Income Smoothing Practices at Sharia Banks: An Overview in Islamic Business Ethics

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ABSTRACT
Sharia Bank is a bank conducting its business activities based on Islamic principles. Sharia bank as an institution based on the principles of Islam are not allowed to manipulate earnings and engineering activities in any form of earnings management is no exception in terms of financial reporting, which is a medium of information for its users. Income smoothing is an act of deliberate manipulation by management to profits fluctuate, which later reported that corporate profits are at levels considered normal. The purpose of this paper is to investigate the income smoothing practices in sharia banks in Indonesia and review of income smoothing practices according to Islamic business ethics. This study used 11 sharia banks (BUS) based on BUS list on Bank Indonesia's website as research object. To know a company is included in the income smoothing group or not, the Eckel index is used. Based on calculations using Eckel index, it can be concluded that 5 out of 11 sharia banks in Indonesia are indicated to practice income smoothing. However, the annual report of the five syariah banks indicated by the practice of income smoothing indicates that all opinions given by the Sharia Supervisory Board regarding operational activities and products or services provided by sharia banks to customers generally comply with the fatwa and sharia provisions issued by DSN- MUI. That is, the policy or practice of income smoothing in Islamic banks is not contrary to the principles of sharia and Islamic business ethics.

Introduction

Conventional banks developed in Indonesia before the existence of Islamic banks. Therefore, Islamic experts form banks with sharia principles (Faradila & Cahyati, 2013). The purpose of establishing a sharia-based financial or banking institution is to meet the needs of the community, especially Muslims, for productive activities based on Islamic law. Harahap (2001) states that the existence of an Islamic accounting system in Islamic banks is expected to be an element that can realize an Islamic economy more fairly, honestly, and wealth does not accumulate on one particular party, does not damage nature, creed, and various stipulated provisions by Allah SWT.
Based on Undang-Undang Republik Indonesia Nomor 21 Tahun 2008, Islamic banking is everything related to Islamic banks and sharia business units, including institutions, business activities, as well as methods and processes in carrying out their business activities. Meanwhile, according to Surya & Asiyah (2020) Islamic banks are banks that carry out their business activities based on sharia principles. Islamic banks by type consist of Islamic commercial banks (BUS) and sharia rural banks (BPRS). BUS is a sharia bank which in its activities provides services in payment traffic, which fully transacts in sharia and is not a business unit. BUS has an independent status and is not under the conventional banking system. The development of the sharia banking system is expected to have high competitiveness by adhering to sharia values, as well as having the ability to compete globally by meeting international financial operational standards (Hajjar et al., 2021).

Broadly speaking, Antonio (2005) states that there are five basic concepts of contract in Islamic banking, namely the principle of pure savings (al-wadi'ah), the principle of profit sharing (syirkah), the principle of buying and selling (at-tijarah), the principle of lease (al-ijarah), and the principle of fee/service (al-ajr wal umula). The implementation of all sharia banking contracts is in accordance with Islamic law (sharia). According to Sudarsono (2012) quoted from Faradila & Cahyati, (2013), philosophically, Islamic banks do not carry out their activities based on an interest system, speculation, or ambiguity. Instead, the Islamic economic system uses a profit-sharing or income-sharing system, which is permitted by Islamic law based on the Al-Quran and Al-Hadith. Islamic banks as institutions based on Islamic principles are not allowed to manipulate profits and carry out engineering activities in any form, including earnings management in terms of financial reporting, which is a medium of information for its users. This is because earnings management manipulates and can mislead users of financial statements in assessing the performance of a company.

Harahap (2001) argues that through the sharia accounting system, reports are presented in full disclosure to meet the needs of financial information in accordance with sharia and meet the needs of Islamic finance report users. Therefore, income smoothing behavior is not in accordance with Islamic teachings and ethics in Islamic business because the profits allowed by Islam are profits that are obtained fairly, do not harm and reduce the rights of both parties who make buying and selling transactions. Putritama (2018) states that the real key to business ethics and morals lies in business people who should adhere to Islamic business ethics and morals. Business and ethics in Islam do not have to be seen as two contradictory things, because business which is a symbol of worldly affairs is also considered an integral part of things that are investments in the hereafter (Lassoued et al., 2018). That is, if the business orientation and investment efforts in the afterlife (intended as worship) then a business will be in line with ethics and morality based on Islamic law. Even in Islam, the notion of business itself is not limited to worldly affairs, but also includes all our activities in the world that aim to gain profits or rewards in the hereafter (Vania et al., 2021).
Business carried out in Islamic law is not only profit-oriented but also oriented towards clarity, honesty, pleasure between business people, and blessings in business transactions.

