in economics possessed by each individual within the Social Security Board (SSB). The utilization of a greater number of SSB qualities is motivated by the necessity for each SSB to engage in consultation and oversight of its bank's management, as highlighted by Almutairi and Quttainah (2017). According to Quttainah and Almutairi (2017), the consultations conducted by each Shari'ah Supervisory Board (SSB) encompassed matters pertaining to Islamic compliance and the ethical management of a bank.

This topic is presented in multiple sections. Section 1 serves as an introductory segment that elucidates the rationale behind doing this research endeavor. Section 2 of the research paper encompasses the literature review and the subsequent elaboration of hypotheses. This section aims to elucidate the significance of corporate governance (CG) within Islamic banks in relation to financial stability and resilience. Additionally, we provide an overview of the prior research that informed the formulation of the hypotheses. Section 3 of the paper delineates the methodology employed in this study. Section 4 presents the findings and outcomes derived from the research and subsequent discussions. Section 5 of the document pertains to the debate. The concluding stage in section 6, this paper includes a comprehensive analysis of the findings and offers insightful recommendations for regulators as well as suggestions for future research endeavors.

2 THEORITICAL FRAMEWORK
2.1 CORPORATE GOVERNANCE MECHANISM IN ISLAMIC BANKS

Islamic banks are financial institutions that adhere to the principles of Islamic law, often known as Sharia, in conducting their activities. In order to ensure the right adherence to Islamic law within the banking sector, each bank is equipped with a Sharia Supervisory Board (SSB). According to Article 32 paragraph 3 of the Law of the Republic of Indonesia No. 21 of 2008, the Sharia Supervisory Board (SSB) is mandated to offer guidance and recommendations to the directors, while also overseeing the banking
operations conducted by the bank in accordance with Islamic principles. Article 32 encompasses the principles that pertain to the alignment of banking operations with the fatwa given by authoritative authorities responsible for determining fatwa within the Sharia sectors.

The expectations of the Islamic community, who are the patrons of Islamic financial institutions, with regards to the governance of these banks extend beyond mere compliance with Islamic principles. These expectations also encompass the ethical conduct of the banks' management. Furthermore, it is imperative for each SSB to fulfill its obligation of offering consultation and supervisory services, while also assessing the ethical conduct of bank managements in relation to Islam, as highlighted by Quttainah and Almutairi (2017). The significance of Islamic ethics in the context of Islamic banking has prompted several scholars to investigate the adherence of Islamic banks to Islamic ethical principles. The development of ethics was undertaken by Haniffa and Hudaib (2007) and Quttainah and Almutairi (2017), who utilized indicators derived from the annual reports of banks, as well as the Ethical Identity Index (EII). In contrast to the study conducted by Haniffa and Hudaib (2007), which focused on the utilization of earning management practices to elucidate the manifestation of Islamic ethics within Islamic banks, the findings indicated that Islamic banks exhibit superior adherence to Islamic ethics compared to conventional banks. Moreover, it was observed that Islamic banks subject to regular supervision by their respective Shariah Supervisory Boards (SSBs) demonstrate a higher level of compliance with Islamic ethics when compared to those lacking such regular oversight.

Several studies have examined the Islamic ethical compliance of Islamic banks by investigating the occurrence of fraud, including both fraud committed by management and employees. Notable researchers who have explored this topic include Astuti et al. (2019), Fathi et al. (2017), Hamdani and Albar (2016), Rahman and Anwar (2014a, 2014b), Suryanto and Ridwansyah (2016), Ngumar et al. (2019), and Yusuf et al. (2016). One primary factor contributing to this phenomenon is the prohibition of deception within the Islamic faith. Islam places a significant emphasis on the virtue of trustworthiness. According to Triyuwono (2004), a paradigm will be established wherein human attitudes are assigned a responsibility value with respect to their obligations towards stakeholders, society, and God. If individuals are linked to fraudulent activities, their adherence to trustful behavior, as defined within the broader framework of Islamic ethics, may serve
as a deterrent against engaging in fraudulent behavior (Abuznaid, 2009; Dupont & Karpoff, 2020).

The utilization of fraudulent practices serves as a means to examine the ethical dimensions within the realm of Islamic banking, with a particular focus on the manipulation of financial figures for deceptive purposes. The implementation of corporate governance has been identified as a viable approach to mitigate the occurrence of fraudulent activities (Eferakeya et al., 2016; Farber, 2005; Halbouni et al., 2016; Salin et al., 2017). According to a study conducted by Farber (2005), a sample of corporations engaged in financial statement manipulation had poor corporate governance practices.

