The Role of Islamic Corporate Governance to Prevention Fraud and Implementation of Maqasid Shariah in Increasing Profitability of Sharia Banking in Indonesia

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Abstract. Fraud phenomenon still occurs and can impact profitability in sharia banking which is must also contribute to the achievement of maqasid shariah. This research used quantitative data from Islamic Commercial banking during 2010-2019. The result of the research shows Islamic Corporate Governance is able the prevention of fraud but has no effect to increase profitability, Islamic Corporate Governance has a significant effect on Maqasid Shariah but has no effect to increase profitability, Islamic Corporate Governance is able to increase profitability and Islamic Corporate Governance has no effect to profitability through fraud prevention and maqasid sharia. Based on this result, Sharia banking must be able to achieve an element of maqasid sharia to contribute to solutions for various finance and banking problems. In addition, the implementation of good governance and fraud prevention efforts has not shown a sufficient contribution to increasing the profitability of Islamic banks. Therefore, Islamic banks need to formulate strategies in increasing the role of Syariah in reducing fraud and increasing the profitability of Islamic banks.

Keywords: Islamic Corporate Governance, Fraud, Maqashid Syariah, ROA, Sharia Bank

1 Introduction

Financial sector and banking has a crucial role in the occurrence of fraud. Sharia Bank become one of the institutions in the financial and banking sector. Based on Transparency International data, Indonesia's corruption Index in 2019 was in the 85th position and decreased drastically in 2020 to be in 102nd position out of 180 countries and based on Survei Fraud Indonesia data in 2019 that the type of industry most harmed by irregularities shows that the financial industry and banking sector is in first place at 41.4%. The following is a graph in the form of data on the number of frauds during the 2015-2019 which has been processed by researchers.
Figure 1 shows that three internal parties that can make fraud in Sharia banks. In line colored orange illustrates that the number of fraud is still a lot to do by a jobholder or employee internal Sharia bank. The occurrence of this fraud can damage stability in the financial sector and banking as a whole and affect bank profitability [1]. There is a possibility to transfer approved financing fund by the bank for personal gain. This is in the form of an act of corruption that can increase non-performing bank financing that can reduce bank profitability and the fragility of the banking industry. Therefore special attention is needed in handling because it can have an impact on companies, investors to the public.

Failure in maintaining strong internal control can improve the possibility of fraud [2]. Corporate governance can use to strengthen the company's internal control system. So that if the individual is under pressure to deviate, it is can be minimized by reminding the individual's commitment not to make fraud [3]. Implementation of Islamic Corporate Governance to be applied by Sharia banks can give the impression to the public that Sharia banks in the implementation of their operations are able to avoid acts of fraud.

Evaluate the risk of corporate fraud, the internal control may consider board size and age factors [4]. A conceptual study on Islamic Corporate Governance Model states that the concept of ICG can reduce fraud cases in Sharia banks [5]. The corporate governance mechanisms can determine whether to reduce a fraud cases [6].

Islamic Corporate Governance in its implementation has a purpose the main goal in achieving Maqasid Shariah that refers to the welfare of the society. Maqasid Shariah principles embodied in the Shari'ah can realize the economic and financial position is strong and stable. To that end, forms of crime such as bribery, breach of trust, fraud, and other things that have a detrimental impact on the nation's economy can be prevented by implementing the maqasid Shari'ah [7].

Maqasid Al-Shari'ah and Islamic Financial Product states the role of the Sharia Supervisory Board is to ensure achievement of maqasid value and the role of directors in supervising mechanism bank operations under sharia to avoid fraud [8]. Fraud prevention to carried out to balance materiality with the maqasid sharia principles [9]. In addition, through sharia compliance and governance, the concept of maqasid sharia is needed [10].
1.1 Disclosure Theory

The concept of disclosure is generally used to predict that companies will increase the level of disclosure or apply better disclosures according to the company's conditions. The company's disclosure behavior will vary depending on the nature of the information to be disclosed. Disclosure of information is measured through an index defined according to general terms such as quantity [11]. Disclosure is financial reporting which includes information concerning the events that occurred in the company that is required by the investors as well as the external other as a means to making decisions or.