Research by Illahi (2019), Maslihatin & Riduwan (2020), and Faradila & Cahyati (2013) shows that Islamic banks carry out earnings management by increasing and decreasing profits to reduce reported earnings fluctuations so that the company looks stable and not high risk and avoids political attention. Maslihatin & Riduwan (2020) states that this is done by Islamic banks because customers are not ready for pure profit sharing fluctuations, this condition provides an opportunity for Islamic banks to perform income smoothing or profit sharing obtained in a certain period by backing it up and issuing the reserves under other conditions. when the profit sharing goes down.

Income smoothing can also be understood within the framework of the agency relationship perspective (Illahi, 2019). Wolk et al., (2013) state that in agency theory, there is a separation of interests in the company between management and owners who are not involved in management decisions. As an agent, the manager is morally responsible for optimizing the profits of the owners (principals) and in return will be compensated according to the contract. Agency theory is relevant to Islamic banking, because it relates to the level of accountability and transparency in the use of customer funds and company owners. Islamic bank managers as agents can account for investor funds carried out in investment contracts or contracts. In addition, managers must also provide assurance to customers that the projects being funded receive adequate supervision and reporting so as to avoid manipulation in the financial statements.

There are several calculation models that can be used to detect earnings management, one of which is income smoothing. According to Zainuldin & Lui, (2020) from year to year many calculation models have been developed, namely the Eckel index in 1991, Healy 1985, DeAngelo in 1896, industrial models by Dechow and Sloan in 1991, Dechow-Dichev in 2002, Kothari in 2005, Stubben in 2010 and a new approach model by Dechow et al., 2011. Almost all of these methods use the discretionary accrual approach, except the Stubben model which focuses on discretionary income. However, in this study, the Eckel index is used because it is considered more capable of distinguishing Islamic banks that perform income smoothing and those that do not (Hajjar et al., 2021; Illahi, 2019; Maslihatin & Riduwan, 2020). Various previous studies have also focused more on using the Eckel index in detecting income smoothing practices in Islamic banks. Therefore, this study aims to find out how many Islamic commercial banks in Indonesia are indicated to carry out income smoothing and discuss the practice of income smoothing according to sharia business ethics.

Literature Review
Profit Management and Income Smoothing

Scott (2015) defines earnings management as the selection of certain accounting policies or concrete actions by managers to achieve certain goals. Earnings management is carried out by exploiting the inherent weaknesses of accounting policies but still within the corridors of generally accepted accounting principles (GAAP). Zainuldin & Lui (2020) explain two ways of understanding earnings management are seeing it as an opportunistic behavior of managers to maximize their utility in dealing with compensation contracts, debt contracts, and political costs (opportunistic earnings management). Second, by looking at earnings management from the perspective of efficient contracting, earnings management gives managers the flexibility to protect themselves and the company in anticipating unexpected events for the benefit of the parties involved in the contract.

Muliati et al., (2021) define earnings management as a condition that occurs when managers use judgments in financial reporting and transaction structuring to modify financial statements, either to mislead some stakeholders about the company’s underlying economic performance or to influence the results. contracts that rely on reported accounting numbers (profits). Wolk et al., (2013) states that perhaps the most common earnings management situations involve management compensation and income smoothing. Management compensation contracts seek to limit management's behavior to the interests of shareholders because the interests of both parties conflict. Earnings in management compensation may be manipulated with discretionary accruals. Discretionary accrual is the recognition of profit or expense that is free and unregulated which is the choice of management policy. Meanwhile, non-discretionary accruals are the recognition of reasonable accruals of profit and if violated will affect the quality of financial statements (not fair). Given the importance of financial statements, one of the existing hypotheses is that managers tend to flatten earnings over time so that the profit flow is more stable and the variance is smaller year by year, resulting in higher firm value or what is known as income smoothing (Obeidat, 2021).