2.2 HYPOTHESIS DEVELOPMENT

The SSB (Almutairi & Quttainah, 2017) is an integral component of the corporate governance framework, tasked with facilitating the incorporation of Islamic ethical principles into managerial practices. The studies conducted by Quttainah and Almutairi (2017) as well as Quttainah, Song, and Wu (2013) have demonstrated the significant contribution of each Shari‘ah Supervisory Board (SSB) in overseeing the ethical conduct of a bank's management, ensuring adherence to Islamic principles. The conduct often referred to as FSF is considered to be in violation of the laws set down by Sharia, as noted by Anisykurlillah et al. (2020) and Obid & Demikha (2011). The primary purpose of a Shariah Supervisory Board (SSB) is to ensure the adherence of Islamic banks to the principles of Islamic law. Consequently, the job of an SSB holds significant importance in mitigating the occurrence of Financial Statement Fraud (FSF).

Previous studies have employed diverse metrics to assess the efficacy of each SSB in fulfilling its responsibilities, including the size of its membership, the level of expertise possessed by its members, and the frequency of its meetings (Almutairi & Quttainah, 2017; Anisykurlillah et al., 2020; Mukhibad et al., 2020; Nomran et al., 2017). Anisykurlillah et al. (2020) discovered that the proficiency of the SSB in the domains of finance and accounting exhibited an adverse impact on fraudulent activities. The aforementioned assertion is corroborated by the research conducted by Mersni and Ben Othman (2016), wherein they discovered that the proficiency of SSBs (Sharia Supervisory Boards) in the field of accounting shown the capacity to mitigate the occurrence of earnings management (EM). Alam, Ramachandran, and Nahomy (2020) as well as Quttainah et al. (2013) conducted studies that examined the impact of the number
of SSB members on earnings management (EM) conditions in Islamic banks. They utilised loan loss provisions (LLP) as an indicator to assess this relationship and found evidence suggesting that a higher number of SSB members could potentially decrease EM in Islamic banks. Anisykurlillah et al. (2020) posit that there exist a minimum of five justifications for the involvement of each Sharia Supervisory Board (SSB) in regulating the Financial Soundness of the Financial Statement Fraud (FSF). These reasons are as follows: 1) SSBs hold a distinctive position within the Islamic banking system; 2) each SSB assumes a crucial role in the enforcement of Islamic law within their respective banks; 3) each SSB operates as an autonomous entity; 4) the presence of an SSB mitigates agency conflicts; and 5) FSF arises due to agency conflicts. Therefore, it is possible to formulate the following hypothesis: H1: The Impact of Sharia Supervisory Board on Financial Statement Fraud

The engagement of banks’ directors in the FSF (financial statement fraud) could potentially be attributed to agency issues. According to Al-Nasser Mohammed and Muhammed (2017), the existence of a Sharia Supervisory Board (SSB) has the potential to mitigate the agency conflict within Islamic banks. In addition to the Sharia Supervisory Board (SSB), the establishment of an independent audit committee might serve as a preventive measure against conflicts. The mitigation of conflict resulting from information asymmetry can be achieved by the utilisation of high-quality financial statements. The audit committee is an essential component of an organisation, playing a crucial role in enhancing the accuracy and reliability of financial accounts (Ghafran & O’Sullivan, 2013). The production of accurate financial statements with the aim of mitigating information asymmetry is a shared responsibility of independent auditors, management, and the auditor committee. The responsibility for the preparation of financial statements, establishment and maintenance of sufficient internal control over financial statements, and evaluation thereof is with management. The primary duty of the independent auditor is to provide assessments regarding the appropriateness of the financial statements, and to present, with significant accuracy, the bank’s financial position, operational outcomes, and cash flows in accordance with established standards (Robinson, 2020). In order to effectively oversee this domain, it is imperative for the audit committee to collaborate with management, internal auditors, and independent auditors to acquire the necessary information (Robinson, 2020).
According to Robinson (2020), it is the responsibility of the audit committee to proactively mitigate instances of fraud, encompassing financial statement fraud (FSF), asset misappropriation, and corruption. Audit Committee affect financial performance (Karlinah, L, et al. 2023). According to Denziana (2015), there exists empirical evidence supporting the notion that the effectiveness of the audit committee and the impartiality of internal auditors have a significant role in mitigating the occurrence of fraudulent financial reporting. The findings of this study were supported by Kusumawati and Hermawan (2013), whose research shown that the presence of audit committees can effectively mitigate the risk of fraudulent activities. Therefore, it is possible to formulate the subsequent hypothesis:

H2: The number of audit committee members has a negative influence on FSF

Similar to any Sharia Supervisory Board (SSB), the commissioners are also responsible for offering guidance and overseeing the administration in any endeavors that prioritize the concerns of the directors. The selection of commissioners occurs during the annual meeting, when the owner possesses the authority to appoint individuals to this role, including the option to appoint oneself as a commissioner. In the event of such an occurrence, it is conceivable that the efficacy of the commissioners' performance may be diminished, hence necessitating the implementation of some type of independent oversight. The presence of autonomous commissioners is essential in order to mitigate fraudulent activities, as they maintain no affiliations with primary shareholders, board of directors, or board of commissioner members. According to Chen, Firth, Gao, and Rui (2006), the implementation of several independent boards can enhance the board's ability to fulfill its responsibilities in safeguarding the shareholders' interests, particularly those of the minority shareholders. According to the research conducted by Beasley (1996) and Uzun, Szewczyk, & Varma (2004), it has been seen that the presence of independent boards can have a mitigating effect on instances of financial fraud. Therefore, it is possible to formulate the subsequent hypotheses.

H3: The number of commissioners members has a negative influence on FSF.

H4: Independent commissioners have a negative influence on FSF.

High-quality audits have the potential to mitigate instances of fraud. According to Farber (2005), organizations that undergo audits by the Big Four auditors see a relatively minimal incidence of fraudulent activities. It is commonly assumed that the major auditing firms, sometimes known as the Big Four, deliver audits of higher quality (Farber,
2005), hence possessing the ability to promptly identify instances of fraudulent activity. Suyanto (2009) demonstrated a substantial correlation between the Big Four auditors and the identification of fraudulent activities in his study. According to Park (2017), external auditors are regarded as "supervisors" who closely oversee the financial reporting operations of a corporation. Therefore, the subsequent hypothesis can be formulated: \( H5: \) Big Four auditors have a negative influence on FSF.

3 METHODOLOGY

The study utilized a sample including 11 commercial Islamic banks operating in Indonesia. The observation period spanned from 2019 to 2022. The utilization of Islamic banks in Indonesia can be attributed to the country's status as the global leader in terms of Muslim population, juxtaposed with its very modest market share in the Islamic banking sector, amounting to a mere 5.3 percent annually (Mukhibad et al., 2020; Muthiah & Mediawati, 2023). Muslims are the primary target audience for Islamic banks, as highlighted by Alam and Seifzadeh (2020). The formation of Islamic banks is deemed imperative for Muslims due to its ability to facilitate financial activities in accordance with Islamic principles, namely the prohibition of interest. The data utilized in our study were acquired through the implementation of the partial least squares (PLS) method. The identical approach was also employed by Mukhibad and Setiawan (2020) as well as Purbawangsa, Solimun, Fernandes, and Rahayu (2020).

Financial statement fraud (FSF) refers to the purposeful and calculated act of presenting inaccurate information in financial statements, with the objective of deceiving the individuals who rely on these statements. In order to assess the potential occurrence of Financial Statement Fraud (FSF), we employed the proxy assumption utilized by Mersni and Ben Othman (2016) and Anisykurlillah et al. (2020), wherein profit manipulation was gauged through the application of discretionary loan loss provisions (DLLP). The concept of DLLP refers to the discretionary power that bank managers possess in effectively managing and assessing the worth of the LLP, which pertains to the valuation of losses incurred during the present fiscal year. Loan Loss Provision (LLP) serves as the principal measure of accrual value within the banking industry, encompassing both non-discretionary and discretionary components:

\[
DLLP = \text{discretionary LLP} + \text{non} - \text{discretionary LLP} \quad (1)
\]
\[
LLP_{it} = \beta_0 + \beta_1 NPL_{it-1} + \beta_2 \Delta NPL_{it} + \beta_3 \Delta TL_{it} + \varepsilon_{it} \quad (2)
\]

\( LLP_{it} \) = total allowance for loans, investment in musharaka (participating finance), mudaraba (trust financing), and murabaha (cost plus trade financing) for bank \( i \) in year \( t \);
\( NPL_{it-1} \) = initial balance of problem loans for bank \( i \) in year \( t \);
\( \Delta NPL_{it} \) = changes in the value of problem loans for bank \( i \) in year \( t \);
\( TL_{it} \) = changes in the total value of loans for bank \( i \) in year \( t \).