1.2 Islamic Corporate Governance

Islamic model of corporate governance can emphasized the Sharia law in assessing the responsibilities of various officials in regulating and supervising the company's operational activities to reduce indications of fraud cases in the banking industry [5].

1.3 Fraud

Fraud as an act that is carried by a person or an entity who understand the fraud that can affect a loss for the individual or the other [12]. A variety of reasons for the possibility of the occurrence of fraud, corruption and the practice of negligence from the angle of view of stakeholder interests [13].

1.4 Maqasid Sharia

Maqashid Syariah can be the basis of the provisions of the law in preventing attempts of fraud. It is because Maqashid Shari'ah requires the enforcement of the law that is transparent and fair [7]. The objective of establishing Islamic financial institutions is to achieve maqasid course Sharia. If that happens, may affect the company's management to run the system to manage it well [14].

1.5 Profitability

Profitability, as measured by Return on Asset (ROA), can show that there is a relationship between fraud and net income in total assets. total assets are mostly formed by the existence of loans, so the higher number of fraud committed can affect the return on assets of the company [15].

2 Method

A quantitative methodology of this research is used in this study. The data is used in the form of numbers and techniques of analysis that are used are method statistics. This research was conducted by analyzing the numbers of the corporate governance report and the annual report of Islamic banks in Indonesia. The population is composed of the whole Sharia Commercial Banks in Indonesia. The sample was determined by using the purposive sampling technique or samples determined by certain criteria based on the research objectives. The criteria for the research sample are as table 1.

<table>
<thead>
<tr>
<th>Table 1: Sample Criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
</tr>
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2. Islamic Banks are not issuing a report yearly on the website official BUS during the period 2010-2019.

3. Islamic Banks which do not publish the report the implementation of procedures to manage the company in a website officially BUS during the period 2010-2019.

4. There are data related to research variables during the 2010-2019 period.

Total 8

(Data processed by the author, 2021)

This research uses the Partial Least Square-Structural Equation Modeling (PLS-SEM) method as a data analysis method. PLS-SEM is a data analysis technique that has a high degree of flexibility in regression research that combines theory and data and can integrate various forms of statistical calculation methods such as path analysis, factor analysis, and regression. This method can be applied in this research because of the small number of samples, and the potential for abnormal distribution of variables and can be used on a ratio data scale. In addition, this method can be used to predict in outlining theories that are still weak. Data analysis using WarpPLS 7.0 application. The model made using PLS-SEM must be evaluated through two stages, namely the evaluation of the measurement model and the evaluation of the structural model. The equations that can be formed in this research are:

\[
\begin{align*}
\text{Fraud} &= \beta_1 \text{ICG} + e \\
\text{MSI} &= \beta_1 \text{ICG} + e \\
\text{ROA} &= \beta_1 \text{ICG} + \beta_1 \text{Fraud} + e \\
\text{ROA} &= \beta_1 \text{ICG} + \beta_1 \text{MSI} + e \\
\text{ROA} &= \beta_1 \text{ICG} + \beta_1 \text{Fraud} + \beta_1 \text{MSI} + e
\end{align*}
\]

3 Result and Discussion

Descriptive analysis is a fundamental analysis to provide an overview of the minimum value, maximum value, average value, and standard deviation of the research variables. The following table shows the data of the research model variables with descriptive statistical methods as table 2.