Earnings management can be done through several patterns. The pattern of earnings management according to Scott (2015) consists of:

1. Taking a bath, this pattern occurs during reorganization, including the appointment of a new CEO by reporting large losses. This action is expected to increase profits in the future.

2. Income minimization, which is carried out when the company experiences a high level of profitability so that if profits in the coming period are expected to drop drastically, it can be overcome by taking profits from the previous period.
3. Income maximization, carried out when profits decrease. Action on income maximization aims to report high net income for the purpose of bigger bonuses. This pattern is carried out by companies that violate debt agreements.

4. Income smoothing, which is done by the company by leveling the reported earnings so that it can reduce fluctuations in profits that are too large because investors generally prefer relatively stable earnings.

According to Wolk et al., (2013), the income smoothing process can be carried out in three ways, namely through the timing of transactions, the selection of allocation methods and procedures, and manipulation of the classification between operating and non-operating income. The transaction time is more often chosen by managers than the allocation method and this method is the most direct and influential method of manipulation in earnings accounting. Several empirical studies support that income smoothing can be achieved both through the selection of accounting methods (allocations) and through setting the classification between transactions that are included in operational and non-operational.

As discussed earlier, income smoothing is an issue related to financial statements in Islamic banks. The profit shown in the income statement will affect the amount of profit sharing obtained by the owner of the fund and the bank as the manager of the fund (Hajjar et al., 2021). This is reinforced by Illahi, (2019) who argues that the calculation mechanism for profit sharing is based on two ways, namely profit sharing (profit sharing) and revenue sharing (revenue sharing). Profit sharing calculation according to profit sharing is a profit sharing calculation based on profits from fund management, namely operating income minus operating expenses. Meanwhile, the calculation of profit sharing according to revenue sharing is a profit sharing calculation based on income from fund management, namely operating income before deducting operating expenses.

Heyworth (1953) as quoted by Belkaoui (2000) states that the motivation behind income smoothing is an improvement in the relationship between managers and creditors, investors, and employees which can facilitate the business cycle through psychological processes. The criteria for the company's management to use the choice among accounting principles is to maximize welfare. In addition, shareholder satisfaction with the company's performance can increase the status and rewards for managers.

**Income Smoothing Practices**

Research on earnings management, one of which is income smoothing, has been carried out by many researchers with various objects ranging from companies to Islamic banking in Indonesia. The practice of income smoothing is associated with
various things in the management's effort to show good performance through the company's profit. Some literature regarding the practice of earnings management and income smoothing that occurs in Indonesia and other countries is summarized in the following discussion.

**Setyawan & Anggraita (2018)** research on incentives for CEOs and the tendency to practice income smoothing. This study provides evidence that the use of discretionary accruals to manipulate reported earnings will potentially occur in companies that provide total CEO compensation related to share value and ownership options. This indicates that the CEO focuses on earnings management to try to achieve bonus targets related to reported earnings.

**Fitriani (2018)** examined the effect of profitability, company size, and financial leverage on income smoothing practices in pharmaceutical companies listed on the Indonesian stock exchange for the 2011-2015 period. Based on the results of statistical testing, it is known that operating leverage and firm size have an effect on the practice of income smoothing. This shows that the operating leverage value is relatively low and indicates that the company is doing income smoothing because the company does not have large liabilities. Meanwhile, the level of profitability of the company does not affect the practice of income smoothing due to the relatively high level of profitability of the company so that the company can meet the needs of the profits earned. Thus, companies have a tendency not to practice income smoothing when profitability is high.

**Faradila & Cahyati (2013)** research was conducted during the observation period, namely in 2011 and 2012 on 11 Islamic commercial banks. The results of the research analysis show that in Islamic banks there are earnings management practices in financial statements, which are measured using the discretionary accrual approach. The discretionary accrual approach is a measurement of the accrual policy used by the company's management in manipulating earnings. Discretionary accruals are events that are operational in a certain period that affect cash. These results are in line with research by **Illahi, (2019)** which shows that Islamic banks minimize income (income minimization), which is carried out when the company obtains high profitability with the aim of not getting political attention.