The DLLP ‘s score shows that there is a possibility of fraud if the score approaches zero (this could be a positive or negative score). To make this DLLP score be one-way, we eliminated negative numbers using the following formula:

\[
SQRTDLLP = \sqrt{DLLP^2}
\]

The attributes of Sharia Supervisory Boards (SSBs) were assessed using three indicators: the size of the SSB, the proportion of SSB members with expertise in accounting, finance, or economics, and the frequency of SSB meetings within a year (Almutairi & Quttainah, 2017; Anisykurlillah et al., 2020; Mukhibad & Setiawan, 2020; Nomran et al., 2017). The Independent Board (INDBOARD) refers to the proportion of independent commissioners in relation to the total number of commissioners (Farber, 2005). The dimension of the board (BOARDSIZE) was determined based on the count of commissioners (Inya et al., 2018). The composition of the audit committee (AUDIT) was established by Anichebe, Agbomah, and Agbagbara (2019) through an examination of the number of members serving on the committee. The measure of the auditor's reputation, referred to as AUDITREPUTATION, was assessed using a binary variable. This variable took a value of one if the bank had undergone an audit conducted by one of the four largest auditing firms, commonly known as the Big Four auditors. Conversely, it took a value of zero if the bank had not been audited by any of the Big Four auditors (Jamal et al., 2018). The control variable utilized in this study was LogAsset (ASSETS), which represents the quantity of assets.

The data underwent analysis through the application of structural equation modeling (SEM) utilizing partial least squares (PLS). In this study, the indicators utilized for establishing the variables of the SSBs were the number of members in each SSB, the ratio of SSB members possessing knowledge in accounting, finance, and economics, and the frequency of SSB meetings held. The model utilized in our study was derived from
the earlier research conducted by Mukhibad and Setiawan (2020). This model comprises six latent variables, specifically SSB, INDBOARD, AUDIT, AUDITREPUTATION, ASSETS, and FSF. In our study, we employed various statistical measures to assess the fitness of our model. These measures included the average path coefficient (APC) values, average R-squared (ARS), average adjusted R-squared (AARS), average block VIF (AVIF), average full collinearity VIF (AFVIF), Sympon's paradox ratio (SPR), R-squared contribution ratio (RSCR), statistical suppression ratio (SSR), and non-linear bivariate causality direction ratio (NLBCDR). The approach proposed by Fernandes (2017) is highly recommended.

4 RESULTS AND DISCUSSION

In this descriptive analysis, the minimum, maximum, average, and standard deviation of the variables utilized in this study are shown. According to the data presented in Table 1, the mean DLLP value is 3.48 percent, with a minimum value of 0.25 percent. A DLLP score nearing zero suggests a reduced likelihood of the bank engaging in FSF, whereas a greater DLLP number indicates the bank's active involvement in FSF. The observed disparity in the mean value of DLLP, whereas the maximum value is 12.71, suggests that Islamic banks exhibit somewhat lower levels of FSF. The mean number of SSB members possessed by Islamic banks in Indonesia is 2.25. This data demonstrates that every Islamic bank possesses a number of SSB members that exceeds the minimum requirement. Moreover, the Indonesian State-Owned Enterprises (SOEs) have convened meetings at an average frequency of 13.66 times each year. This exceeds the minimal threshold mandated, which is a frequency of 12 occurrences each annum.

<table>
<thead>
<tr>
<th>DLLP</th>
<th>Num. of SSB membe rs</th>
<th>SSB expertise</th>
<th>Num. of SSB meetin gs</th>
<th>Num. of audit committe e members</th>
<th>Independe nt board ratio</th>
<th>Number of commissione rs</th>
<th>Extern al auditor quality</th>
</tr>
</thead>
<tbody>
<tr>
<td>Min</td>
<td>0.25</td>
<td>2</td>
<td>0</td>
<td>9</td>
<td>2</td>
<td>0.33</td>
<td>2</td>
</tr>
<tr>
<td>Max</td>
<td>12.71</td>
<td>3</td>
<td>1</td>
<td>26</td>
<td>7</td>
<td>1.5</td>
<td>6</td>
</tr>
<tr>
<td>Mean</td>
<td>3.48</td>
<td>2.25</td>
<td>0.57</td>
<td>13.66</td>
<td>3.70</td>
<td>0.71</td>
<td>3.75</td>
</tr>
<tr>
<td>St. dev.</td>
<td>2.95</td>
<td>0.44</td>
<td>0.50</td>
<td>3.33</td>
<td>1.17</td>
<td>0.25</td>
<td>0.94</td>
</tr>
</tbody>
</table>