<table>
<thead>
<tr>
<th>Year</th>
<th>ICG</th>
<th>ROA</th>
<th>Fraud</th>
<th>MSI</th>
</tr>
</thead>
<tbody>
<tr>
<td>X</td>
<td>Y</td>
<td>Z1</td>
<td>Z2</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>0.549</td>
<td>0.581</td>
<td>2.625</td>
<td>0.400</td>
</tr>
<tr>
<td>2011</td>
<td>0.552</td>
<td>1.888</td>
<td>2.375</td>
<td>0.319</td>
</tr>
<tr>
<td>2012</td>
<td>0.557</td>
<td>1.810</td>
<td>3.750</td>
<td>0.395</td>
</tr>
<tr>
<td>2013</td>
<td>0.565</td>
<td>1.153</td>
<td>10.375</td>
<td>0.368</td>
</tr>
<tr>
<td>2014</td>
<td>0.578</td>
<td>0.375</td>
<td>7.500</td>
<td>0.466</td>
</tr>
<tr>
<td>2015</td>
<td>0.574</td>
<td>0.399</td>
<td>2.625</td>
<td>0.441</td>
</tr>
</tbody>
</table>
Based on the table above, the descriptive statistical value of each variable and data analysis are as follows:

a) ICG Index value in 2010-2019 obtained an average value of 0.568, minimum value of 0.549, maximum value of 0.579 and a standard deviation of 0.011. These data indicate, the level of ICG value has constantly increased even though it decreased in 2015, 2018 and 2019.

b) ROA value in 2010-2019 obtained an average value of 0.706, minimum value of -0.721, maximum value of 1.888 and a standard deviation of 0.759. These data indicate, Return on Assets increased until 2011 but decreased in 2017 and increased again in 2018.

c) Fraud value in 2010-2019 obtained an average value of 5.9, minimum value of 2.375, maximum value of 12.875 and a standard deviation of 3.503. These data indicate, the amount of fraud at Sharia Bank tend to fluctuate, this indicates that there are still many cases of fraud in the Sharia Bank.

d) Maqasid Sharia Index value in 2010-2019 obtained an average value of 0.412, minimum value of 0.319, maximum value of 0.466 and a standard deviation of 0.044. These data indicate, overall development of Maqasid Sharia Index levels tend to fluctuate, indicating the achievement of maqasid Sharia in Sharia banks is still fluctuating.

Before testing hypotheses, model fit is calculated to evaluate whether the hypothesized model has been accepted or not with the data. The overall test results of the fit model in this research model have a fit value according to the criteria so that it is declared acceptable based on testing the 10 fit model indices. The results of tests based on indicators of weight each variable has a significant value to measure the variables in the study. The VIF value indicates the indicator used in the study is 0.000 or < 2.5, it can be concluded that there is no multicollinearity.

The level of significance used in this research is 5%. The following are the results of the direct and indirect influence using WarpPLS 7.0:
Based on the figure and table above, the following hypothesis is obtained:

**Hypothesis 1 states that Islamic Corporate**

Governance can directly affect fraud prevention. A positive coefficient value and significance of less than 0.05 states the ICG has a positive influence on fraud prevention. The results of this hypothesis state ICG indicates the high-value application of good governance accompanied by disclosure transparency, it shows the number of frauds disclosed in the report properly.
This research was supported by Girau et al. [4] state that published the corporate governance report to be the method to identify the extent of the deviation to assist public companies in designing the company's governance structure and renew the monitoring mechanism. Hashim [16] state that governance helps in the implementation of the legislation, the system of responsibility and accountability, protecting the interests of minority shareholders, and to realize optimal efficiency and effectiveness so as to reduce fraud and the exploitation of power.

**Hypothesis 2 states that Islamic Corporate Governance**

Governance can directly affect Maqasid Sharia. A negative coefficient value and significance of less than 0.05 states the ICG has a negative influence on Maqasid Sharia. The results of this hypothesis state each increasing level of ICG cause decreased levels of MSI. Disclosure of the implementation of the ICG on the application of Islamic Bank revealed already good indicator but the achievement maqasid Sharia Islamic Bank is still not stable.

This research was supported by Jumansyah and Syafei (2013) with Atiqah and Rahma (2018) state that implementation of corporate governance in Islam has not reached a stable application of maqasid Sharia. This means there is no maximum attention to the development of Sharia banking practices on measuring devices to be used in determining the achievement of maqasid Sharia. The use of maqasid sharia is not limited to legislation on issues and current issues, but can also be used in the formulation of the policy of a country in all fields and sectors.