The research of **Anngerindasari et al., (2016)** aims to analyze changes in earnings management in the financial statements of Islamic banking in 2005-2015. Based on the results of the analysis, Bank Muamalat Indonesia, Bank Syariah Mandiri, and Bank Mega Syariah are indicated to practice earnings management in the financial statements presented in 2010-2015. Earnings management carried out by the three Islamic banks is to increase and decrease profits, this can be seen from discretionary accruals which have positive and negative values in those years. Meanwhile, the results of research by **Ahmed (2020)** who conducted a study at Bank Muamalat
Indonesia and Bank Syariah Mandiri showed that the financial statements of Islamic banks contained earnings management practices. This is evidenced by the results of the calculation of the average total accruals during the year of observation (2002-2006) which are positive and negative.

The four studies conducted on earnings management practices in Islamic banks, namely Faradila & Cahyati, (2013), Illahi, (2019), Anngerindasari et al., (2016), and Ahmed (2020), show indications of earnings management practices. However, these studies have not investigated further the suitability of earnings management actions in Islamic banks with Islamic business ethics.

**Income Smoothing and Islamic Business Ethics**

According to the Webster Dictionary (2017) ethics is a branch of science that describes good and bad things, moral duties or obligations, to a collection of moral principles or values. Based on this explanation, it can be said that ethics can be a measure of good or bad behavior. When associated with Islam, according to Harahap (2011) ethics or morals are the result of a person's faith and piety based on belief in the truth of Allah SWT. Business ethics in relation to Islamic teachings, means a thought or reflection on morality that limits its frame of reference to the conception of an organization in economics and business based on Islamic teachings (Vania et al., 2018). An ethical perspective on an action or business activity is very important, because business ethics can be used as a way to align the strategic interests of a business or company with the demands of morality (Antonio, 2005). Business ethics can also change public awareness about business by providing a new understanding or perspective, namely that business cannot be separated from ethics.

Profits allowed by Islam are profits that are obtained fairly, do not harm and reduce the rights of both parties who make buying and selling transactions. Meanwhile, earnings management contains elements of "packaging" in an inappropriate form to deceive the company's financial reporting. Earnings management occurs with various underlying reasons, so there are driving factors in individuals, especially managers, in carrying out these practices. The pattern of income smoothing is carried out by the company by smoothing reported profits so that it can reduce fluctuations in profits that are too large because investors generally prefer relatively stable earnings (Arisandy, 2015). This has been explained in QS Annisa Verse 29-30 which means:

"O you who believe, do not eat each other's wealth in a false way, except by means of commerce which is carried out with mutual consent between you. And do not kill yourselves, indeed Allah is Most Merciful to you. And whoever does this in violation of rights and wrongdoing, then We will admit him to hell. That is easy for Allah. If you stay away from major sins among the sins that you are forbidden to do, We will certainly erase your mistakes (your small sins) and We will enter you into a noble place (heaven) ".

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Allah SWT Forbids His believing servants from consuming the wealth of some of them over others by means of vanity, namely through businesses not recognized by the Shari'a, such as by means of usury and gambling and other methods that fall into this category by using all kinds of deception and deception. This is also clarified in Q.S Al-Baqarah verse 188, which means:

"And do not some of you eat the wealth of others among you in a false way and (do not) take the property to the judge, so that you can eat some of the property of others with (the way of doing) sin, even though you know."

Fatwa of the Dewan Syariah Nasional-Majelis Ulama Indonesia (DSN-MUI) Number 87/DSN-MUI/XII/2012 concerning the Income Smoothing Method of Third Party Funds states that it allows the policy of income smoothing practices in Islamic financial institutions (LKS) with a provide protection for Islamic banking from the risk of massive diversion of funds, not the tendency of hidden and clandestine usury practices. The fatwa defines income smoothing as an arrangement for the recognition and reporting of profit or income from time to time by withholding a portion of the income in one period and transferring it to another period with the aim of reducing excessive fluctuations in profit sharing between LKS and depositors of funds (third party funds).