Source: Results of data analysis by the authors
The quantity of audit committee members in Islamic banks exceeds the number of members of each bank's Sharia Supervisory Board (SSB), with an average of 3.70 individuals. Additionally, the number of independent commissioners beyond the minimal need. A significant proportion exceeding 50 percent of the Islamic banks operating in Indonesia have opted to use independent auditors who maintain affiliations with the prominent Big Four auditing firms. The attainment of the mean value of the variables, beyond the minimum threshold, provides backing for the execution of enhanced performance by Islamic banks that are more responsible, particularly in their efforts to prevent the occurrence of Financial Statement Fraud (FSF).

Table 2. Results of hypotheses testing

<table>
<thead>
<tr>
<th>Independent variable</th>
<th>Alpha</th>
<th>Sig.</th>
<th>( R^2 )</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>SSB</td>
<td>0.260</td>
<td>0.031*</td>
<td></td>
<td>Accepted</td>
</tr>
<tr>
<td>AUDIT</td>
<td>0.275</td>
<td>0.024*</td>
<td></td>
<td>Accepted</td>
</tr>
<tr>
<td>BOARDSIZE</td>
<td>0.100</td>
<td>0.246</td>
<td></td>
<td>Rejected</td>
</tr>
<tr>
<td>INDBOARD</td>
<td>0.005</td>
<td>0.487</td>
<td>0.50</td>
<td>Rejected</td>
</tr>
<tr>
<td>AUDITREPUTATION</td>
<td>0.297</td>
<td>0.016*</td>
<td></td>
<td>Accepted</td>
</tr>
<tr>
<td>ASSETS</td>
<td>&lt;</td>
<td>0.571</td>
<td>0.001**</td>
<td>Accepted</td>
</tr>
</tbody>
</table>

Source: Results of data analysis by the authors

Table 2 presented above demonstrates the adverse impact of a SSB, the audit committee, and the quality of the external auditor on discretionary loan loss provisions (DLPP). There are three factors that assess the attributes of each Sharia Supervisory Board (SSB): the frequency of SSB meetings, the composition of SSB members, and the level of knowledge possessed by SSB members in the fields of accounting, finance, and economics. The table presented below displays the outcomes of the key metrics utilized in assessing the effectiveness of Sharia Supervisory Boards.

Table 3. Combined loading and cross-loading of SSB

<table>
<thead>
<tr>
<th>Indicator of SSB</th>
<th>Combined loading</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of meetings of SSB</td>
<td>0.662</td>
</tr>
<tr>
<td>Number of members of SSB</td>
<td>0.794</td>
</tr>
<tr>
<td>SSB expertise</td>
<td>-0.828</td>
</tr>
</tbody>
</table>

Source: Results of data analysis by the authors
According to the findings presented in Table 3, it can be observed that among the three indicators used to assess the features of SSBs, the indicator with the highest combined loading and cross-loading value (0.828) is SSB expertise. This is followed by the number of SSB members, while the indicator with the lowest value is the number of SSB meetings. This observation suggests that the proficiency of each SSB in accounting, finance, and economic matters is necessary to deter its banks' management from engaging in FSF. The competence possessed by each SSB in their respective subjects serves to complement their existing knowledge in the domains of jurisprudence and Islamic law.

The major responsibility of each bank's Sharia Supervisory Board (SSB) is to offer consultancy services to the bank's management on the Sharia compliance of all operational areas of their business. Prior to the introduction of a new product, banks may conduct discussions to ensure conformity with Sharia principles. The management of the Islamic bank will request its Sharia Supervisory Board (SSB) to evaluate whether the newly introduced product complies with the principles of Islamic law. In order for SSB to effectively provide its services, it is imperative that the SSB possesses knowledge regarding the purpose of the product in question. Additionally, the SSB has the option to evaluate the practicality and acceptability of the product by its consumers. The SSB may conduct an assessment by examining established fiqh laws and considering the evolution of transactions and the dynamic demands of the general populace. The SSB takes this factor into account when performing its responsibilities. The successful execution of the responsibilities of an SSB requires the expertise of its members in several domains such as Islamic law, accounting, finance, and economics (Almutairi & Quattainah, 2017; Elamer et al., 2019; Farook et al., 2011; Raman & Bukair, 2013).