**Hypothesis 3 states that Islamic Corporate Governance**

Governance can directly affect Profitability. A positive coefficient value and significance of less than 0.05 states the ICG has a positive influence on profitability. The results of this hypothesis state each increasing level of ICG cause increased level of ROA. This shows that the company's capability to apply the principles of governance in managing management will affect the company's ability to generate profits.

This research was supported by Herwiyanti et al. [17] and Buallay [18] state that the principles of ICG as a whole can provide an increase in the performance of a company, one of which is profitability. The company's ability to generate profits to attract investors to invest their funds to develop their business profitability investor influence policy on investments made. In addition, Francis et al. [19] states that in measuring the relationship between governance mechanisms and financial performance, it can be seen that the implementation of governance can maintain financial stability and mitigate risk.

**Hypothesis 4 states that Islamic Corporate Governance**

Governance can indirectly influence Fraud intervening variable to Profitability. A result of p-value is 0.284 which means greater than 0.05 state that ICG has no influence indirectly to Profitability through Fraud. The results of this hypothesis state the size of Islamic Corporate Governance level changes do not affect the level of ROA through fraud.

The results of ICG can directly influence fraud prevention can show that the implementation of corporate governance can reduce the occurrence of irregularities so that the size of the deviation cases disclosed in the corporate governance report does not have an impact on the level of profitability.

**Hypothesis 5 states that Islamic Corporate Governance**
Governance can indirectly influence to Maqasid Sharia intervening variable to Profitability. A positive coefficient value and significance of less than 0.05 states the ICG has a positive influence indirectly to Profitability through Maqasid Sharia. The result of this research state every change in the ICG level causes the Maqashid Syariah level and profitability to increase or decrease. When Islamic Banks have implemented Islamic corporate governance well, they can apply Maqashid Syariah well in the company's financial system through the priority of justice, it can guarantee that Islamic Banks will get high profits.

This research was supported by Rahman and Haron [20] state that the characteristics of the DPS and the board of directors influence the achievement of Maqasid and the Maqasid Shariah performance index can assess the extent to which the role of Islamic banks in contributing to society. In addition, Asutay (2012) state Sharia banks are built not only based on the financial dimension to maximize profits but require a religious dimension to generate profits according to Islamic morals embedded in Maqashid Syariah.

Hypothesis 6 states that Islamic Corporate Governance can indirectly influence to Maqasid Sharia and fraud prevention intervening variable to Profitability. A result of p-value is 0.482 which means greater than 0.05 state that ICG has no influence indirectly to Profitability through Maqasid Sharia and Fraud. The results of this hypothesis state the size of Islamic Corporate Governance level changes do not affect the level of ROA through Maqashid Sharia and Fraud.

The implementation of ICG that has been disclosed is only guided by profit generation but has not contributed to the achievement of the Maqashid value. Obedience to rules and laws, public benefit with the development of human resources is one of the main objectives of maqashid sharia which has not been able to control the occurrence of fraud. The occurrence of fraud in Islamic banks does not affect the level of profitability. Fraud, corruption, fictitious financing, and other cases of irregularities do not have a large impact on the level of profitability where the level of profitability can be influenced by other factors.

This research was supported by Syam and Najda (2012) state that the quality of governance has no impact on the company's performance as measured by ROA. Choudhury and Mohammad (2013) state the proportion of maqashid sharia in Islamic corporate governance cannot accept ethical deviations so that the proportion of maqashid sharia needs to be reformed so that it can be realized in sharia banks in accordance with sharia.

4 Conclusion

Based on the results of this research, conclusion can be taken as follows:

a) Islamic Corporate Governance (ICG) can directly affect fraud prevention, maqasid sharia and profitability in Sharia Commercial Banks in Indonesia.

b) Islamic Corporate Governance (ICG) has indirect effect on Maqasid Sharia intervening variable to Profitability but has no indirect effect on Maqasid Sharia and Fraud intervening variable to Profitability in Sharia Commercial Banks in Indonesia.

References