The income smoothing policy in the DSN-MUI Fatwa Number 87/DSN-MUI/XII/2012 can be done by:
1. Establishing a reserve fund is an arrangement for the distribution of profits from time to time on profit sharing between LKS and depositors of funds by establishing a profit equalization reserve. A reserve fund in principle may be established through a profit allowance before being distributed with 2 conditions, namely the actual profit sharing exceeds the projected rate of return and with the permission of the TPF customer;
2. Without establishing reserves is an arrangement for the recognition and reporting of profits from time to time for the purpose of arranging profit sharing between LKS and customers without the formation of reserves. If the operating results that are shared are lower than projected, LKS may waive their rights (isqath al-haqqalattanazul'an al-haqq) to adjust the rewards for TPF customers so that they are competitive and can be notified to customers.

The income smoothing policy is not justified if in its implementation there is a tendency for hidden usury practices, for example, returns are given without regard to actual results or profits. In addition, this policy is carried out by sharia banking management with the obligation to comply with standard operating procedures (SOP) and pay attention to the opinion of the Sharia Supervisory Board (DPS). That is, Islam views that Islamic banking management must have honest character, keep the trust, and be honest in reporting the results of financial reports to its users. Honesty is one
of the most important capital in doing business because honesty will avoid things that can harm one party.

**Method**

The object of this research is 11 Islamic commercial banks (BUS) based on the BUS list on the Bank Indonesia website as of August 31, 2021. The year of observation starts from 2014 to 2019. The data used in this study is secondary data, namely the annual financial report data of Islamic commercial banks in Indonesia. The data source is the BUS website which is the object of research.

This study uses a quantitative descriptive analysis technique. The steps taken in conducting the analysis are:

a. Calculating income smoothing index. According to Suhartono & Hendraswari (2020), to find out whether a company is included in the group that performs income smoothing or not, the Eckel index (1981) is used. Income smoothing index = CVΔI/CVΔS. CVΔI and CVΔS can be calculated as follows:

\[
\sqrt{\frac{\sum (\Delta I - \bar{X})^2}{n - 1}} = \bar{X}
\]

Description:
- \(S\) = Change in sales/revenue in one period
- \(I\) = Change in net income/profit in one period
- \(CV\) = Coefficient of variation of the variable, ie the standard deviation divided by the expected value.

b. Identification of BUS as a company that performs income smoothing or not. The criteria for a company not to be classified as a company performing income smoothing is if CVΔI > CVΔS. If the calculation results show the opposite result, Islamic commercial banks are considered to be doing income smoothing.

c. If the BUS is indicated to be doing income smoothing, further analysis is carried out on the financial statements related to the opinion of the Sharia Supervisory Board of the BUS in order to determine the suitability of the income smoothing practice carried out by the BUS with the DSN-MUI Fatwa Number 87/DSN-MUI/XII/2012.
Result and Discussion

Indications of Income Smoothing Practices at Islamic Commercial Banks in Indonesia Based on the Eckel Index

This article uses as many as 11 Islamic commercial banks (BUS) as objects based on the list of BUS on the Bank Indonesia website as of August 31, 2021. The data used are obtained from various sample bank websites. The observation year is 6 years starting from 2014 to 2019. The following shows the number of variable coefficients of income and profit that have been calculated based on data on changes in income and changes in profits using the Eckel index (1981) during 2014-2019 at 11 BUS in Indonesia.

Based on the data in Table 1, it can be seen that the coefficient of variation in the highest profit change data is owned by PT. Bukopin Islamic Bank, which is 10.1966. While the coefficient of variation of the lowest profit change is PT. Bank Muamalat Indonesia, with a value of -11.6803. Meanwhile, for the coefficient of variation in the data on changes in income, the highest is PT Bank Maybank Indonesia Syariah, worth 23.1254, and the lowest is with a value of -5.9537, at PT Bank Mega Syariah. After calculating the coefficient of variation on the data on changes in income and changes in profit, the next step is to calculate the income smoothing index, with the aim of knowing that a company (in this case Islamic commercial banks) practices earnings
management in its financial statements or not. Table 2 contains a summary of the calculation of the income smoothing index.