Another aspect of a Sharia Supervisory Board (SSB) that contributes to its effectiveness in fulfilling its responsibilities is the size of its membership. Increasing the number of members in the SSB can potentially mitigate the conduct of bank management and deter them from engaging in Financial Statement Fraud (FSF). The management will refrain from engaging in profit management practices as the effectiveness of their bank's surveillance system, SSB, increases. In their study, Quattainah and Almutairi (2017) discovered that each Sharia Supervisory Board (SSB) not only oversaw the appropriateness of Islamic banking products but also monitored the ethical conduct of the bank's directors, aligning with Islamic ethical principles. In Indonesia, regulatory authorities mandate that Islamic banks must establish a Sharia Supervisory Board (SSB)
comprised of two to three individuals. The results of our study suggest that Islamic banks in Indonesia have already established Sharia Supervisory Boards (SSBs) with a higher number of members than the minimum need. Therefore, Indonesian banks can ensure compliance with Islamic law by maintaining a higher number of employees in their Sharia Supervisory Boards (SSBs) than the mandated minimum requirement.

In addition to the quantity of SSB members, it has been observed that the efficacy of each SSB is enhanced through regular convening of meetings. The interactions between the SSB and the directors of its affiliated bank demonstrate the effective implementation of consulting and oversight services. During these sessions, a Sharia Supervisory Board (SSB) has the opportunity to engage in deliberations with the directors of a bank in order to assess the Sharia compliance of newly proposed financial products. During these meetings, the respective Sharia Supervisory Boards (SSBs) and their bank's directors have the opportunity to collaboratively cultivate the ethical conduct of employees in alignment with Islamic principles. Furthermore, our findings also indicate that the SSBs had convened an average of 13.66 meetings per annum. The frequency of this gathering exceeds the minimum criterion, which stipulates a mere 12 occurrences each year. The evaluation of the SSBs based on three criteria indicates a detrimental impact on FSF. The present study's results provide support for the findings reported by Quttainah and Almutairi (2017) as well as Quttainah et al. (2013).

According to the data presented in Table 2, there is no conclusive evidence to support the notion that the presence of independent commissioners effectively mitigates the occurrence of financial statement fraud (FSF). Islamic banks in Indonesia currently possess a substantial proportion of autonomous directors. Nevertheless, our findings indicate that the presence of independent commissioners does not exert any influence on the incidence of FSF. This discovery is inconsistent with the discoveries made by Beasley (1996) and Uzun et al. (2004). The results of our study suggest that it is conceivable that the independent commissioners have yet to observe any type of oversight over the conduct of directors involved in FSF. It is conceivable that the commissioners now lack sufficient competencies and understanding to effectively identify FSF.

Aside from the presence of independent commissioners, the quantity of commissioners has no impact on the ability to regulate the FSF. This data potentially substantiates the notion that the commissioners overseeing Islamic banks in Indonesia have not successfully mitigated the occurrence of financial statement fraud (FSF).
Another potential indicator might be attributed to the restricted ownership structure of Islamic banks in Indonesia, wherein conventional banks serve as the dominant shareholders of these Islamic institutions. The establishment of Islamic banks in Indonesia, initially initiated by conventional banks, has resulted in their role as blockholders. The very limited prevalence of ownership in certain cases might lead to a lack of agency conflict, which in turn may lead to dysfunction within the board of commissioners responsible for overseeing a bank's performance. According to El-Halaby and Hussainey (2015), the block-holder has the ability to acquire information directly from the directors, bypassing the need to rely solely on the information presented in the bank's annual reports.