Table 1

<table>
<thead>
<tr>
<th>No</th>
<th>Sharia Commercial Bank</th>
<th>CV $\Delta$ I (profit)</th>
<th>CV $\Delta$ S (Income)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>PT Bank Syariah Mandiri</td>
<td>-8,8310</td>
<td>0,5775</td>
</tr>
<tr>
<td>2</td>
<td>PT Bank Muamalat Indonesia</td>
<td>-11,6803</td>
<td>-2,9690</td>
</tr>
<tr>
<td>3</td>
<td>PT Bank Syariah BNI</td>
<td>3,4095</td>
<td>0,3532</td>
</tr>
<tr>
<td>4</td>
<td>PT Bank Syariah BRI</td>
<td>2,9550</td>
<td>2,3119</td>
</tr>
<tr>
<td>5</td>
<td>PT Bank Mega Syariah</td>
<td>9,0129</td>
<td>-5,9537</td>
</tr>
<tr>
<td>6</td>
<td>PT Bank Jabar dan Banten Syariah</td>
<td>-2,1850</td>
<td>1,0279</td>
</tr>
<tr>
<td>7</td>
<td>PT Bank Panin Syariah</td>
<td>1,7000</td>
<td>0,2531</td>
</tr>
<tr>
<td>8</td>
<td>PT Bank Syariah Bukopin</td>
<td>10,1966</td>
<td>0,8303</td>
</tr>
<tr>
<td>9</td>
<td>PT Bank Victoria Syariah</td>
<td>-1,3491</td>
<td>1,6725</td>
</tr>
<tr>
<td>10</td>
<td>PT BCA Syariah</td>
<td>1,0796</td>
<td>0,6256</td>
</tr>
<tr>
<td>11</td>
<td>PT Bank Maybank Syariah Indonesia</td>
<td>-4,4468</td>
<td>23,1254</td>
</tr>
</tbody>
</table>

Data source: BUS income statement and other comprehensive income for 2014-2019 (processed data).

Table 2

<table>
<thead>
<tr>
<th>No</th>
<th>Sharia Commercial Bank</th>
<th>Income Smoothing Index</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>PT Bank Syariah Mandiri</td>
<td>-15,29</td>
<td>Indicated Doing Income Smoothing</td>
</tr>
<tr>
<td>2</td>
<td>PT Bank Muamalat Indonesia</td>
<td>3,93</td>
<td>Not indicated for doing income smoothing</td>
</tr>
<tr>
<td>3</td>
<td>PT Bank Syariah BNI</td>
<td>9,65</td>
<td>Not indicated for doing income smoothing</td>
</tr>
</tbody>
</table>

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Based on Table 2, it is known that there are 5 BUS indicated to practice income smoothing, this is based on the calculation of the income smoothing index using the Eckel index. Eckel index calculation is done by comparing between CVΔI and CVΔS. If the calculation result > 1, then Islamic commercial banks are not proven to be doing income smoothing, and vice versa. Furthermore, a more in-depth search was carried out on the annual financial statements of 5 BUS which indicated that they were practicing income smoothing. This is done by analyzing the opinions of the five BUS DPS to determine the suitability of the income smoothing practice carried out by the BUS with the MUI DSN Fatwa.

Fatwa from the National Sharia Council-Indonesian Ulema Council (DSN-MUI) Number 87/DSN-MUI/XII/2012 states that the income smoothing policy is not justified if its implementation creates a tendency to practice usury. Therefore, it is necessary to refer to the opinion of the Sharia Supervisory Board in the BUS annual report. Table 3.3 shows the DPS opinion of each Islamic bank which is indicated to carry out income smoothing actions. Based on the opinions of the DPS of the five Islamic banks presented in Table 3, it can be seen that in general the operational activities and products or services provided by Islamic banks to customers have followed the fatwa and sharia provisions issued by the DSN-MUI. This shows that the practice of income smoothing in Islamic banks has referred to the provisions in the