Table 2 presents empirical evidence indicating that the size of the audit committee has a significant impact on the control of financial statement fraud (FSF). The audit committee, in collaboration with both internal and external auditors, is responsible for ensuring the veracity of the financial statements provided by the management (Robinson, 2020). In order to execute this assignment, the audit committee has the capacity to conduct an audit. By engaging in the process of auditing, various actions that contribute to the production of substandard financial statements, including transaction irregularities, asset misappropriation, measurement errors, and recognition issues, can be mitigated. Consequently, it can be asserted that the audit committee possesses the capability to proactively avert the manifestation of financial statement fraud (Robinson, 2020). The present study's findings corroborate the conclusions drawn by Denziana (2015) and Kusumawati and Hermawan (2013), which indicate that the effectiveness of an audit committee has the potential to mitigate instances of fraudulent activities.

One noteworthy outcome of our research is the significant impact of the external auditor's reputation on mitigating the frequency of financial statement fraud (FSF). The study employed the services of the Big Four audit companies, well recognized for their credibility as external auditors. The findings indicate that engaging the services of these firms can effectively mitigate the frequency of financial statement fraud (FSF). The Big Four auditors possess a wealth of knowledge, comprehension, and practical expertise in performing audits, enabling them to effectively detect and perhaps mitigate Financial Statement Fraud (FSF). This condition is unquestionably optimal. Furthermore, it is imperative for external auditors to safeguard against material misstatements and fraudulent activities by rendering their final findings or views subsequent to conducting...
the audit. This is due to their rigorous oversight of the financial reporting process (Park, 2017).

High-quality audits play a crucial role in mitigating the risk of directors engaging in fraudulent financial statement fraud (Farber, 2005). This finding is consistent with the viewpoint expressed by Farber (2005), who posited that the Big Four auditors provide superior audit quality compared to other auditors. This aligns with the research conducted by Suyanto (2009), which demonstrated a substantial impact of the Big Four auditors on the occurrence of fraud.

5 CONCLUSIONS

The engagement of Islamic banks in FFR is considered to be morally questionable due to its potential to generate misleading information for their stakeholders. Additionally, the implementation of FSF may result in inaccurate computations for profit-sharing. The findings derived from our study on Islamic banks in Indonesia indicate that the banks' Sharia Supervisory Boards (SSBs) exert a significant impact on the Financial Soundness of the institutions. Among the three variables employed to assess each SSB, namely the number of members, the number of meetings, and the members' knowledge, it is the latter that exerts the most significant impact in mitigating the occurrence of FSF. Specifically, the expertise possessed by SSB members in the fields of accounting, finance, or economics holds the greatest potential in preventing FSF. This implies that the occurrence of Financial Statement Fraud can be mitigated through the enhancement of attributes associated with each Sharia Supervisory Board (SSB). These attributes include augmenting the proportion of SSB members possessing a sufficient comprehension of accounting, finance, and economics, as well as their knowledge of Islamic law. Additionally, increasing the quantity of SSB members (within specified boundaries) and the frequency of SSB meetings can contribute to the reduction of Financial Statement Fraud.

Furthermore, the findings of this study suggest that there exists a negative correlation between the size of audit committees and the quality of external auditors, and the occurrence of Financial Statement Fraud. The quantity of commission members and the proportion of the independent board do not exert any influence on the occurrence of Financial Statement Fraud. The control of FSF can also be exercised by means of the audit committee's involvement and the engagement of respected external auditors,
including the prominent Big Four auditors. This research does not provide evidence about the impact of the number of commissioners and the proportion of independent commissioners in mitigating financial statement fraud (FSF).

The research suggests that it would be beneficial for an Islamic bank to select individuals with proficiency in accounting, finance, and economics, with their competence in Islamic law, for the purpose of appointing them to its Shari'ah Supervisory Board (SSB). Furthermore, it is imperative to enhance the caliber of the audit committee and external auditors in order to effectively manage and mitigate instances of Financial Statement Fraud.

The research is limited in its focus on Financial Statement Fraud (FSF) within the institutional framework. It seeks to identify the factors that contribute to fraud by examining institutional elements such as the Supervisory Board (SSB), the composition of the board of commissioners, the audit committee, and the external auditors. Further research should consider examining the fraudulent behavior of individual offenders. Therefore, it is recommended that future studies incorporate this aspect into their investigations. Fraudulent behavior is assessed by evaluating the likelihood of Financial Statement Fraud (SFS) transpiring through the utilization of the DLLP approach. This approach is limited in its ability to accurately assess instances of fraud, as it may only capture a partial picture and may not align with the actual occurrence. Consequently, future researchers are advised to employ a proxy, such as objective proof of the number of fraud cases, as a more reliable indicator for evaluating fraud, rather than relying just on subjective tendencies.
REFERENCES