<table>
<thead>
<tr>
<th>No</th>
<th>Sharia Commercial Bank</th>
<th>Income Smoothing Index</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
<td>PT Bank Syariah BRI</td>
<td>1,28</td>
<td>Not indicated for doing income smoothing</td>
</tr>
<tr>
<td>5</td>
<td>PT Bank Mega Syariah</td>
<td>-1,51</td>
<td>Indicated Doing Income Smoothing</td>
</tr>
<tr>
<td>6</td>
<td>PT Bank Jabar dan Banten Syariah</td>
<td>-2,13</td>
<td>Indicated Doing Income Smoothing</td>
</tr>
<tr>
<td>7</td>
<td>PT Bank Panin Syariah</td>
<td>6,72</td>
<td>Not indicated for doing income smoothing</td>
</tr>
<tr>
<td>8</td>
<td>PT Bank Syariah Bukopin</td>
<td>12,28</td>
<td>Not indicated for doing income smoothing</td>
</tr>
<tr>
<td>9</td>
<td>PT Bank Victoria Syariah</td>
<td>-0,81</td>
<td>Indicated Doing Income Smoothing</td>
</tr>
<tr>
<td>10</td>
<td>PT BCA Syariah</td>
<td>1,73</td>
<td>Not indicated for doing income smoothing</td>
</tr>
<tr>
<td>11</td>
<td>PT Bank Maybank Syariah Indonesia</td>
<td>-0,19</td>
<td>Indicated Doing Income Smoothing</td>
</tr>
</tbody>
</table>

Data source: BUS income statement and other comprehensive income for 2014-2019 (processed data).
DSN-MUI fatwa Number 87/DSN-MUI/XII/2012 concerning the Income Smoothing Method of Third Party Funds. The fatwa allows the income smoothing policy on the condition that Islamic banks seek approval from customers whose rights are not fulfilled as they should be.

This indicates that PT Bank Syariah Mandiri, PT Bank Mega Syariah, PT Bank Jabar and Banten Syariah, PT Bank Victoria Syariah, and PT Bank Maybank Syariah Indonesia may be in a condition that is considered to have the potential to pose a risk of withdrawing customer funds due to the level of return (for results) from non-competitive Islamic banking (displaced commercial risk). Therefore, Islamic banks can regulate the distribution of profits from time to time on profit sharing between LKS and depositors by establishing a profit equalization reserve. Such reserves can be formed only if the actual profit sharing exceeds the projected profit sharing level so that the amount of profit sharing distributed after the provision is made will remain competitive.

Table 3
Opinion of the Sharia Supervisory Board on Sharia Commercial Banks

<table>
<thead>
<tr>
<th>No</th>
<th>Sharia Commercial Bank</th>
<th>Sharia Supervisory Board Opinion</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>PT Bank Syariah Mandiri</td>
<td>Based on letter number: 16/01/DPS/1/2014; 17/01/DPS/1/2015; 18/01/DPS/1/2016; and 19/01/DPS/1/2017 14/01/DPS/1/2018 and 15/01/DPS/1/2019 DPS Bank Syariah Mandiri stated that in general the sharia aspects in the Bank's operations and products have complied with the fatwas and sharia provisions issued by the DSN-MUI as well as sharia opinions from the DPS. Based on letter number: 001/BMS/DPS/II/2014; 001/BMS/DPS/II/2015; 001/DPS-BMS/III/2016; 001/DPS-BMS/XII/2017; 001/DPS/III/2018 and 001/DPS/I/2019;</td>
</tr>
<tr>
<td>2</td>
<td>PT Bank Mega Syariah</td>
<td>The Bank's DPS has provided an opinion regarding the Bank's operations and products. In this opinion, the Bank's DPS is of the opinion that in general the operational and product aspects of the Bank have complied with the fatwas and sharia provisions issued by the MUI DSN. Based on letter number: 002/DPS-BJBS/2015; 002/DPS-BJBS/2016; 001/DPS-BJBS/2017; 007/DPS-BJBS/2018; and 002/DPS-BJBS/2019;</td>
</tr>
</tbody>
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### Sharia Supervisory Board Opinion

<table>
<thead>
<tr>
<th>No</th>
<th>Sharia Commercial Bank</th>
<th>Sharia Supervisory Board Opinion</th>
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<td>3</td>
<td>PT Bank Jabar and Banten Syariah</td>
<td>The Bank's DPS has provided opinions regarding the Bank's operations and products. DPS Bank is of the opinion that in general the operational and product aspects of the Bank have complied with the fatwas and sharia provisions issued by the DSN-MUI.</td>
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<td>4</td>
<td>PT Bank Victoria Syariah</td>
<td>Letter of the Bank's Sharia Supervisory Board (DPS Bank) No. 001/DPS/JKT/II/2019 states that based on its general supervision, operational and product aspects, the Bank has followed the fatwa and sharia provisions issued by the MUI DSN. Based on letter number: 119/Srt.COD/MSI/02-2017; 715/Srt.SSMD/MSI/08-2018; and 0181/Srt.SSMD/MSI/02-2019.</td>
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<td>5</td>
<td>PT Bank Maybank Syariah Indonesia</td>
<td>The Bank's DPS states that in general the sharia aspects of the Bank's operations and products have complied with the fatwas and sharia provisions issued by the DSN-MUI, as well as the sharia opinion of the DPS.</td>
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In addition, the five banks indicated to perform income smoothing are allowed to make arrangements for the recognition and reporting of earnings from time to time. The aim is to arrange profit sharing between LKS and customers but without the formation of reserves. If the profit-sharing amount to be distributed to customers is lower than the projected profit-sharing rate, the Islamic bank may waive its right to adjust the remuneration for TPF customers so that it is competitive and can be notified to customers.

**Conclusion**

The Islamic financial system used by Islamic banks is expected to encourage bank management to present financial reports in full disclosure to meet the needs of financial information in accordance with sharia and meet the needs of Islamic finance report users. However, based on calculations using the Eckel index, it is known that 5 out of 11 Islamic commercial banks in Indonesia are indicated to practice income smoothing. However, based on the explanation of the financial statements obtained by the author, it is also known that even if 5 BUS perform income smoothing, the income smoothing is still within the framework of what is allowed in the Fatwa of the National
Sharia Council-Indonesian Ulema Council (DSN-MUI) Number 87/DSN-MUI /XII/2012 concerning the Income Smoothing Method of Third Party Funds.

The fifth annual report of Islamic banks which are indicated to practice income smoothing shows that all opinions given by the Sharia Supervisory Board (DPS) regarding operational activities and products or services provided by Islamic banks to customers are generally in accordance with the fatwas and sharia provisions issued by DSN-MUI. This means that income smoothing policies or practices in Islamic banks do not conflict with Islamic principles and Islamic business ethics.

The implication of this research is to look at the application of DSN-MUI Fatwa Number 87/DSN-MUI/XII/2012 on BUS in Indonesia. However, the limitation in this case is that the researcher has not been able to find any specific statements in the DPS opinion that discusses the practice of income smoothing in each Islamic bank. Therefore, the researcher cannot discuss in more detail about this matter. The second limitation is that although researchers have an interest in the theme of this study, researchers also find it difficult because secondary data regarding the formation of income smoothing reserves or profit equalization reserves (PER) are not stated and disclosed in DPS opinions and Islamic bank financial statements. In addition, researchers also have limited knowledge in conducting data searches in BUS financial reports. Since the beginning this research is a qualitative research that has not been designed to conduct in-depth interviews to obtain research data. Therefore, further research is expected to conduct interviews with the management and DPS of Islamic banks, so that evidence of the implementation of the DSN Fatwa Number 87/DSN-MUI/XII/2012, either in the form of PER or regulation of profit recognition and reporting by BUS.

The next limitation is that the calculation of the income smoothing index only uses the Eckel index (1981), so it cannot compare the calculation results with other calculation models. Meanwhile, according to Faradila & Cahyati, (2013), there are several measurement models that can be used to determine the existence of income smoothing practices, namely the Sloan Model (1996) which is the calculation of total accruals with a cash flow approach and income statement, the second is Healy’s (1999) model by comparing the average total accruals divided by the total accruals of the previous period. The next model is De Angelo (1986) by calculating the initial difference in total accruals and assuming that the first revenue is expected to be 0 (no earnings management). In addition, there are also industrial adjusted models by Dechow and Sloan (1991), Brave and Engel models (1996), Kaznik models (1999), Jones models (1991), and the Cross-Sectional model (1991). Future research is expected to be able to use various calculation models to detect earnings management practices or income smoothing in financial statements.
References


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